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Report to Policy and Finance Committee
from Peter O'Brien, Property Advisor and Murray Kennedy, Strategy and Asset Manager

Wainuiomata Tunnel Easement to Hutt City Council and Valuation

1. Purpose

To provide the Committee with background information on determining a fair value for the Wainuiomata Tunnel Easement, granted to the Hutt City Council.

2. Exclusion of the Public

Grounds for exclusion of the public under Section 48(1) of the Local Government Official Information Act 1987 are:

That the public conduct of the whole or relevant part of the meeting would be likely to result in the disclosure of information for which good reasons for withholding exist, i.e. to carry on commercial negotiations.

3. Background

Report 02.2 to the Policy and Finance Committee on 31 January 2002 requests the Committee to approve the acceptance of \$500,000 from the Hutt City Council, for an easement through the Water Group's Wainuiomata Tunnel and a small amount of Regional Council land each end of the tunnel.

Information in this report is to assist the Committee in deciding whether or not the easement sum is fair.

4. The Easement

The easement granted to the Hutt City Council enables a 320mm diameter wastewater pipe to be run through Regional Council land from Waiu Street in Wainuiomata, through the Wainuiomata tunnel and out to Tunnel Grove in Gracefield. This route essentially provides the shortest route a pipeline can take to link Wainuiomata with the Hutt Valley.

The impacts on the Regional Council vary. For the land on both the Wainuiomata and the Gracefield ends of the tunnel the impact is negligible as the pipe will be set in the ground, will not inhibit the Council use of the surface of the land and is sufficiently well removed from the Council water pipe as to have no negative impact.

The portion of the pipe that passes through the tunnel will have an impact. It has been agreed that the pipe will run along the north east side of the tunnel at the confluence of the floor and the wall. This gives rise to two issues, one is the need for the easement fee to reflect the benefit of use of the tunnel and the second is for the easement fee to recognise the nuisance factor created. The nuisance arises from the loss of available work space within the tunnel as it will reduce the walkway from 720mm to 400mm.

5. Valuation Methodology

In undertaking this assessment, a New Zealand wide search was undertaken to locate relevant comparable transaction data. The data collated was not at all relevant and in the main related to power, and communication cables. It was therefore necessary to collate what data was available and to formulate methods which would use that data. What was available was an ability to assess the replacement cost of the tunnel, an ability to assess the cost of using the best alternative route and thereby derive the savings benefit and we know what Telecom and Saturn had each paid to pass a fibre optic cable through the tunnel. The data collated did provide confirmation that the payment received by the Council for the Telecom and Saturn cables was greater than any other comparable.

Without directly comparable market data available on which to base the easement fee, it was considered necessary to utilise at least three assessment methods so that a range of indicated worth was available from which a balanced view could be taken. While these assessments were undertaken well before any communication and sharing of information with Hutt City Council, it is interesting to note that one of the methods used was almost identical in its format to that adopted by the Hutt City valuer and a second method was similar.

Valuations were undertaken by O'Brien Property Consultancy Limited for the Regional Council and Crighton Anderson of Christchurch for the Hutt City Council.

The Regional Council assessments were:

5.1 Comparability to Communication Cables.

The tunnel hosts two telecommunication fibre optic cables. These were installed in August 1999. The licence has a term of 10 years and the licence fee was negotiated to be \$6,519.50 per annum on the basis that the full 10 years of fees was payable at term commencement. The 10 year lump sum of \$65,195 in effect represents an annual equivalent of \$9,282 if a 7% rate is applied to achieve the present day value. This annual sum can then be capitalised to represent a sum which would be paid for the right in perpetuity. It was then necessary to apply a multiplier to this sum to reflect that the wastewater pipe occupies more of the tunnel area and that there is a nuisance factor to be addressed.

Subjectivity is involved in the percentage rate applied to convert the 10 year payment into an annual sum, the rate applied to the capitalisation of the annual sum and to the adoption of a multiplier.

5.2 Sharing of Cost Saving Benefits.

Utility Services was able to construct a model of the additional costs which would be incurred in taking the wastewater pipe over the next most economic route, the Wainuiomata Hill Road. The additional costs fell into two distinct categories, being capital costs of pipes including the costs to install and the additional energy required to pump the wastewater up the additional height. The additional energy avoided is assessed as an annual saving and this is capitalised to reflect the savings in perpetuity.

While the costs to install additional pipes is relatively straight forward to assess, the additional cost of energy can be debated on several fronts, including the long term cost of the energy, the real cost to be incurred, the capitalisation rate to be applied and how much of the benefit should accrue to each council.

5.3 The Proportion of Benefit of Use of the Tunnel Relative to its Cost.

This method is the most subjective of the three as it utilises many portions of data. All can be debated and many are subjective. Interestingly, it is this method that is the predominant method adopted by the Hutt City Council valuer and the one method the two valuers were agreed on as to format.

Step one is to assess the worth of the land involved in the easement and to apply a percentage to that to reflect the benefit derived by the wastewater pipe. As this step involved a few hundred dollars, it was not an item of debate. The second step is to assess the optimised depreciated replacement cost of the tunnel and to then apply a percentage to that to reflect the portion occupied by the wastewater pipe, including the nuisance factor.

The second step is full of debatable and subjective issues including what does comprise the optimised tunnel? what would the current cost be to replace the optimised tunnel? what is the expected economic life of the tunnel? and what is the

appropriate percentage to reflect use of the tunnel by the wastewater pipe, inclusive of the nuisance it imposes?

6. Summary

At the commencement of the process the Regional Council assessed the worth of the easement at \$750,000 and the Hutt City Council assessed the worth at \$60,000.

Exploratory meetings between the valuers were held and reports and supporting data was exchanged. Right from the beginning the valuers conducted a very open process as each recognised that there was no firm benchmark to work from or any directly comparable data upon which to rely. Over a 10 month period the valuers entered a process of debating each aspect of the assessment, seeking outside engineering input where it was required and constantly refining the respective assessments as each benchmark was agreed or at least altered in any way.

One of the critical factors was the cost to construct the optimised tunnel. Initially the Regional Council estimate, based both on a report from OPUS and on an analysis of the original construction cost, assessed the replacement cost, before depreciation, at some \$7 million. The Hutt City estimate was \$3.275 million. After a raft of engineering input it was appreciated that there was agreement on the cost to line the tunnel and the differential related to the excavation cost. Reference was made to the actual records of metres per day achieved when the tunnel was constructed and this resolved the impasse.

With agreement held by the valuers on the optimised replacement (ORC) cost of the tunnel at \$3.5 million, the debate then centred on the remaining economic life of the tunnel and the depreciation rate to apply. It was agreed that no depreciation should apply to the driven tunnel shaft but depreciation should apply to the tunnel lining component. The expected economic life of the tunnel was finally agreed at 150 years, which resulted in an indicated optimised depreciated replacement cost (ODRC) of \$3 million. The only unresolved issue related to the percentage rate to apply to reflect the benefit of use and the nuisance caused.

The end result of the process was as follows:

Method employed	Assessed by WRC	Assessed by HCC
Comparability to communication cables	\$550,000 being \$110,000 at a 5 times multiplier.	\$377,000 being \$107,700 at a 3.5 times multiplier.
Cost savings benefit by using the tunnel instead of the hill road	\$615,000 (50% share each council)	Not assessed but questioned the capitalisation rate used and the % benefit ascribed to WRC
ODRC of the tunnel and percentage use	\$550,000 being ODRC of \$3m at a use factor of 18.3%	\$450,000 being ODRC of \$3m at a use factor of 15%
Preferred settlement sum	\$550,000 plus GST	\$420,000 plus GST

From these respective positions it was appreciated by the valuers that nothing would be gained from further analysis or negotiation. Both valuers also appreciated that the respective positions were based on a number of subjective options and opinions and were, to varying degrees, fragile. No one assessment is right or wrong. Both valuers openly acknowledged that recourse to mediation or arbitration was unlikely to improve the result as it would simply represent another person's opinion. An attempt was therefore made to address the differential by a pragmatic proposition, one that each valuer would recommend to the respective client council. That resulted in the \$500,000 plus GST recommended settlement, see attachment 1.

7. Discussion

The issue for the Regional Council is whether or not an easement value of \$500,000 represents fair value. If the value of \$500,000 is not accepted, then the issue will have to go to mediation, and if this does not resolve it, arbitration. Because the issues are relatively technical, in that they are engineering related more than property related, a number of experts would have to be called in by the WRC for an arbitration hearing. External costs for WRC's expert advisors and WRC's share of the arbiter's cost are likely to be between \$20,000 - \$30,000. The arbitration figure, therefore has to be in excess of \$520,000 - 530,000 before the WRC would be better off than accepting the \$500,000 recommended by the advisors to the two Councils. This might be achieved at arbitration, but there is also a risk that the arbitration value could arrive at a figure less than \$500,000. Because of the uniqueness of this valuation, it is very difficult to predict where the result might be. On this basis, proceeding to mediation or arbitration is not supported.

8. Recommendation

It is recommended that the sum of \$500,000 plus GST (if any) is accepted as a fair value for the easement granted to the Hutt City Council.

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Attachments

Attachment 1: Letter of recommendation from Crighton Anderson