

Christchurch International Airport Limited

Price Setting Event Disclosure for the Pricing Period

1 July 2008 to 30 June 2011

**Prepared in accordance with the Commerce Act (Specified Airport Services
Information Disclosure) Determination 2010**

31 October 2011

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1. Introduction

Amendments to the Commerce Act 1986 in 2008 introduced a revised¹ information disclosure regulatory regime for New Zealand's three main airports. The regime requires New Zealand's three major airports to disclose information:

- After each price setting event, which means each time after consultation on landing and terminal charges is undertaken with substantial airline customers; and
- Annually showing the airports financial outcomes for a financial year, some of which must be in a manner prescribed by the Commerce Commission's (Commission) input methodologies. Annual disclosure requirements also include a range of service quality information. Christchurch International Airport Limited (CIAL) first annual disclosure for the year ended June 2011 is due on 31 May 2012, with annual disclosures after this due within 5 months of the end of each financial year.

This disclosure is the first to be provided by CIAL under the new regime, and is required by Clause 2.10(3) of the Commerce Act (Specified Airport Services Information Disclosure) Determination 2010 (the Determination) for the price setting event immediately preceding the commencement date of the Determination.

This price setting event disclosure for CIAL provides the information required by Clause 2.5 of the Determination and covers the period from 1 July 2008 to 30 June 2011 for the charges to airlines as detailed on page 37, description of Charged Services. It is of note that the outcome of this price reset still results in a total net under recovery of allowable revenue for the 3 year pricing reset period to 30 June 2011 of -\$16.30 million after-tax and -\$15.49 million on a present value basis.

The Determination requires information to be disclosed for the future period five to 10 years, for certain information, however CIAL consulted with its substantial customers for a shorter three year period, whilst Capital consultation on CIAL's new integrated terminal development was completed. Pricing as a consequence of this significant investment was then to be reassessed and implemented following completion of the terminal construction. This completion is now expected to be by November/December 2012 and as such the existing prices will continue through to that date.

The Commerce Commission has provided an exemption for this initial disclosure in respect of the information disclosure requirements beyond the three year period. Further comment on this, and other issues where CIAL has not been able to provide the information for this disclosure, is provided in this paper.

The contact person for this disclosure is;

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¹ CIAL was previously required to publish annual Disclosure Financial Statements pursuant to the Airport Authorities (Airport Companies Information Disclosure) Regulations 1999

2. Directors Certification

Schedule 21 – Certification for Forecast Total Revenue Requirements and Pricing Disclosures

Commerce Commission exemption:

Airports are exempted from the clause 2.7(2) requirement to **publicly disclose** a certificate in the form set out in Schedule 21 in respect of the information required to be disclosed pursuant to clause 2.5 for the **price setting event** immediately preceding the **commencement date** as required under clause 2.10(3).

3. Price Setting Event Disclosures

Transition Provision Clause 2.10(3)

Each Airport must disclose the information required pursuant to clause 2.5 for the price setting event, in respect of the airport, immediately preceding the commencement date of the information disclosure requirement.

Clause 2.5(1): Disclosures of Forecast Information

Clause 2.5(1)(a) Public Disclosure of Forecast Total Revenue Requirement

Disclosure requirement

An airport must disclose information relating to its forecast total revenue requirement by completing the Report on Forecast Total Revenue Requirements set out in Schedule 18 of the Determination in relation to the specified airport services supplied by the airport for the disclosure year.

Commerce Commission exemptions:

When complying with clause 2.10(3), **airports** are exempted from the requirement to apply the clause 1.4 definition of **forecast operational expenditure**. The term must instead be interpreted to mean *“operational expenditure used by an **airport** in determining the **airport’s** total revenue requirement for the purposes of consultation undertaken as part of the **price setting event**”*.

That is, **operational expenditure** will cease to be a defined term in this definition and consequently no link to the **IM determination** will be required.

- When complying with clause 2.10(3), **airports** are exempted from the requirement in clause 2.5(1)(a) to disclose in Schedule 18(b)(i) and (ii) information in respect of Year 0, the year preceding the **pricing period starting year**.
- When complying with clause 2.10(3), **Auckland International Airport Ltd and Christchurch International Airport Limited** are exempted from the requirements in clause 2.5(1)(a) to insert in the Schedule 18 Report on Total Revenue Requirements “all information relating to the **specified airport services** supplied by the airport for that **disclosure year**”.

The **airport** must, however, insert in the Schedule 18 Report on Total Revenue Requirements all information relating to the forecast total revenue requirements consulted on by the airport for that

disclosure year as part of the **price setting event** immediately preceding the **commencement date**.

- When complying with clause 2.10(3), **airports** are exempted from the requirement in clause 2.5(1)(a) to disclose in Schedule 18(b)(iv) **forecast operational expenditure** by three categories; corporate overheads; asset management and airport operations; and asset maintenance.
- When complying with clause 2.10(3), **Auckland International Airport Ltd and Christchurch International Airport Limited** are exempted from the clause 2.5(1)(a) requirement to disclose in Schedule 18(b)(iii) a 10 year forecast of capital expenditure and the components of that forecast, except that if the **airport** has such forecast numbers available for any of the 10 years and that forecast information was used by the airport in its decision to set prices for the **price setting event** immediately preceding the **commencement date**, then those numbers must be disclosed.

Commerce Commission clarifications:

- Factors that do not appropriately fit in the specified categories should be entered in the 'other factors' box. Other factors are required to be described in the comment box or as supplementary material.

Disclosure

The required disclosure Schedule 18 is attached at Appendix 1.

Notes

—Schedule 18a - Other Factors

The Commission's revenue requirement calculation in Schedule 18a is not consistent with the approach used in CIAL's forecast model to establish CIAL's maximum revenue entitlement for the pricing period.

The Commission has requested that any differences are recognised in the "Other Factors" line in Schedule 18a with comments to be provided in this document explaining the differences.

There are several fundamental differences:

- The Commission's approach assumes that CIAL's forecast required revenue will enable CIAL to achieve its cost of capital. This was not the case with CIAL making a commercial decision in light of the prevailing economic and industry conditions to set forecast revenue below the level required for CIAL to achieve its cost of capital.
- The Commission's schedule assumes that required revenue is determined by applying the building block approach in each individual year of the pricing period. CIAL's application of the building block model is applied cumulatively for the pricing period to enable prices to be smoothed during the period.
- The Commission's approach gives no regard to the discounting of future cash flows which is a fundamental requirement for a net present value calculation.

In order to assist in clarifying these differences CIAL's summarised building block financial forecast from its pricing proposal² was as follows:

ALLOWABLE REVENUE				
Financial Year Ending June \$Millions	2008E <i>Current</i>	2009F <i>Year 1</i>	2010F <i>Year 2</i>	2011F <i>Year 3</i>
Operating Expenses		\$17.8	\$16.7	\$17.0
Depreciation		\$8.0	\$8.7	\$9.0
Total Operating Expenses (Pre Tax)		\$25.8	\$25.4	\$26.0
Assets Employed	\$222.9	\$222.2	\$229.4	\$232.3
WACC (Post Tax)		8.62%	8.62%	8.62%
Capital Charge	\$	19.2	\$ 19.5	\$ 19.9
Total Allowable Revenue (\$m)		\$53.2	\$53.1	\$54.4
Revenue (Pre Tax)		\$41.2	\$45.4	\$50.9
(Under)/Over recovery of Allowable Revenue (\$m)		-\$12.0	-\$7.7	-\$3.5

This table demonstrates that CIAL did not forecast to achieve Total Allowable Revenue during the forecast period.

Furthermore the method used to determine the Total Economic Profit for the period reflects the application of a discounted cash flow approach. This was also shown in CIAL's pricing proposal as follows:

ECONOMIC PROFIT - POST TAX				
Financial Year Ending June \$Millions	2008E <i>Current</i>	2009F <i>Year 1</i>	2010F <i>Year 2</i>	2011F <i>Year 3</i>
Economic Profit - Post Tax				
Airfield		-\$9.86	-\$7.60	-\$5.79
Terminal – Domestic		\$1.54	\$1.84	\$2.17
Terminal - International		-\$0.08	\$0.35	\$1.14
TOTAL		-\$8.41	-\$5.41	-\$2.48
Net Present Value to FY09				
WACC		8.62%	8.62%	8.62%
Discount Factors		1.0000	0.9207	0.8476
Airfield		-\$9.86	-\$7.00	-\$4.91
Terminal – Domestic		\$1.54	\$1.69	\$1.84
Terminal - International		-\$0.08	\$0.32	\$0.97
TOTAL (\$m)		-\$8.41	-\$4.98	-\$2.10

² Christchurch International Airport Limited Pricing Proposal Aeronautical Charges Reset 1 July 2008 – 30 June 2011

The total under recovery for the 3 year pricing reset period to 30 June 2011 amounts to -\$16.30 million after-tax and on a present value basis an under recovery of -\$15.49 million.

Other Factors to be Included in Schedule 18a

As requested by the Commission CIAL has shown these items in the Other Factors item in schedule

18. The Other Factors total is therefore made up of:

Other Factors in Commission Schedule 18a	2009	2010	2011
Forecast revenue below Total Allowable Revenue	(12,011)	(7,730)	(3,541)
Tax impact of forecast revenue reduction	3,603	2,318	1,061
Remaining differences due to smoothed prices over period, averaging of year end assets and discounting of annual financial outcomes	32	(306)	(127)
Total	(8,376)	(5,718)	(2,607)

Clause 2.5(1)(b) Public Disclosure of Demand Forecast

Disclosure requirement

An airport must disclose information relating to its forecast total revenue requirement by completing the Report on Demand Forecasts set out in Schedule 19 of the Determination in relation to the specified airport services supplied by the airport for the disclosure year.

Commerce Commission exemptions:

- When complying with clause 2.10(3), **airports** are exempted from the clause 2.5(1)(a) requirement to disclose in Schedule 19(a) 10 year forecasts of busy hour passenger numbers and in Schedule 19(b) 10 year forecasts of busy hour and busy day aircraft movements, except that:
 - (a) if the **airport** has such forecast numbers available for any or each of the 10 years and that forecast information was used by the airport in its decision to set prices for the **price setting event** immediately preceding the **commencement date**, then those numbers must be disclosed; and
 - (b) if the **airport** has used other forecasts in determining the need for **key capital expenditure projects**, these forecasts must be disclosed
- When complying with clause 2.10(3), **Auckland International Airport Ltd and Christchurch International Airport Limited** are exempted from the clause 2.5(1)(a)(ii) requirement to disclose in Schedule 19(a) 10 year forecasts of annual passenger numbers and the requirement to disclose in Schedule 19(b) 10 year forecasts of annual aircraft landings for years outside the pricing period, except that if the airport has such forecast numbers available for any of the 10 years and that forecast information was used by the **airport** in its decision to set prices for the **price setting event** immediately preceding the **commencement date**, then those numbers must be disclosed.

Commerce Commission clarifications:

- When preparing materials for disclosure under the clause 2.10(3) transition provisions, airports

should use best endeavours to complete the schedule 19 demand forecast tables. If forecasts used by the company for capital planning do not conform to the table labels then the airport may choose to disclose the forecasts used for capital planning purposes in the commentary box or as supplementary material, including explanatory notes for doing so.

- Passenger forecasts disclosed under the clause 2.10(3) transition provisions can be split 50:50 between inbound and outbound passengers if airports are comfortable this is a reasonable proxy. Explanatory notes are to be provided in the comments box to explain the approach adopted. If the busy periods used in the forecasts differ from those defined in the ID determination, then this should also be noted.

Disclosure

The required disclosure Schedule 19 is attached at Appendix 1.

CIAL's Methodology for Developing Traffic Forecasts

The passenger demand forecasts used were based on the actual 2007 and forecast 2008 results, excluding General Aviation Activity (aircraft <3 Tonne) and extrapolated by the forecast growth rates initially developed by CIAL. These forecasts were then revised following discussions with the individual substantial customers to derive the passenger growth rates and volumes. The information was consolidated to provide an overall perspective thereby avoiding the disclosure of confidential individual airline information.

Clause 2.5(1)(c) Description of Components of Report on Forecast Revenue Requirements

Disclosure requirement

In respect of each of the following components of the Report on the Forecast Total Revenue Requirements set out in Schedule 18:

- (i) forecast value of assets employed;
- (ii) forecast cost of capital;
- (iii) forecast operational expenditure;
- (iv) forecast depreciation;
- (v) forecast tax;
- (vi) forecast revaluations); and
- (vii) any other components,

publicly disclosing a description of how each of these components has been determined, including an explanation of:

- (viii) the rationale for the basis of preparing these components, and any related assumptions;
- (ix) the extent to which each component is used to determine the forecast total revenue requirement;

and

- (x) the differences (if any) between the preparation of each component and the most recent corresponding historical financial information disclosed in accordance with clause 2.3.

Commerce Commission clarification:

No disclosure is required in accordance with clause 2.5(1)(c)(x) for the September 2011 disclosure as there has not been a disclosure in accordance with clause 2.3, therefore it is not applicable to include an explanation of the difference.

2.5(1)(c)(i) Forecast Value of Assets Employed

Disclosure requirement

Consistent with 2.5(1)(c), each airport must publicly disclose a description of how the Forecast value of Assets Employed has been determined.

“Forecast Value of Assets Employed” is defined as the value of assets used by an airport in determining the airport’s total revenue requirement for the purposes of consultation undertaken as part of a price setting event.

Disclosure

CIAL established the value of assets contained in the forecast asset base by first considering how the value of assets for pricing (or regulatory) purposes should be determined. The opening asset values for the 1 July 2008 to 30 June 2011 pricing reset were based on the actual values from the 30 June 2007 Financial Statements. There was then an allocation of assets directly attributable to initially Specified Airport activities and then to Pricing activities and in the case of the terminal assets, where there was a multi activity use, such assets were allocated based on the terminal footprint ascribed to the pricing activity. To this sum was added the forecast addition for the financial year ending 30 June 2008 less a deduction for that year’s depreciation to arrive at the opening asset base used in the pricing reset.

CIAL then addressed the changes in the asset base that were expected to occur over the pricing period from 1 July 2008 to 30 June 2011, as shown in Schedule 18b(i) (attached as Appendix 1).

From this cumulative year end forecast asset base totals the component of required revenue necessary to produce a return on assets (based on the forecast assets employed times the Weighted Average Cost of Capital) was derived.

CIAL’s Forecast Value of Assets Employed for each year, as shown in schedule 18a, was therefore equal to the year-end Forecast Asset Base, as shown in schedule 18b(i).

CIAL’s Forecast Value of Assets Employed was used to determine the forecast total revenue requirement consistent with the building blocks method that CIAL employed to determine its revenue requirement.

—Valuation Methods

CIAL concluded that valuation methods applied for its asset base should be methods that were consistent with the outcomes that would be expected in a market that was characterised by workable or effective competition.

This led CIAL to:

- *Establish an “opportunity cost” valuation for land* – the opportunity cost was the value of land at its next best alternative use or Market Value Alternative Use (MVAU). The MVAU was estimated by applying a comparative market approach to identified land zones within the airport precinct. Valuation rates were identified for each land zone from reference to recent market sales of comparable land.
- *Establish Optimised Depreciated Replacement Cost (ODRC) valuations for non-land fixed assets* - the ODRC of an asset was considered to be an estimate of the value of the asset in a hypothetical second hand market and recognises the age and modern efficient replacement form for the asset.

Opening valuations for the pricing period were established by CIAL using updated valuations required for preparation of CIAL’s 2007 Annual Financial Statements. Seagar and Partners undertook the valuation of land while Opus International Consultants Ltd valued other assets. These valuations were incorporated into the Financial Statements for the year ending 30 June 2007, from which the opening asset base used for the pricing reset was derived.

The respective valuation reports, attached at Appendix 3, provide further detailed comment on the rationale and assumptions applied to establish the asset valuations and were made available to the airline experts for review and comment as part of the consultation process.

—Asset Optimisation

Asset optimisation is based on the notion that an alternative substitute product or service would be priced on the basis of the latest best practice and technology, with the cost of any unnecessary or surplus elements being excluded. This is tantamount to the way a perfectly competitive market would price substitute products and services.

CIAL consulted with its substantial customers on the land that was to be included in the asset base for charging purposes.

Following these discussions CIAL concluded that the asset base should include the areas surrounding both the main and cross wind runways, land required for REPA areas, areas required for airside building lines taking into account the necessary height/slope ratio and relevant areas for airside activities such as fire training. Both the land area and the valuation per hectare were adjusted in the final Pricing Proposal following consultation with the airlines.

The area required for general aviation activity was excluded from the asset base.

CIAL concluded that land held for future development would be excluded from the asset base for this

pricing period (this amounted to 104.86ha).

No optimisation adjustments were considered necessary for non-land assets.

—Asset Allocation

As part of the building block approach to aeronautical pricing, directly attributable assets and costs such as airfield land, runways, taxiways and aprons, were allocated in full to the respective airfield or terminal activity.

Terminal asset allocations were based on terminal footprints.

Assets common to all terminal activities were allocated based on relative share of terminal footprint.

Specific allocation assumptions applied were:

- Where terminal footprints were used:

	International	Domestic	Airfield
Airfield			100%
Airfield + Terminal	Revenue Split		
Terminal (Dom+Internation	80%	20%	0%
Terminal + Commercial	39%	10%	0%
Domestic Terminal	0%	100%	0%
Domestic Terminal + Com	0%	31%	0%
International Terminal	100%	0%	0%
International Terminal + C	58%	0%	0%

Assets common to both terminal and airfield activities, primarily minor infrastructure/support assets, were allocated based on the relative share of forecast revenue.

- Where revenue allocations were used:

Revenue Ratios	FY2009	FY2010	FY2011
Terminal - International	48%	44%	41%
Terminal - Domestic	11%	11%	10%
Airfield	40%	45%	49%

2.5(1)(c)(ii) Forecast Cost of Capital

Disclosure requirement

Consistent with 2.5(1)(c), each airport must publicly disclose a description of how the Forecast Cost of Capital has been determined.

“Forecast Cost of Capital” is defined as the cost of capital used by an airport in determining the airport’s total revenue requirement for the purposes of consultation undertaken as part of a price setting event.

Disclosure

CIAL established a Weighted Average Cost of Capital (WACC) for its total aeronautical business given the absence of a sound empirical basis for setting different WACC's for separate business activities within the company. In order to establish the appropriate WACC CIAL obtained independent expert advice from Allen Consulting Group (Brisbane) on the approach to recover returns on infrastructure assets and the recommended WACC parameters to be incorporated in the Capital Asset Pricing Model (CAPM) to be used as the basis for determining the return on capital requirement. In addition reference was also made to the PricewaterhouseCoopers Cost of Capital Publication dated December 2007 for reference to the Risk Free Interest Rate.

The WACC was determined in accordance with the prevalent CAPM approach for New Zealand (the Brennan Lally model).

CIAL's Forecast Cost of Capital was used to determine the forecast total revenue requirement consistent with the building blocks method that CIAL employed to determine its revenue requirement.

The WACC finally established by CIAL, included the initial specific assumptions used, and was then amended to incorporate adjustments arising from consultation, as detailed in the following table;

Input Parameter	
Risk-free rate	4.44%
Corporate tax rate	30.0%
Investor tax rate	28.0%
PTMRP	7.5%
Debt premium	2.72%
Cost of debt	7.2%
Asset beta	0.65
Equity beta	0.93
Cost of equity	10.2%
Gearing (D / D + E)	30.0%
Aeronautical post-tax nominal WACC	8.62%

2.5(1)(c)(iii) Forecast Operational Expenditure

Disclosure requirement

Consistent with 2.5(1)(c), each airport must publicly disclose a description of how the Forecast Operational Expenditure has been determined.

“Forecast Operational Expenditure” is defined as the forecast **operational expenditure** used by an airport in determining the airport's total revenue requirement for the purposes of consultation undertaken as part

of a price setting event.

Commerce Commission exemptions:

- When complying with clause 2.10(3), **airports** are exempted from the requirement to apply the clause 1.4 definition of **forecast operational expenditure**. The term must instead be interpreted to mean “*operational expenditure used by an **airport** in determining the **airport’s** total revenue requirement for the purposes of consultation undertaken as part of the **price setting event**”.*

That is, **operational expenditure** will cease to be a defined term in this definition and consequently no link to the **IM determination** will be required.

Disclosure

CIAL in preparing for the pricing consultation used its forecast business plan for the 3 years to June 2010 plus CPI for the 2011 year as the basis of costs that would be ascribed to activities covered by the pricing reset. In addition and in recognition of the need to improve its cost performance CIAL undertook to review its operating cost base, using the 2007 actual year outcomes as a baseline. This resulted in a commitment to establishing a cost improvement programme over the 2009-2010 period. Airlines were advised that whilst the specific activities that would generate such improvement had yet to be identified CIAL committed to incorporating an estimate of cost efficiencies to be achieved into the cost base to be used for pricing. CIAL targeted a 10% cost efficiency saving over the period

In making this commitment CIAL noted however that achieving cost improvements comes at a cost and its forecast operating costs for the pricing period included both a share of the improvements and the one-off costs that would be incurred to achieve the future outcomes.

CIAL historically adopted a range of normal, common sense cost allocation methodologies to allocate its common costs amongst aeronautical and non-aeronautical activities.

These methodologies included allocations based on staff numbers, capex splits, respective floor areas, etc.

For the pricing period CIAL applied the % allocation of costs incorporated in the 2007 Disclosure Accounts, for airfield and terminal activity cost allocations.

The forecast costs, cost drivers for each of the major cost categories and the associated assumptions for the projections over the forecast period are outlined in Appendix 2. The allocation of costs used the same cost allocation drivers as incorporated into the 2007 Disclosure Financial Statements which were based on the allocation of costs into the respective business activities they were directly attributable to, together with an allocation of terminal wide operating costs on the basis of terminal footprint and a proportionate allocation of overheads based on attributable costs previously allocated.

CIAL’s Forecast Operational Expenditure was used to determine the forecast total revenue requirement consistent with the building blocks method that CIAL employed to determine its revenue requirement.

2.5(1)(c)(iv) Forecast Depreciation

Disclosure requirement

Consistent with 2.5(1)(c), each airport must publicly disclose a description of how the Forecast Depreciation has been determined.

“Forecast Depreciation” is defined as the forecast depreciation used by an airport in determining the airport’s total revenue requirement for the purposes of consultation undertaken as part of a price setting event.

Disclosure

In determining the depreciation charge used in the pricing reset the following approach was applied;

Depreciation, especially the Terminal, was comprised of the following:

1. Depreciation of existing assets, plus
2. Depreciation of new asset additions (in line with the forecast capex included in the pricing model scheduled capex)

In determining the level of depreciation for each category the following approach was taken;

(1) Existing assets

- Depreciation was based on the Opus Valuation Report 2007,
- The terminal value was then split by foot print into aeronautical and commercial
- The terminal value was based on the remaining life of the terminal (as per the Valuation Report)
- Depreciation on assets covered by the \$5 Passenger Departure charge was removed from the relevant international and airfield assets recovered by this charge

(2) New additions

Based on the assumed life time of the asset, with the depreciation charge being incorporated in depreciation costs in the year following asset completion. An allocation of this depreciation charge to aeronautical was required where the capex covered other activities in addition to aeronautical activities.

CIAL as noted above, currently applies standard accounting practices for depreciating fixed assets (on a straight line basis) which reflects the normal economic lives of the assets concerned and continued to apply this practice for the pricing period for this interim price reset. However it was noted that following the completion of ITP further consideration would be given to this approach. In making this consideration a preliminary analysis was made as to which time path of prices would optimise the use of airside assets.

The broad conclusions of this analysis were that:

- prices would need to rise from the current levels in order to allow CIAL’s efficient costs to be recovered; but
- an efficient time path for prices would require a slower (or deferred) return of capital than implied by accounting rates of depreciation – so that prices would not need to rise to the level that would be implied by accounting depreciation methods.

The proposed increase in charges for this pricing period has taken account of the results of this preliminary analysis of the efficient time path of prices and is based upon progressively moving towards the efficient level of pricing, whilst at the same time taking recognition of CIAL’s comparative current and future market position. In addition the company in considering the final pricing decision took consideration of the size of the price change proposed in light of the prevailing market conditions owing to the impacts of the Global Financial Crisis and the comparative positioning with competitor airports.

- Depreciation on new capital expenditure. Economic lives were established for each individual project in the forecast. The rates applied were:
 - Civil works infrastructure projects 25-40 years
 - Building fit out 10-15 years
 - Fire appliances 20 years
 - Information technology 5 years
 - Other plant and vehicles 5-15 years

CIAL’s Forecast Depreciation was used to determine the forecast total revenue requirement consistent with the building blocks method that CIAL employed to determine its revenue requirement.

2.5(1)(c)(v) Forecast Tax

Disclosure requirement

Consistent with 2.5(1)(c), each airport must publicly disclose a description of how Forecast Tax has been determined.

“Forecast Tax” is defined as forecast tax used by an airport in determining the airport’s total revenue requirement for the purposes of consultation undertaken as part of a price setting event.

Disclosure

Historically for CIAL, there was a reasonable alignment between the standard company tax rate in New Zealand and the actual tax paid by CIAL, excluding the one-off adjustments required as a consequence of the adoption of NZ IFRS from 1 July 2006 (refer 2007 Annual Report and Financial Disclosure Statements).

Accordingly CIAL applied a corporate tax rate of 30% for the pricing period, and excluded any timing differences between accounting and tax depreciation.

CIAL's Forecast Tax was used to determine the forecast total revenue requirement consistent with the building blocks method that CIAL employed to determine its revenue requirement.

2.5(1)(c)(vi) Forecast Revaluations

Disclosure requirement

Consistent with 2.5(1)(c), each airport must publicly disclose a description of how Forecast Revaluations has been determined.

"Forecast Revaluations" is defined as the forecast revaluations used by an airport in determining the airport's total revenue requirement for the purposes of consultation undertaken as part of a price setting event.

Disclosure

CIAL determined not to revalue its regulatory asset base at the end of the pricing period after considering the economic basis for asset revaluations.

In particular CIAL noted that the economic implications of revaluing assets at successive price reviews had been questioned elsewhere, as ongoing asset revaluations:

- expose the asset owner to substantial risk, more than is appropriate for a capital intensive organisation;
- create excessively strong financial incentives to minimise cost; and
- remove the flexibility to select the path that prices are expected to take over time, and may preclude a time-path for prices that maximises the use of assets.

CIAL also noted that it would bear the risk of whether new values would be lower or higher than forecast and this would generate uncertainty amongst the airlines that CIAL might adopt deliberately conservative forecasts of revaluation gains. In contrast to this, CIAL considered that the successive revaluation of assets exposed it to an asymmetric risk, as the quantum of revaluation changes are never an issue when asset valuations fall, but are central when the risk borne by CIAL stands to deliver a gain.

Accordingly CIAL determined that it would not revalue assets at the end of the pricing period but would commence with the asset value at the start of the pricing period and adjust it for capital expenditure and depreciation, the roll forward method.

Clause 2.5(1)(d) Valuation to Determine Forecast Value of Assets Employed

Disclosure requirement

Where the forecast value of assets employed is based on a value other than that used for the purposes of

the latest disclosure under clause 2.3, each airport must publicly disclose the valuation report on which the value of the forecast value of assets employed is based.

Forecast Value of Assets Employed is defined as the value of assets used by an airport in determining the airport's total revenue requirement for the purposes of consultation undertaken as part of a price setting event.

Disclosure

A copy of the valuation reports from Seagar and Partners and Opus International Consultants are attached at Appendix 3.

The value reports were as at 30 June 2007. As the valuations were for the company as a whole an allocation of asset values was applied into the respective business activities where they were directly attributable to the business activity. The amounts allocated included an added allocation of terminal wide asset infrastructure on the basis of the relative terminal footprint to the overall activity of the terminal.

The approach to the allocation of land was initially to determine the area of land involved in aeronautical activity. From this a deduction was made for land held for future development to arrive at the value of assets employed. The final and allocated was adjusted as a consequence of the consultation process following consideration of the airlines response to land area used and the basis of allocation.

The value per hectare of land was initially set as per the Seagar and Partners valuation report which applied a comparative market approach to identified land zones within the airport precinct, following which valuation rates were identified for each land zone from reference to recent market sales of comparable land. This value per hectare of use was then adjusted, following consultation with the airlines, to be based on a weighted average per hectare for the total aeronautical activity of use to reflect the concept that under an alternate use methodology the actual areas used would not necessarily reflect the present concentrations of use.

The table below shows how CIAL derived its commencing assets for pricing purposes from the total identified airport activity assets included in CIAL's published 2007 Disclosure Financial Statements.

ASSETS CATEGORY					
	2007 Disclosure of Specified Airport Activities	Assets for Specified Airport Services not included in Pricing Asset Base	Pricing Asset Base 2007	Net addition for 2008	Total Identified Airport Activity Assets for Pricing as at 30 June 2008
Land	103,571	47,363	56,208		56,208
Buildings	15,891	14,522	1,370		1,370
Computers & Furniture	1,404	376	1,028		1,028
Motor vehicles	1,788	106	1,682		1,682
Plant & equipment	1,006	275	732		732
Airfield Runway Apron Taxi	83,654	25	83,628	-10053	73,575
Terminal facilities	117,279	33,285	83,993	-4976	79,017
InfraStructure	9,511	186	9,325		9,325
TOTAL ASSETS	334,104	96,137	237,967	-15029	222,938

Clause 2.5(1)(e) Forecast Capital Expenditure by Category and Key Capital Expenditure Projects

Disclosure requirement

Each airport must publicly disclose the airport's forecast capital expenditure by category and key capital expenditure project as disclosed in accordance with Schedule 18 and the aims and objectives of any proposed investments.

A Key Capital Expenditure Projects is defined as a current or future project or programme of capital expenditure that involves total expenditure of more than \$5 million over the life of the project or programme. For the avoidance of doubt, any amount of forecast capital expenditure that is planned to be incurred in a disclosure year must be disclosed in the disclosure year it is incurred. For the purpose of this definition, a programme is a group of projects that together contribute to one output (or a set of broadly overlapping outputs). In making disclosures regarding programmes, airports must provide details of each individual project that the programme comprises.

Commerce Commission exemptions:

- When complying with clause 2.10(3), **airports** are exempted from the requirement in clause 2.5(1)(e) of “**publicly disclosing** the airport's **forecast capital expenditure** by category and **key capital expenditure project** as disclosed in accordance with Schedule 18 and the aims and objectives of any proposed investments”.

The **airport** must instead **publicly disclose** the aims and objectives of each **key capital expenditure project** as disclosed in accordance with Schedule 18.

Disclosure

CIAL's capital expenditure forecast included in pricing was for the three year period consulted on with airlines. Full details of the key capital expenditure projects for this period are provided in CIAL's comments for clause 2.5(1)(f).

While capital expenditure for the new Integrated Terminal Development (ITP) was initially included in the Initial Draft Pricing Proposal it was subsequently removed from the Final Pricing Proposal of August 2008 as the Capital Consultation Process, as required by Section 4b of the Airport Authorities Act 1966, and timing of the project, were not resolved at that time and as a consequence the final outcome was still uncertain. This process involved full disclosure to interested parties of the planning work undertaken to arrive at the proposed solution and included a comprehensive description of the ITP, the functional requirements to be met, the consequential service delivery outcomes arising post completion, the development work undertaken to arrive at the present proposal and the indicative timing and cost of the total development.

Clause 2.5(1)(f) Future Key Capital Expenditure Projects

Disclosure requirement

Each airport must publicly disclose, for the period of five consecutive years immediately following the price

setting event, a description of each key capital expenditure project, including an explanation of:

- (i) the aims and objectives of each key capital expenditure project;
- (ii) the process by which the need for the key capital expenditure project was determined, including any assessment criteria;
- (iii) any consumer engagement undertaken as part of the process referred to in this clause 2.5(1)(f), including a description of how consumer demands have been assessed;
- (iv) any alternative expenditure projects considered, and the rationale for excluding those alternative projects;
- (v) the extent to which the key capital expenditure project is reflected in pricing; and
- (vi) any constraints or other factors on which successful completion of each key capital expenditure project is contingent.

Key Capital Expenditure Projects are defined as a current or future projects or programmes of capital expenditure that involves total expenditure of more than \$5 million over the life of the project or programme. For the avoidance of doubt, any amount of forecast capital expenditure that is planned to be incurred in a disclosure year must be disclosed in the disclosure year it is incurred. For the purpose of this definition, a programme is a group of projects that together contribute to one output (or a set of broadly overlapping outputs). In making disclosures regarding programmes, airports must provide details of each individual project that the programme comprises.

Commerce Commission exemptions:

- When complying with clause 2.10(3), **Auckland International Airport Ltd and Christchurch International Airport Limited** are exempted from the requirements in clause 2.5(1)(f) of “**publicly disclosing**, for the period of five consecutive years following the **price setting event**, a description of each **key capital expenditure project**”.

The airport must, however, **publicly disclose**, for the period of five consecutive years, following the **price setting event**, a description of each **key capital expenditure project** as disclosed in accordance with Schedule 18.

Disclosure

CIAL's key capital expenditure projects detailed in the forecast information for the 2009-2011 pricing period, forecast information was not prepared for the ensuing years, are shown in the following table:

	Key Capital Expenditure Projects
Disclosure Requirement	Pavement Maintenance
	Forecast expenditure: 2009 \$4.645m, 2010 \$6.870m, 2011 \$9.410m
Description of works	To provide the annual major maintenance works required by the 20 year Airfield Pavement Maintenance Programme, to remedy pavement deterioration on Runways, Taxiways and Aprons
Aims and objectives	To maintain the pavement at the required condition necessary for sustainable airfield operations for the Airlines, with the objective to achieve a maximum projected asset lifecycle before replacement is required
Process by which need for the expenditure was determined	A rolling 20 year pavement maintenance programme is developed using the external expertise of Beca Infrastructure. Prior to the annual works being carried out a 3 day pavement inspection takes place to assess surface condition and identify the planned works to be carried out, accelerated or deferred to later periods. In developing this 20 year programme Beca make recommendations on the work programme required for separate pavement components identifying which areas require replacement, repair or remain fit for purpose. CIAL follows the advice provided by Beca
Any consumer engagement undertaken as part of process and how consumer demands have been assessed	Engagement occurs with the airlines as part of the normal service delivery discussions with the necessary airline and airport staff involved. This is to ensure airlines are assured that CIAL is maintaining the pavement to the necessary standards. Other agencies on the airport are also involved and include Airways, Aviation Security, Fuel and Energy suppliers
Any alternative projects considered and the rationale for excluding the alternatives	Consideration of alternate surface forms has been carried out in the past and the present construction was deemed to have a more cost effective asset lifecycle cost for Christchurch airport
The extent to which the project is reflected in pricing	The annual pavement maintenance programme was included in the asset base to determine the allowable revenue but in light of present level of prices for airfield services CIAL is not recovering the required return on such investment
Any constraints or other factors on which successful completion of the project is contingent	The constraints on achieving the successful completion are predominantly operational (working hours outside park airport operating times) and weather conditions

Clause 2.5(1)(g) Assumptions or Justifications for Forecast Operational Expenditure by Category

Disclosure requirement

Each airport must publicly disclose any assumptions or justifications of the airport's forecast operational expenditure by category as disclosed in accordance with Schedule 18.

Commerce Commission exemptions:

- When complying with clause 2.10(3), **airports** are exempted from the entirety of clause 2.5(1)(g). However, the assumptions and justifications that would otherwise be made under clause 2.5(1)(g) in respect of the aggregate forecast operational expenditure must be disclosed under clause 2.5.1(c)(iii).

Disclosure

CIAL's methodology and assumptions used to determine its operating expenditure forecast is detailed in the disclosures for clause 2.5(1)(c)(iii) above.

Clause 2.5 (2): Disclosures Associated with Pricing Methodology

Clause 2.5(2)(a) Summary of Pricing Methodology

Disclosure requirement

Each airport must publicly disclose a summary of the airport's pricing methodology.

"Pricing methodology" is defined as the methodology or methodologies used by an airport to set standard prices, including all material assumptions, pricing principles, models, estimates, calculations and processes used as part of a price setting event.

Disclosure

CIAL commenced consultation with its substantial customers (airline customers accounting for 5% or more of revenue from landing and terminal charges) in July 2007 by proposing a set of pricing principles that would be used as points of reference throughout the pricing consultation.

The principles were:

- achievement of an outcome that is satisfactory to the majority of the major airlines
- delivery of an appropriate commercial return for CIAL (with a progressive, transition from the current low rates of return to a full, industry-representative WACC)
- targeting of future growth/development of Christchurch airport (for the economic wellbeing of the greater Christchurch region and the rest of the South Island)
- effective airport demand and utilisation management (through economically efficient prices and incentives, and a correspondingly balanced and 'fit for purpose' capital programme)
- allocative efficiency (with no material cross-subsidisation either between different activities or individual users)
- timely and meaningful consultation, leading to implementation of a new set of charges as soon as possible after the scheduled expiry of the current charges
- an effective and sustainable charging structure, with equitable risk sharing.

CIAL's core objective was to undertake a consultation which delivered pricing outcomes that were fair and reasonable from the airlines' point of view, but which also reflected the commercial reality and responsibility that CIAL faced in operating one of New Zealand's principal gateway airports.

The aim was therefore to achieve pricing outcomes which were economically efficient and were demonstrably reasonable based on a sound and transparent combined economic and commercial rationale.

In this context, CIAL's return on invested capital needed to be aligned with an acceptable weighted average cost of capital ("WACC") return on an appropriate asset base, and recover an efficient level of operating costs.

CIAL utilised the building block approach to determine future prices and as the method for determining CIAL's total cost that was to be recovered through prices.

The building block approach is a 'bottom-up' calculation that determines the total cost as the sum of the various cost items. In general terms, the total cost is determined as the sum of:³

$$\begin{aligned}
 \text{Total cost} &= \text{return on capital investment} \\
 &+ \text{return of capital investment (depreciation)} \\
 &+/- \text{revaluation gain / loss} \\
 &+ \text{operating and maintenance costs}
 \end{aligned}$$

³ An allowance for company taxation is also included, either as an operating-type expense (the method preferred by the Commerce Commission) or by using a higher ('pre-tax') rate of return.

The component of total cost which is the return on capital investment is calculated as a value attributed to the capital assets used in the provision of services multiplied by a rate of return.⁴ The ‘return of’ capital investment (or the depreciation allowance) represents the return to investors of the value that is attributed to the capital assets, much like the return of principal on a home loan. A revaluation gain or loss arises if the value of the aeronautical asset base is reset in the year independent of capital expenditure and depreciation.

The building block formula can therefore be re-written as:

$$\begin{aligned}
 \text{Total cost} &= \text{aeronautical asset base} \times \text{rate of return} \\
 &+ \text{aeronautical depreciation allowance} \\
 &+/- \text{revaluation gain / loss} \\
 &+ \text{operating and maintenance costs}
 \end{aligned}$$

After the total cost has been calculated, this value becomes the amount that prices for the aeronautical services should be set to recover in aggregate – and is typically referred to as the allowable revenue requirement⁵, referred to as Forecast Total Revenue Requirement in the Determination.

CIAL then established its aeronautical prices by first allocating the allowable revenue requirement to the respective service activities (airfield, domestic terminal and international terminal) and then dividing this allocated revenue requirement by the forecast of future aircraft movements (for airfield charges on a MCTOW basis) or departing seats based on aircraft seat capacity (for terminal activities).

Finally, as the revenue requirement would vary from one year to the next CIAL ‘smoothed’ the calculated prices, which identified that the present value of the forecast revenue under the smoothed prices was still less than the present value of the allowable revenue requirement.

2.5(2)(b)(i) Description of Charged Services

Disclosure requirement

Each airport must publicly disclose a description of charged services.

“Charged services” is defined as category or group of specified airport services in respect of which a standard charge applies.

⁴ *Weighted Average Cost of Capital (WACC)*

⁵ *It follows that the building block approach can be thought of as a simplified profit and loss account applied in reverse. That is, a standard profit and loss account commences with revenue, deducts expenses and depreciation and the residual item is profit. The building block approach sums together the allowed profit, depreciation and expenses to compute the revenue requirement, which is then converted into prices.*

Disclosure

CIAL's charges were established in respect of the airfield and specified terminal airport services with charges for terminal use considered separately for the international and domestic terminals.

Guidance for the specific services within each of these activities is provided in the activity definitions contained in the Airport Authorities Act 1966 (AAA).

The specific services included by CIAL for charging purposes, which fall within the AAA definitions are:

- Airfield services
 - Runway and taxiways including all entrances and exits
 - Aprons including parking stands and aircraft manoeuvring areas
 - Airport fire services
 - Airside safety services
 - Asset management of airfield services including planning and repairs and maintenance.
- Terminal services
 - Landside areas for passengers and visitors
 - Secure airside areas for passengers following security screening and gate lounges for passengers not requiring security screening
 - Egresses throughout terminal for arriving and departing passengers
 - Baggage collection area and facilities for airlines/Aviation Security to process baggage
 - Terminal systems required for processing or administration of passengers including security, flight display system, public address system, building fire system, closed circuit television system and communication systems.
 - Non leased facilities required by for the operation of border control services for international passengers.
 - Non leased facilities required for the operation of security and police services.
 - All building infrastructure to provide passenger utility and comfort including wash facilities, heating and air conditioning, electricity and lighting.
 - Operations staffing and management to facilitate effective daily operation of the terminal building and interaction with airlines.
 - Asset management of terminal services including planning and repairs and maintenance.
 - Use of air bridges for departing and arriving passengers
 - Asset management of air bridge services including planning and repairs and maintenance.

- Corporate costs
 - Company overheads allocated to other activities for corporate functions including executive management, finance, human resources, information technology, property management and marketing and communications.
 - Company management overhead costs such as directors' fees, non activity attributable insurances and office administration costs.
- The manner in which these costs are allocated between aeronautical activities and non aeronautical activities is explained in CIAL's comments on clauses 2.5(1)(c)(iii)

2.5(2)(b)(ii) Relationship between Quality of Service and Cost for Each Charged Service

Disclosure requirement

Each airport must publicly disclose a description of the relationship between the quality of service provided and the cost for each charged service.

Disclosure

There is no direct link between service quality and prices for the services provided by CIAL that is detailed in formal service agreements.

CIAL however maintains a strong commitment to providing a high level of service quality to airlines, passengers and other users of airport facilities. CIAL intended to maintain a consistent standard of service for the established facilities throughout the pricing period and expected to achieve this despite the intention to seek further cost efficiencies.

CIAL intended to achieve this by:

- Ensuring that its asset maintenance programme is proactive, and promptly reactive where necessary, to ensure CIAL's core facilities are available for the maximum period of time and as a minimum meet all required safety and security standards.
- Operational staff engaging with airlines daily concerning the availability and suitability of CIAL's facilities.
- Major capital expenditure projects are developed in consultation with airlines to ensure facility design will efficiently meet airline and passenger needs.
- Undertaking passenger surveys on a quarterly basis to monitor service quality trends in a number of specific service areas.

Improvements in facilities and services, both in terms of range and quality of service provided for passengers will be achieved following completion of the terminal development project but as commented above this was not considered in the consultation to set prices for this three year period.

2.5(2)(b)(iii) Methodology Used to Allocate Costs to Particular Charged Services

Disclosure requirement

Each airport must publicly disclose a description of the methodology used to allocate costs to particular charged services.

Disclosure

CIAL's disclosure for clauses 2.5(1)(c)(i) and 2.5(1)(c)(iii) above detail the methodology used to allocate costs to airfield and terminal activities.

2.5(2)(b)(iv) Significant Changes to, or Rebalancing of Prices from the Previous Pricing Period

Disclosure requirement

Each airport must publicly disclose a description of significant changes to prices for charged services, including any rebalancing of prices, compared with equivalent services provided during the previous pricing period.

Disclosure

CIAL adopted fundamentally the same pricing mechanisms that preceded the new pricing period, namely:

- Landing charges continued to be assessed on a weight (MCTOW) basis; with the same weight breaks as previously applied (any future Code F aircraft (e.g. the A380) would be included in the 40 tonne and overweight break category).
- Passenger terminal charges would continue to be levied on a departing aircraft basis per available seat.
- Passenger Departure charges (PDC) of \$25.00 (incl. GST) per adult departing international passenger (and nil for domestic passengers) were retained, with the same exemptions still applying.

However the methodology to recover PDC revenues was amended. For the new pricing period the charge was divided by two and has been set for each arriving and departing passenger (rather than just departing as previously occurred). The charge would be recovered from airlines instead of directly from passengers by CIAL, as had occurred in previous pricing periods. The revised charging approach was to come into force on 1 January 2010 but post the March 2009 Pricing Decision; this was amended, following subsequent discussion with the Airlines, to a revised implementation date of 1 July 2010.

CIAL is not recovering an economic return for its airfield activity and therefore proposed a price increase that would partially redress this deficit.

The airfield charge per tonne was increased from \$7.72 to \$12.07 on 1 July 2008, with 3% CPI equivalent increases to apply on 1 July 2009 and 1 July 2010, but was still at levels insufficient to receive an

appropriate economic return.

The terminal charges and international departure charge were not altered for this period and were to be considered in the next pricing reset period following completion of the ITP.

CIAL's forecast showed that CIAL is expected to receive an appropriate economic return for the specified terminal activity over the pricing period.

2.5(2)(b)(v) Methodology for Determining Pricing for Charged Services and How These Were Reconciled With the Forecast Revenue Requirement

Disclosure requirement

Each airport must publicly disclose a description of the methodology for determining the proposed prices for charged services, and how those prices are reconciled with the forecast total revenue requirement.

Disclosure

CIAL has provided comment on the application of the building block model in 2.5(2)(a) above.

Required revenue is divided by forecast aircraft movement and aircraft seat volumes to establish the appropriate prices, or change in prices, that could be levied to achieve a net present value of zero.

Airfield

CIAL made a commercial judgment on the level of price increase to be applied, as detailed above, and proposed an increase in airfield charges that was seen as the maximum the market could bear but was still forecast to be inadequate and produced an under recovery of revenue for the airfield activity.

CIAL then gave further consideration to the existing market circumstances, predominantly global financial crisis, that were prevalent at the time the increase in airfield charges was introduced.

As a consequence CIAL offered airlines a prompt payment discount arrangement where proportions of the increased charges would be rebated if airline payments were received by the 20th of the month following an invoice. This commenced at 50% of the increase in charges for the period April to June 2009, 33% of the total increase for the period July 2009 to June 2010 and nil post July 2010.

The details of the rebates are shown in the pricing schedule attached at Appendix 4.

Specified Terminal

CIAL also determined as part of this price reset to retain terminal charges per seat at the existing price levels for the reasons outlined above.

Total Required Revenue

CIAL's total required revenue was therefore comprised the following:

	2009 \$000	2010 \$000	2011 \$0001
<i>Airfield</i>			
Airfield Landing Charges	\$18,189	\$23,426	\$24,938
Allowance for Prompt Payment Discounts	(\$1,711)	(\$2,961)	\$0
Other Airfield Income	\$61	\$62	\$64
<i>Specified Terminal</i>			
Domestic Seat Charges	\$4,718	\$4,832	\$4,892
International Seat Charges	\$3,636	\$3,656	\$3,875
International Passenger Charge	\$16,275	\$16,412	\$17,117
Total Required Revenue	\$41,168	\$45,427	\$50,886

2.5(2)(b)(vi) Terminal Access Charges

Disclosure requirement

Each airport must publicly disclose a description of any terminal access charges (even if these are bundled into other charges) and the methodology for determining any differentiation in terminal access charges on the basis of the means of access to the terminal (such as air bridge access, transfer bus access or walking access).

Disclosure

CIAL does not have any separate terminal access charges as all charges are covered by the Terminal Charges detailed above.

2.5(2)(c) Explanation of the Extent to Which the Airport Pricing Methodology Will Lead to Efficient Prices including whether there are any Cross Subsidies

Disclosure requirement

Each airport must publicly disclose an explanation of the extent to which the airport considers that the application of the pricing methodology will lead to efficient prices, including whether there are any cross-subsidies.

Commerce Commission clarifications:

- In its explanation of why the pricing methodology will lead to efficient prices an airport should outline any areas where the airport considers that there are cross subsidies. Airport consideration of cross-

subsidies is limited to where an airport has identified and considered the matter. An airport is not required to further investigate cross-subsidies for the purpose of this requirement. Further clarification on what the Commission defines as cross-subsidies can be taken from the subsidy-free discussion in footnote 354 of the Input Methodologies (Electricity Distribution and Gas Pipeline Services) Reasons Paper.

Disclosure

CIAL in developing its pricing obtained advice from Allen Consulting Group in relation to the economic principles relevant to the review of aeronautical prices to identify the principles that would provide for the most efficient way for CIAL to charge for infrastructure over the life of that infrastructure. These principles covered the key elements of;

- Measuring the financial success of new infrastructure investments
- Revaluations – past and future
- Elasticity of return through variation in charges
- Weighted Average Cost of Capital

The above economic principles from this review posit that in setting the efficient time path of prices two key outcomes should be met from prices for the use of services generally, which are:

- to ensure that the provider of the services expects to be able to recover at least the efficient cost of providing the service; and
- to provide users of the service with a signal about how much it costs society to provide those services.

The first of these outcomes is necessary to ensure that the incentive and capacity to provide the services is preserved.

The second of these outcomes ensures that users of infrastructure services have an incentive to use the service only if they value that service more than it costs society to produce – but equally that they will use the service whenever they place a sufficient value on the service.

It is important to understand that cost in this context is economic cost, namely the additional (forward-looking) cost of providing the relevant increment of service.

For infrastructure services, however, these two outcomes typically cannot be met simultaneously. The fact that much of the cost of providing infrastructure services is typically fixed (and so independent of the level of usage) means that the cost of providing an additional unit of service (i.e. the marginal cost) is typically very low, at least until capacity constraints are reached. Thus, if prices were set at the marginal cost of providing the service, then the service provider would fail to recover its total costs. In this circumstance, the second of the pricing outcomes summarised above must be varied so that the desired outcome is that:

- users of infrastructure services face a price that is at least the marginal cost of providing the service; and
- the residual amount of cost is recovered in a manner that has the least impact on the level of use of the relevant infrastructure service.

It is clear that if the marginal cost of using the relevant service is very low, then the pricing outcomes summarised above imply that the pricing policy should seek to maximise the use of the facility (at least until capacity constraints occur).

The principles set out above apply to individual users. In addition, prices that are charged to any group of users should recover at least the additional costs caused by that group of users, but not recover more than it would cost to serve that group of users in isolation.

These are the formal conditions for avoiding any one group of users providing a subsidy to another group of users, and are intended to ensure that groups of users (e.g., those requiring a specific service) are provided with an incentive to explore alternatives where those may be efficient.

Setting prices between these upper and lower bounds also ensures that all groups of infrastructure users share in the cost reductions that are available from building larger assets that serve multiple users (i.e., the economies of scale).

There are a number of pricing methods available to recover the residual cost in a manner that minimises the effect on the use of the service, which include using a combination of fixed and per unit charges, and recovering more of the residual cost from users that have a greater capacity to pay (i.e., a lower price sensitivity of demand).

Efficient pricing and the time-path of prices

The outcomes for pricing discussed above are typically directed towards deciding upon the structure of prices that is set at any point in time (for example, the appropriate charging parameters and the balance between those parameters, whether prices should differ between users, etc.).

However, the principles also apply to the question of how the recovery of the cost associated with infrastructure assets should be spread over time. In particular, the desired outcome for pricing is that:

- the prices set in any period should recover at least the costs caused by using the infrastructure assets in that period; and
- the residual amount of cost should be recovered across periods in a manner that has the least impact on the level of use of the relevant infrastructure service.

The conditions for avoiding subsidies discussed above are most relevant where use of the relevant infrastructure is growing and surplus capacity is installed initially in order to meet that future demand. In this situation, neither the current nor future users would be subsidising (nor being subsidised by) the other if:

- the prices that are charged in any period recover no more than what it would cost to serve just those users in that period (i.e., with assets that were sized just sufficient to meet the needs of those users); and
- the prices that are charged in any period recover at least the incremental cost of serving users in that period (i.e., the cost of the incremental capacity that was installed, including the financing costs incurred prior to the use of the surplus capacity).

A number of factors will influence what is an efficient time-path for prices over time, including:

- *type of use* – if there is reason to believe that the price sensitivity of users to the relevant service will change over time, then the pattern of cost-recovery can be designed with that in mind, otherwise it is reasonable to assume that a more even recovery of cost should be preferred, all else constant;
- *marginal cost of usage* – if the marginal cost of using the asset is expected to change over time, then the minimum price similarly will vary between periods; and
- *future competition* – competition imposes a constraint to the ability to recover cost in any period, and if this constraint is expected to become more binding over time (i.e., the competitive price is expected to fall in real terms) then it will be necessary to recover more of the cost earlier.

If the cost caused by using the infrastructure assets in any period and the price sensitivity of users are expected to remain approximately constant, and future competition is not expected to impose an increasing pricing constraint in the future, then setting prices that are approximately constant (in real terms) over time is likely to be the most efficient outcome (that is, to optimise the use of the assets).

These principles are aimed at the longer term and it is CIAL's intention to consider this approach in the setting of future prices post the development of ITP. This will apply to both terminal and airfield infrastructure development.

This interim price reset has considered only one aspect of these elements – airfield, as the charging regime for domestic terminal activities over this interim price reset is providing CIAL with the requisite economic return and international terminal activities are addressed through the passenger departure charge.

Airfield infrastructure however is not providing CIAL with the return it expects to be able to recover at least the efficient cost of providing the service, which despite the positive return from terminal activities is still resulting in a net under recovery of required return on total assets involved in aeronautical pricing

The pricing increase established by CIAL addressed this issue; however the price increase proposed gave consideration of the present challenging market environment which constrained the ability to recover increased costs in the interim price reset period.

Clause 2.5(3): Disclosure of Standard Prices

Disclosure requirement

Each airport must publicly disclose a list of the airport's standard prices for all specified airport services, including whether the standard prices are inclusive or exclusive of GST.

Disclosure

CIAL provided airlines with a schedule of standard unit prices as part of the final pricing decision communicated directly to Airlines in March 2009.

CIAL also advised its charges on a per aircraft basis in the annual disclosure financial statements required by the former information disclosure regime.

CIAL's prices for the period 1 July 2008 to 30 June 2011 and as presented in CIAL's final price setting advice are shown in Appendix 5.

Appendix 1

Schedule 18: Report on the Forecast Total Revenue Requirement and Schedule 19: Report on Demand Forecasts

		Regulated Airport Pricing Period Starting Year Ended	Christchurch International Airport Limited 30 June 2009														
SCHEDULE 18: REPORT ON THE FORECAST TOTAL REVENUE REQUIREMENTS																	
6	18a: Revenue Requirement																
7	Overview of the methodology used to determine the revenue requirement																
8	CIAL utilises the building block to determine the total revenue requirement, or as presented by CIAL in its pricing proposal, "the total cost that is to be recovered through prices." CIAL depicts the building block model as:																
9	<table border="0"> <tr> <td>Total cost</td> <td>=</td> <td>aeronautical asset base × rate of return</td> </tr> <tr> <td></td> <td>+</td> <td>aeronautical depreciation allowance</td> </tr> <tr> <td></td> <td>+/-</td> <td>revaluation gain / loss</td> </tr> <tr> <td></td> <td>+</td> <td>operating and maintenance costs</td> </tr> </table>					Total cost	=	aeronautical asset base × rate of return		+	aeronautical depreciation allowance		+/-	revaluation gain / loss		+	operating and maintenance costs
Total cost	=	aeronautical asset base × rate of return															
	+	aeronautical depreciation allowance															
	+/-	revaluation gain / loss															
	+	operating and maintenance costs															
10	An allowance for company tax is also included as either an operating type-expense (the method preferred by the Commerce Commission) or by using a higher ('pre tax') rate of return.																
11	This CIAL approach is consistent with the Commission's approach in this schedule. Further comment is provided in the information disclosure document accompanying this Schedule.																
12																	
13																	
14																	
15																	
16																	
17																	
18	(\$000)																
19		Year 1 30 Jun 09	Year 2 30 Jun 10	Year 3 30 Jun 11	Year 4 30 Jun 12	Year 5 30 Jun 13											
20	Forecast value of assets employed	222,223	229,354	232,333													
21	Forecast cost of capital	8.62%	8.62%	8.62%													
22	Forecast return on assets employed	19,147	19,761	20,018	–	–											
23	plus Forecast operational expenditure	17,815	16,690	16,976	–	–											
24	plus Forecast depreciation	7,966	8,675	9,037													
25	plus Forecast tax	4,616	6,019	7,462													
26	plus (less) Forecast revaluations	–	–	–													
27	less Forecast other income	–	–	–													
28	plus (less) Other factors	(8,376)	(5,718)	(2,607)													
29	Forecast total revenue requirement	41,168	45,427	50,886	–	–											
30	Forecast total revenue requirement for the following regulated activities																
31	Airfield activities	16,539	20,527	25,002													
32	Aircraft and freight activities																
33	Specified passenger terminal activities	24,629	24,900	25,884													
34	Total	41,168	45,427	50,886	–	–											
35	Description of any other factors that are considered in determining the forecast total revenue requirement																
36	Refer to CIAL Price Setting Event Disclosure for the Pricing Period 1 July 2008 to 30 June 2011																
37																	
38																	
39																	
40																	
41																	
42																	
43																	
44																	
45																	

SCHEDULE 18: FORECAST TOTAL REVENUE REQUIREMENTS (cont)

ref		Year 0 *	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6	Year 7	Year 8	Year 9	Year 10	Total	
	(\$000)	for year ended	30 Jun 09	30 Jun 10	30 Jun 11	30 Jun 12	30 Jun 13	30 Jun 14	30 Jun 15	30 Jun 16	30 Jun 17	30 Jun 18		
52														
53	Year of most recent disclosure (year ended)	N/A												
54														
55														
56	18b(i): Forecast Asset Base													
57	Forecast asset base—previous year		222,938	222,223	229,354									
58	less Forecast depreciation		7,966	8,675	9,037									
59	plus Forecast revaluations													
60	plus Assets commissioned		7,251	15,806	12,016									
61	less Asset disposals													
62	plus (less) Forecast adjustment resulting from cost allocation													
63	Forecast asset base		222,223	229,354	232,333									
64														
65	18b(ii): Forecast Works Under Construction													
66	Works under construction—previous year		21,001	22,471	24,566									
67	plus Capital expenditure		8,721	17,901	15,136									
68	less Assets commissioned		7,251	15,806	12,016									
69	Works under construction		22,471	24,566	27,686									
70	18b(iii): Forecast Capital Expenditure													
71	Capital Expenditure by Category													
72	Capacity growth													
73	Asset replacement and renewal		8,721	17,901	15,136									
74	Total capital expenditure		8,721	17,901	15,136									
75	Capital Expenditure by Key Capital Expenditure Project													
76	Pavement Maintenance		4,645	6,870	9,410								20,925	
77	[Project 2]													
78	[Project 3]													
79	[Project 4]													
80	[Project 5]													
81	[Project 6]													
82	[Project 7]													
83	[Project 8]													
84	[Project 9]													
85	[Project 10]													
86	[Project 11]													
87	[Project 12]													
88	[Project 13]													
89	[Project 14]													
90	[Project 15]													
91	[Project 16]													
92	[Project 17]													
93	[Project 18]													
94	[Project 19]													
95	[Project 20]													
96	Other capital expenditure		4,076	11,031	5,726								20,833	
97	Total Capital Expenditure		8,721	17,901	15,136								41,758	
98	* Year 0 disclosure applies only if the pricing period starting year and the year of most recent disclosure do not coincide													
99														

SCHEDULE 18: FORECAST TOTAL REVENUE REQUIREMENTS (cont 2)

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Basis for Cost Allocation

Refer to CIAL Price Setting Event Disclosure for the Pricing Period 1 July 2008 to 30 June 2011

An explanation of where and why disclosures differ from the cost-allocation Input Methodology and/or, where costs are shared between regulated and non-regulated assets, an explanation of the basis for that allocation.

Key Capital Expenditure Projects—Consumer Demands Assessment

Refer to CIAL Price Setting Event Disclosure for the Pricing Period 1 July 2008 to 30 June 2011

An explanation of how consumer demands have been assessed and incorporated for each reported project and the degree to which consumers agree with project scope, timing and cost.

(\$000)

for year ended Year 1 Year 2 Year 3 Year 4 Year 5
30 Jun 09 30 Jun 10 30 Jun 11 30 Jun 12 30 Jun 13

18b(iv) FORECAST OPERATIONAL EXPENDITURE

Corporate overheads
Asset management and airport operations
Asset maintenance
Total operational expenditure

CIAL did not prepare. Exemption received from the Commission for this Disclosure.				
17,815	16,690	16,976	-	-

SCHEDULE 19: REPORT ON DEMAND FORECASTS

ref			Year 1	Year 2	Year 3	Year 4	Year 5	Year 6	Year 7	Year 8	Year 9	Year 10
			30 Jun 09	30 Jun 10	30 Jun 11	30 Jun 12	30 Jun 13	30 Jun 14	30 Jun 15	30 Jun 16	30 Jun 17	30 Jun 18
6	19a: Passenger terminal demand											
7		(\$000)										
8			<i>for year ended</i>									
9	Busy hour passenger numbers	Inbound passengers	Domestic	<div style="border: 1px solid black; padding: 5px; color: red; text-align: center;"> CIAL did not prepare. Exemption received from the Commission for this Disclosure. </div>								
10		International										
11		Combined *										
12												
13	Outbound passengers	Domestic	<div style="border: 1px solid black; padding: 5px; color: red; text-align: center;"> CIAL did not prepare. Exemption received from the Commission for this Disclosure. </div>									
14		International										
15		Combined *										
16	<i>* No disclosure of combined terminal forecasts is required for airports with no shared passenger terminal functional components.</i>											
17	Number of passengers during year	Inbound passengers	Domestic	2,124,376	2,166,054	2,209,277						
18		International	787,478	794,126	828,273							
19		Total	2,911,854	2,960,180	3,037,550	-	-	-	-	-	-	-
20												
21	Outbound passengers	Domestic	2,124,376	2,166,054	2,209,277							
22		International	787,478	794,126	828,273							
23		Total	2,911,854	2,960,180	3,037,550	-	-	-	-	-	-	-
24												
25		International transit and transfer passengers [†]										
26	[†] NB. Forecasts of international transit and transfer passenger numbers relate only to airports with extant or planned international transit and transfer facilities											
27												

SCHEDULE 19: REPORT ON DEMAND FORECASTS (cont)

ref			Year 1	Year 2	Year 3	Year 4	Year 5	Year 6	Year 7	Year 8	Year 9	Year 10
	(\$000)	for year ended	30 Jun 09	30 Jun 10	30 Jun 11	30 Jun 12	30 Jun 13	30 Jun 14	30 Jun 15	30 Jun 16	30 Jun 17	30 Jun 18
34	19b: Aircraft Runway Movements											
37	Movements during busy period (total number of aircraft)	During the runway busy hour	CIAL did not prepare. Exemption received from the Commission for this Disclosure.									
38		During the runway busy day										
40	Landings during year (total number of aircraft)	Aircraft 30 tonnes MCTOW or more	28,395	26,762	27,330							
41		Aircraft 3 tonnes or more but less than 30 tonnes MCTOW	9,263	10,677	10,512							
42		Aircraft less than 3 tonnes MCTOW	CIAL did not consult on General Aviation activity under 3 Tonne accordingly no forecasts of such movements were prepared.									
43		Total	37,658	37,439	37,842	-	-	-	-	-	-	-
45	Landings during year (total MCTOW in tonnes)	Aircraft 30 tonnes MCTOW or more	1,708,007	1,669,843	1,736,690							
46		Aircraft 3 tonnes or more but less than 30 tonnes MCTOW	204,786	213,798	210,147							
47		Aircraft less than 3 tonnes MCTOW	CIAL did not consult on General Aviation activity under 3 Tonne accordingly no forecasts of such movements were prepared.									
48		Total	1,912,793	1,883,641	1,946,837	-	-	-	-	-	-	-
50	Landings during year (total number of aircraft)	Air passenger services—international	5,750	5,589	5,893							
51		Air passenger services—domestic	31,908	31,850	31,949							
52		Other aircraft	CIAL did not consult on General Aviation activity under 3 Tonne accordingly no forecasts of such movements were prepared.									
54	Landings during year (total MCTOW in tonnes)	Air passenger services—international	631,818	631,536	672,525							
55		Air passenger services—domestic	1,280,975	1,252,104	1,274,312							
56		Other aircraft	CIAL did not consult on General Aviation activity under 3 Tonne accordingly no forecasts of such movements were prepared.									
57	Description of the basis for forecasts, and/or assumptions made in forecasting											
58	The passenger demand forecasts used in the consultation were based on the actual 2007 and forecast 2008 results. To this the following assumptions were considered and used as the basis for the forward projections											
59	New Zealand Tourism Reseach Council											
60	Current and Forward Airline Schedules											
61	- Estimated load factors on the routes											
62	These forecasts were discussed with individual airlines as part of the consultation process. The final demand forecast used in the Pricing Proposal to the Airlines was the culmination and consolidation of the adjustments to these inputs to arrive at the total forecast used as the basis in setting prices, which was deemed reasonable by the Airlines. The forecasts											
63	used in the consultation did not include General Aviation activity involving aircraft under 3 Tonne.											
64												
65												
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This information disclosure under the Commerce Act (Specified Airport Services Information Disclosure) Determination 2010 has not been audited.

Appendix 2

Cost Allocation for 2009-2011 Pricing Period

Asset and Cost Allocation

Overview

- CIAL's assets and operating activities are identified by a unique identifier code (Asset/activity code(ASAC)), approximately 300 in number
- ASAC's are aggregated into 11 groups (Primary Identifiers) for reporting purposes
- The Primary Categories Costs and asset are identified into

Primary Identifier	
Airfield Specified Terminal Aircraft and Freight	Specified Activities as per Disclosure Regulations 1999
Contestable Terminal Contestable Property Travel and Information Carpark	Contestable Activities
Farm Maintenance Administration Terminal	Overhead activities to be allocated to Specified and Contestable identifiers

- All transactions (revenue and costs) are allocated with an ASAC code and allocated to an asset/activity (ASAC code)
- All assets/activities are grouped into their Primary identifier (as defined in the Airport Disclosure Regulations 1999 for Specified Activities, and by business type for Contestable Activities and Overhead activities)
- All ASAC codes are aggregated into the primary identifier categories
- The revenue and costs of Overhead Identifiers are then allocated to Specified and Contestable identifiers
- Prior to allocation all transactions in overhead activities are reviewed to find any possible direct relationships with prime identifiers
- These are then allocated manually to prime identifiers by the driver linking them. E.g. Salaries of Executive staff
- From Maintenance Overhead – the income and expenditure is allocated using the maintenance costs already directly allocated to other Primary Activities as the driver.
- From Administration Overhead – income and expenditure is allocated using the total costs already allocated to Primary activities (including those costs allocated in the maintenance allocation above

to primary identifiers)

- Farm – allocated to appropriate primary activity as per land area being farmed (Airfield and Contestable Property)
- Terminal – income and expenditure allocated according to physical area of the specified and non-specified terminal
- All allocations made within General Ledger accounts
- Total company is allocated as follows;
 - Airfield, Specified Terminal, Aircraft & Freight
 - + Non-specified Terminal, Contestable Property, Travel and Information, and Carpark
 - = Total Company
- All assets are allocated an asset or activity code
- Asset identifiers are aggregated to Primary identifiers
- Overhead identifiers are reviewed to locate unique drivers of items, e.g. roading allocated according to vehicles using roads
- Remaining assets in overhead identifier allocated by percentage of that asset type in the primary identifier (e.g. non allocated sewer line allocated to those primary identifiers with sewer lines)
- All company assets and appropriate depreciation are allocated to prime identifier
 - Airfield, Specified Terminal, Aircraft & Freight
 - + Non-specified Terminal, Contestable Property, Travel and Information, and Carpark
 - = Total Company

Airline Pricing

- From the above allocation of costs into the relative Specified Airport Activities the operating costs used in the setting of prices applied the same principle used above in that;
 - costs where directly attributable to airline pricing activities were allocated to such business areas, plus
 - terminal wide operating costs were then allocated on the basis of terminal footprint plus
 - a proportionate allocation of overheads based on attributable costs previously allocated.

Appendix 3

Seagar and Partners and Opus International Consultants Limited Asset Valuation Reports Prepared for Disclosure Pursuant to the Airport Authority (Airport Companies Information Disclosure) Regulations 1999 as at 30 June 2007

Separately appended.

Appendix 4

Christchurch International Airport Limited

Landing and Terminal Charges at Christchurch International Airport

Effective 1 July 2008 to 30 June 2011

Following consultation with its substantial customers as required by section 4B of the AAA, CIAL determined to revise the input components and price reset parameters and implement the Pricing Reset as follows:

Item	Decision
Airfield Charges	<ul style="list-style-type: none"> • Increase MCTOW charges with effect from 1 March 2009 from an average of \$7.72/Tonne to \$12.07/Tonne, with two further increases of annual CPI movement on 1 July 2009 and 1 July 2010;
Domestic Terminal Charges	<ul style="list-style-type: none"> • Charges remain unchanged at \$1.62 plus GST per departing passenger;
International Terminal Charges	<ul style="list-style-type: none"> • Charges remain unchanged at \$3.39 plus GST per departing international passenger;
Passenger Departure Charges	<ul style="list-style-type: none"> ▪ The passenger departure charge to international passengers will continue at the current level of \$25.00 including GST per eligible departing passenger until 1 January 2010 from which time: <ul style="list-style-type: none"> ○ the International PDC will be charged at \$11.11 plus GST in respect of each arriving and departing eligible passenger; and ○ either: <ul style="list-style-type: none"> - an agency arrangement will be entered into with all the airlines for the collection of the International PDC from eligible departing and arriving international passengers; or - the International PDC will be charged directly to the airlines.

In arriving at this decision CIAL considered the current economic climate where all businesses, including tourism, were attempting to cope with the effects of the economic recession and to this end determined to provide the following incentive structure as a fair and reasonable solution for airlines to manage the price increase transition over the next 3 years.

Period	Prompt Payment Discounts
From 1 March to 30 June 2009	A rebate equal to 50% of the total value of the incremental increase in charges effective 1 March 2009, for the period 1 March to 30 June 2009
From 1 July 2009 to 30 June 2010	A rebate equal to 33% of the total value of the incremental increase in charges effective 1 July 2009, for the period 1 March to 30 June 2009
From 1 July 2010 to 30 June 2011	Payment of Charges in full

Airport Charges (as per Annual Disclosure Financial Statements)

Schedule of Airport Charges

Airport charges are levied on an aircraft departure basis.

	as at 1 Apr 2009			as at 1 July 2009			as at 1 July 2010		
	Airfield	Terminal	Total	Airfield	Terminal	Total	Airfield	Terminal	Total
International									
B747-400	4,864	1,297	6,161	5,010	1,297	6,307	5,160	1,297	6,457
B747-300	4,629	1,423	6,052	4,768	1,423	6,191	4,911	1,423	6,334
B777-200	3,516	1,270	4,786	3,621	1,270	4,891	3,730	1,270	5,000
B767-300	2,290	789	3,079	2,358	789	3,147	2,429	789	3,218
B767-200	1,961	677	2,638	2,020	677	2,697	2,081	677	2,758
B757-200	1,420	630	2,050	1,463	630	2,093	1,507	630	2,137
B737-800	968	522	1,490	997	522	1,519	1,027	522	1,549
B737-700	868	386	1,254	894	386	1,280	921	386	1,307
B737-300	782	386	1,168	805	386	1,191	830	386	1,216
A320	945	710	1,655	973	710	1,683	1,002	710	1,712
Domestic									
A320	945	236	1,181	973	236	1,209	1,002	236	1,238
B767-300	2,290	377	2,667	2,358	377	2,735	2,429	377	2,806
B737-300	782	184	966	805	184	989	830	184	1,014
BE19	69	31	100	71	31	102	73	31	104
BA31	61	29	90	63	29	92	65	29	94
BA41	95	47	142	98	47	145	101	47	148
Dash 8-100	138	64	202	142	64	206	146	64	210
Dash 8-300	170	81	251	176	81	257	181	81	262
ATR72-500	197	107	304	203	107	310	209	107	316
Metroliner	58	31	89	60	31	91	61	31	92
CV58	230	91	321	237	91	328	244	91	335

- Note:
- All charges are levied on aircraft departing Christchurch International Airport.
 - The terminal component of the charge will only apply to passenger operations.
 - Aircraft that are included in the aircraft and freight category for these financial statements incur the airfield component of these charges only.
 - General aviation is the term used for aircraft under 2,000kg.