

LINZ Report: Crown Pastoral Lease Rents: Final Policy Matters

Date:	8 November 2010	Priority: Medium
Security Level:	In Confidence	

Purpose:	To seek policy decisions on three matters: <ul style="list-style-type: none"> • the dispute resolution scheme • the method for calculating the rental rate • making the process of opting in to the new system simpler.
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Action Sought

Deadline

Minister for Land Information	<ol style="list-style-type: none"> 1. Agree to the recommended dispute resolution scheme described in paragraphs 15 and 16; 2. Note officials recommend the following method for calculating RATE in the formula for setting rents as set out in paragraph 21; 3. Note that the method for calculating RATE will be set out in Regulations that can be made once primary legislation is in force; and 4. Agree that the provision to opt in to the new system for setting rent be available to any lessee whose rent fell to be reviewed after 1 July 2002 and whose rent has not already been fixed under the existing system. 	12 November 2010
Minster of Agriculture		
Minister of Conservation		

Contact for Telephone Discussion (if required)

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Recommendations

Officials recommend that you

- 1. **Agree** to the recommended dispute resolution scheme described in paragraphs 15 and 16;

[Signature]
Kate Wilkin

Agreed (Hon Williamson)

Agreed (Hon Carter) ✓

Agreed (Hon Wilkinson)

- 2. **Note** officials recommend the method for calculating RATE in the formula for setting rents as set out in paragraph 21;

[Signature]
Kate Wilkin

Noted (Hon Williamson)

Noted (Hon Carter) ✓

Noted (Hon Wilkinson)

- 3. **Note** that the method for calculating RATE will be set out in Regulations that can be made once primary legislation is in force; and

[Signature]
Kate Wilkin

Noted (Hon Williamson)

Noted (Hon Carter) ✓

Noted (Hon Wilkinson)

- 4. **Agree** that the provision to opt in to the new system for setting rent be available to any lessee whose rent fell to be reviewed after 1 July 2002 and whose rent has not already been fixed under the existing system.

[Signature]
Kate Wilkin

Agreed (Hon Williamson)

Agreed (Hon Wilkinson) ✓

Agreed (Hon Carter)

RE O'Reilly

pp **David Crawford**
 Manager Policy and Regulatory
 Date: 8 / 11 / 2010

Background

1. On 2 August 2010 Cabinet approved the new system for setting pastoral lease rents. Cabinet provided for some elements of the system to be designed by officials and considered by you:
 - o an alternative dispute resolution scheme
 - o the method for calculating RATE in the formula for setting rents
 - o a general power to decide outstanding policy matters.
2. Officials have prepared recommendations on the alternative dispute resolution procedure and the method for calculating RATE.
3. Officials also recommend that you use your delegated power to decide outstanding policy matters to make the process of opting in to the new system simpler.
4. Drafting instructions were issued to the Parliamentary Counsel Office in September 2010 for the Crown Pastoral Leases (Rents) Bill, and additional instructions will be sent to incorporate decisions about appointing expert determiners made at the meeting of South Island High Country Ministers on 8 November. Those decisions are incorporated in paragraph 15
5. Once decisions have been made on the matters covered in this paper a final version of the Bill can be produced and submitted to the Cabinet Legislation Committee.

Alternative dispute resolution process

6. In August 2010 Cabinet directed Land Information New Zealand and Ministry of Justice officials to report back to South Island High Country Ministers and the Minister of Justice in September 2010 with a detailed proposal for an alternative dispute resolution scheme.
7. Officials from Land Information New Zealand and the Ministry of Justice have agreed on a detailed design for the alternative dispute resolution scheme.
8. Ministry of Justice officials are separately briefing your colleague on the dispute resolution scheme. The Ministry of Justice officials recommend your colleague approve the design for the alternative dispute resolution scheme which is described in exactly the same way as it is in this paper.
9. LINZ officials developed the scheme with assistance from John Larmer and Ross Crotty, both very experienced practitioners of alternative dispute resolution. John Larmer has extensive experience with the South Island High Country and Ross Crotty co- authored the Legislation Advisory Committee guidelines on dispute resolution provisions in legislation.
10. The High Country accord sub-committee dealing with earning capacity rents agree with the proposed alternative dispute resolution scheme.
11. The dispute resolution scheme would apply to disputes over the values for base carrying capacity BASE and current plausible carrying capacity CURRENT in the formula for setting rents.

12. BASE will be set once and for all so there will only be a single round of disputes over that value.
13. The value for CURRENT will be assessed at every rent review so the dispute resolution scheme will have an ongoing application to that value.
14. The initial assessments of the values for BASE or CURRENT will be made by the Crown using information which will be shared with the lessee. The Crown will follow the Rules and Guidelines promulgated by the Valuer-General and make an initial proposition to the lessee.
15. If the Lessee does not agree with the Crown’s initial proposition the lessee can invoke the dispute resolution scheme as set out below:

ADR			
1	Crown assessor, Lessee’s assessor and an expert determiner visit leased property.		<p>The expert determiner will be appointed by the Commissioner of Crown Lands in agreement with the lessee. If those parties cannot agree the Valuer-General will nominate an expert determiner</p> <p>All of steps 1- 3 should be able to be scheduled at one time, as a sequence which will play out until a resolution is reached.</p> <p>The expert determiner’s role is to understand the nature of the property, how the assessors have used the information and indicative figures, applied the Valuer-General’s guidelines, and exercised professional judgment.</p>
2	Crown assessor and Lessee’s assessor endeavour to agree, with assistance (if they wish) from the expert determiner	10 Working days from visit	<p>Expert determiner is available to assist the assessors either</p> <p>in response to a joint approach from both assessors or</p> <p>in response to an approach from one assessor (in which case information summarising the approach and response must be copied to the other assessor)</p>
3	Formal hearing chaired by expert determiner (who sets procedure) Crown assessor and Lessee’s assessor attend.	Hearing occurs if no agreement by the final date for step 2	<p>Expert determiner has a role in two phases</p> <p>First facilitating agreement between Crown assessor and lessee’s assessor</p> <p>Second, if the assessors do not agree, making an expert determination of the figure in dispute.</p>
4	Expert determiner makes and publishes a decision		<p>Minimum set of contents for decision will be set out by Valuer-General in Rules. Decisions will establish best practice for subsequent assessments.</p>
5	Expert determiner makes a costs award		<p>Presumption is that expert determiners costs are met 50/50 by Crown and Lessor and each party pays the costs of their own assessor.</p> <p>If one party has put the other to unreasonable trouble a costs award can be made of up to 100% of expert determiners costs and an amount of the other party’s costs to an amount fixed by the expert determiner</p> <p>Costs can be recovered as a civil debt.</p>

16. There would also be an appeal to the High Court on points of law only, and

- an exclusion of liability for the expert determiner for all acts done in good faith as part of the ADR scheme
 - an exclusion of the Arbitration Act because (in line with expert advice) the ADR scheme should operate as a code.
17. The dispute resolution scheme is designed to focus on the technical issues associated with assessing BASE and CURRENT. It also incentivises the parties to take a reasonable position and agree at an early stage.
 18. The appeal to the High Court would not (as the current system does) allow for a reassessment of factual issues. The current appeal to the Land Valuation Tribunal on facts is complex, expensive and uncertain. Officials consider such an appeal should not be replicated in the new system.
 19. The Valuer-General would support the dispute resolution scheme by approving qualifications for assessors and appointing or deciding who may act as an expert determiner.

The method for calculating RATE

20. The Cabinet decisions in August 2010 delegated to the South Island High Country Ministers the power to agree on the method to calculate RENT in the formula for setting rents:

$$\text{Rent} = \text{RATE} \times (\text{BASE} + (\text{INCREASE} \times 0.15))$$

21. Officials recommend the following method for setting RATE:

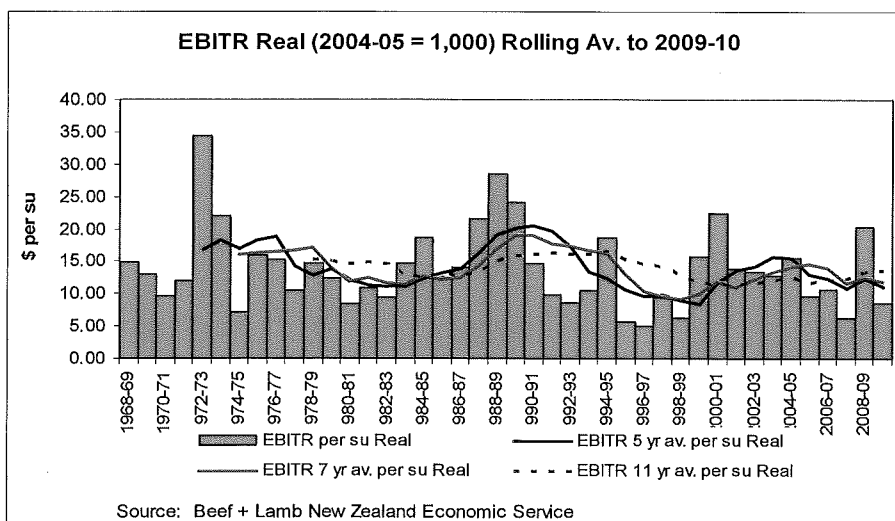
0.33 of average EBITR per stock unit for farms in the Beef and Lamb New Zealand 'Sheep and Beef Farm Survey - Class 1 South Island High Country' denominated in real dollars and smoothed on a five year rolling average.

RATE should also contain a floor of \$ 2.50 (2010 Dollars) inflated by Beef and Lamb New Zealand farm costs index

22. Using the recommended method, a rent review on 1 July 2005 would (on reasonable assumptions about the other elements of the formula) use the rate of \$5.14 per stock unit, while a rent review on 1 July 2010 would use the rate of \$4.62 per stock unit. This method would produce results consistent with the modeling in the March 2010 report to High Country Ministers and the August 2010 Cabinet paper.
23. The method for calculating RATE would (again using reasonable assumptions about the other elements of the formula) produce rents in the same range as rents that would be fixed if the existing system carried on into the future.
24. The method for calculating RATE will (in accordance with Cabinet decisions) be set out in Regulations. The Regulations can be made after the primary legislation is in force.
25. The Valuer-General will calculate and publish RATE every year applying the method set out in the Regulations. The value for RATE published by the Valuer-General will be used in all rent reviews that year.

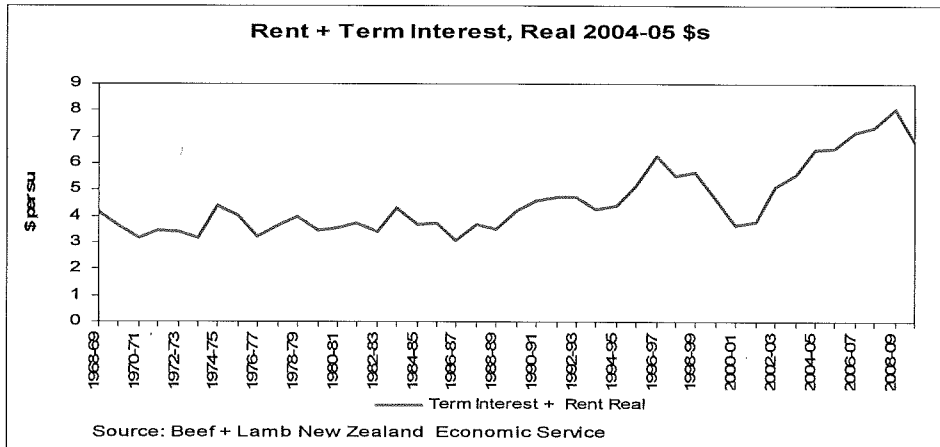
How officials developed the recommended method for calculating RATE

26. LINZ and MAF officials worked with a representative of the High Country Accord and an expert group. The members of the expert group all have a background in agricultural economics. The experts were Peter Clough (NZIER) Stuart Ford (Agribusiness Group), and Rob Davison (Beef and Lamb NZ Economic Service). John Yeabsley (NZIER) also critiqued the group's work.
27. The group commissioned a study of available data series to determine which one was the best proxy for farming operations on pastoral leases.
28. The study looked at 20 data series (including the High Country model in MAF's Farm Monitoring series). The study showed that the Beef and Lamb New Zealand 'Sheep and Beef Farm Survey - Class 1 South Island High Country' best captured the economics of farming on Crown pastoral leases.
29. Half of the farms in the Beef and Lamb series are Crown pastoral leases. The series excludes farms with significant non pastoral income and provides a long term series with data back to 1968 available electronically.
30. The expert group took it as axiomatic that the method should address net (rather than gross) earnings so it captures actual earning capacity. The group started with EBIT (earnings before interest and tax) which is a very widely used net income measure. The group decided to use EBITR (earnings before interest, tax, and rent) because the net measure ought not to include rent costs since the measure is being used as a step in rent setting.
31. The group decided that EBITR from the Beef and Lamb New Zealand series should be smoothed to reduce some very significant fluctuations year to year. Unsmoothed data would produce significant variations in rent depending on the year in which a rent review falls.
32. The group chose to smooth using a 5 yr rolling average. This was the shortest smoothing period that damped fluctuations effectively. This smoothing technique still links RATE to medium term trends in net earning capacity as shown in the diagram below.

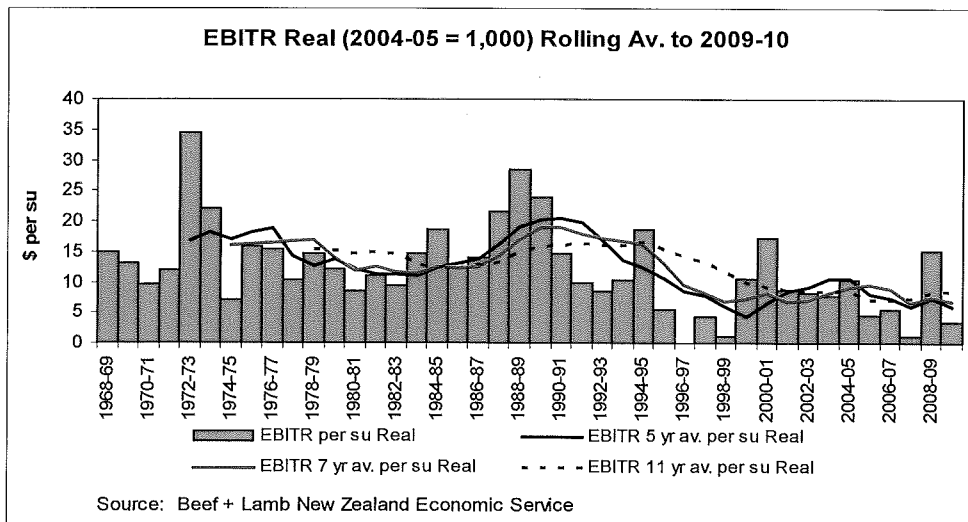


33. To decide what proportion of EBITR per stock unit should be paid in rent, the group looked at what farmers actually pay for land. Analysis identified rent plus term debt (that is excluding seasonal overdraft debt) as roughly representing

what farmers pay for land through rent and mortgage interest. The long term trends in this rent+ term interest figure are shown below.



34. The long term (1968 - 2009) average for this rent + term interest figure is 0.33 of EBITR per stock unit.
35. In the absence of any more convincing rationale the group considered that this long term average was a reasonably good and empirical basis for setting RATE in the rent setting formula.
36. The August 2010 Cabinet decisions required a floor so that RATE will produce a minimum rent independent of net revenue figures. A floor recognises that a lease has value for pastoral purposes even if for a time the data series show a zero net return from pastoral farming.
37. The group established a plausible floor level by asking what a well-informed and reasonable person would pay for the possibility of income in future years even if EBITR reached zero in a particular year. The group answered this question by taking the lowest recent year for EBITR (1996/97), artificially lowering it to zero, and lowering subsequent years by the same amount. This process is shown in the diagram below.
38. The net present value of those future years was around \$2.50 and the group settled on this figure for the floor. The floor would be adjusted in years after 2010 in line with farm costs.



39. The group also settled on the Beef and Lamb New Zealand farm costs index as the most appropriate index for calculating real dollars and inflating the floor. It also agreed on an approach to defining standard stock units.

Amending the opt-in provision

40. The new system will apply to all rents which fall for renewal after the legislation (including the Regulations and Rules) are in force and operative.
41. Cabinet decided that lessees whose rents fell for renewal prior to this date could opt in to the new system if their rent:
- fell for renewal on or after July 2002; and
 - is the subject of appeals to the Land Valuation Tribunal.
42. Officials have looked in more detail at how lessees could opt in to the new system and want to remove the requirement that there be an appeal to the Land Valuation Tribunal.
43. As it stands an opt in can only occur if the Crown prepares a valuation and the lessee advises that he or she requires the valuation to be determined by the Land Valuation Tribunal.
44. This process in the Cabinet paper automatically invokes the jurisdiction of the Land Valuation tribunal even though no one expects a substantive hearing will ever occur. Land Valuation Tribunal practice can require a valuation from the lessee at an early stage. This valuation can typically cost \$10 000.
45. Officials want to avoid invoking the Land Valuation Tribunal's jurisdiction and the costs and complications it could generate. Rather, there should be a simple administrative process to opt in administered by the Commissioner of Crown Lands.
46. Officials propose that lessees can opt in to the new system if their rent:
- fell for renewal on or after July 2002; and
 - has not been fixed under the existing system.
47. Officials consider that this suggested change is within the scope of the authorisation from Cabinet to South Island High Country Ministers to determine any outstanding policy matters. The change does not affect the scope of the policy, but rather allows the policy to be implemented more efficiently and cheaply.