

Technical changes to an appropriation in Vote Lands to support more transparent reporting and funding of tenure review of pastoral leases

Proposal

- 1 I seek a technical change to the multi-year appropriation for tenure review of Crown pastoral leases; the change would have no effect on the Crown's financial position.

Executive Summary

- 2 Tenure reviews occur under Part 2 of the Crown Pastoral Land Act 1998 (CPLA 1998). Tenure reviews allow the lessees of Crown pastoral leases to opt into a process which sees:
 - 2.1 areas most suited to farming being freeholded to the lessee
 - 2.2 areas with significant conservation values becoming part of the conservation estate.
- 3 Land Information New Zealand (LINZ) administers tenure reviews and is adopting a new, simpler, and more transparent approach to the way it conducts, reports, and accounts for them.
- 4 The new approach is based on market valuations of the two elements most central to tenure reviews:
 - 4.1 the value of the pastoral lease
 - 4.2 the value of the land to be freeholded.
- 5 The multi-year appropriation that enables tenure reviews (and annual baseline forecasts) are calculated using the approach formerly used by LINZ — based on values involved in the exchange of interests between lessee and lessor. These exchange of interests values required complex valuation methods, were difficult to understand, and made negotiations with lessees too complex. LINZ is no longer obtaining exchange of interest values or using them in tenure reviews.
- 6 I consider that the multi-year appropriation and the annual baseline forecasts should be recalculated using market values referred to in paragraph 4.1 so they support the values now being used in conducting reporting and accounting for tenure reviews. The market values that I propose are significantly higher than the old exchange of interest values but the increases will be exactly matched by an increase in capital receipts.
- 7 I consider the changes to appropriations and forecasts should be made sooner than would be possible if they were considered on the normal timetable for changes to LINZ's four-year budget plan. Changes to multi-year appropriations during the life of the appropriation require Cabinet approval (Treasury Circular 2007/05).
- 8 The increases I propose total \$540.469m:

- 8.1 an increase of \$284.128m to the multi-year appropriation in Vote Lands (which runs to 30 June 2014)
 - 8.2 an increase of \$85.447m (over the current \$10.667m) in each of 2014/15–2016/17 and outyears.
- 9 LINZ will over the same period account (as Land Tenure Reform Sales), for a matching total \$540.469m increase in capital receipts — \$284.128m over the life of the multi-year appropriation and \$85.447m in each of 2014/15–2016/17 and outyears.
 - 10 The changes I propose will have no net effect on the Crown's financial position. There is no impact on the Crown's operating or debt position, and the proposals will not conflict or interfere with the process for Budget 2013. The changes will not affect the number of tenure reviews completed by LINZ.

Background

- 11 There are 215 Crown pastoral leases that cover around 1.5 million ha of Crown land mostly in the South Island high country. Crown pastoral leases are perpetually renewable every 33 years, are subject to rent review every 11 years, and require the land to be used for pastoral farming.
- 12 Lessees of pastoral leases can opt to enter tenure review, the framework for which is set out in Part 2 of the CPLA 1998. The practical effect of tenure review is that:
 - 12.1 areas most suited to farming are freeholded to the lessee (usually with easements and covenants for conservation purposes)
 - 12.2 areas with significant conservation values become Crown land held as part of the conservation estate.
- 13 Part 2 of the CPLA 1998 balances conservation and farming outcomes and includes roles for the Minister of Conservation, and a statutory officer, the Commissioner for Crown Lands. In practice tenure reviews are administered by LINZ.
- 14 Cabinet decisions in 2009 (Crown Pastoral Land — 2009 and Beyond (EGI Min (09) 14/5) set the strategic direction for tenure review and introduced (recommendations 14 and 15) a process under which LINZ seeks funding approval from the Minister for Land Information.
- 15 The CPLA 1998 and the Cabinet decisions referred to in paragraph 14 leave considerable discretion about the valuations that must be made, how negotiations are conducted and how income and expenditure are accounted for.
- 16 LINZ has in the past used five values in conducting, reporting, and accounting for tenure review:
 - 16.1 the value of the lessee's interest under the pastoral lease
 - 16.2 the value of the land to be freeholded
 - 16.3 the value of the lessee's interest attributable to the land to go to the conservation estate
 - 16.4 the value of the Crown's interest attributable to the land to be freeholded

- 16.5 the value of the land to go to the conservation estate.
- 17 The valuations of the pastoral lease and the land to be freeholded (referred to in 16.1 and 16.2) are easily produced, replicable, and auditable because they are based on current market information. They are readily understood by lessees and others with an interest in tenure review. LINZ has based its new approach to conducting and reporting tenure reviews around these values.
- 18 The valuations based around the exchange of interests (referred to in 16.3 and 16.4) were included because they:
- 18.1 replicated practices historically used in freeholding other categories of lease under the Land Act 1948
- 18.2 suited LINZ's former asset management arrangements.
- 19 One of the exchange of interests values (that referred to in 16.3) was aggregated to calculate the multi-year appropriation and annual baseline forecasts.
- 20 The exchange of interest valuations required complex valuation methods, were difficult to understand, and complicated negotiations with lessees. LINZ is no longer assessing the exchange of interest values or using them as part of tenure reviews or in its asset management.
- 21 The valuations of the land that goes into the conservation estate (the value referred to in 16.5) remain necessary at the end of tenure reviews when land designated for conservation is ultimately transferred to Department of Conservation. LINZ is no longer including this value in the substantive stages of tenure review because it complicates negotiations with lessees.

Specific problems with the old exchange of interests approach

- 22 The exchange of interests values were in the past used in critical elements of conducting, reporting, and accounting for tenure review. In particular the exchange of interests values were used:
- 22.1 in negotiations with lessees
- 22.2 as financial information given to lessees with substantive proposals under s47 of the CPLA 1998 — if accepted these proposals operate like a contract
- 22.3 to calculate appropriations for tenure review and in baseline forecasts.
- 23 Because they have been used in these critical elements of tenure review the exchange of interest values assumed a primary role in the process. LINZ re-evaluated how the exchange of interest valuations operated and found them poorly suited to this central role.
- 24 The Crown's interest in a pastoral lease is difficult to value because, there are no comparable sales. Valuations also rely on a discounted cash flow analysis that is highly sensitive to assumptions around inflation and discount rates. Complex cross-checking process between the different valuations were also needed.
- 25 The process of apportioning values to the freehold and conservation land also causes problems. The apportionment is driven from yet further valuations, of land exclusive of Improvements (LEI) prepared for setting pastoral lease rents. These LEI valuations

are themselves highly subjective and hard to moderate or audit. In any case LEI valuations will no longer be available. Amendments to the CPLA 1998 in 2012 abandoned LEI valuations in favour of a new system for setting rents based on the productive capacity of pastoral leases.

- 26 Exchange of interest valuations can complicate negotiations with lessees because negotiations end up focusing on the difficult and easily disputed elements of the exchange of interest valuations.
- 27 The exchange of interest valuations are also a poor way of describing what is occurring in tenure reviews because they are hard to relate to the most important and recognisable values involved in the process — those of the pastoral lease and the land freeholded.
- 28 The problems with the exchange of interests values have been understood for some time and minor adjustments to protocols and systems have been made in the past to try to ameliorate them.
- 29 It has become clear that the problems with these values are inherent in the exchange of interests approach and are essentially insoluble. Advice from valuers and auditors also suggests LINZ should cease using the exchange of interest valuations. I consider the best option is to abandon the exchange of interests approach altogether.

New approach based on market values

- 30 LINZ is adopting a simpler and more transparent system for reporting on and accounting for tenure reviews based on two valuations:
 - 30.1 the value of the pastoral lease
 - 30.2 the value of the land to be freeholded.
- 31 The new system has been developed with advice from expert valuers and is consistent with the way the Commissioner of Crown Lands considers he should exercise his statutory powers under the CPLA 1998. The new approach is being applied to all stages of tenure reviews including:
 - 31.1 negotiations with lessees
 - 31.2 preliminary proposals under s34 CPLA 1998
 - 31.3 ministerial approvals of funding as provided for in the Cabinet decisions (EGI Min (09) 14/5 recommendation 14)
 - 31.4 substantive proposals under s47 CPLA 1998
 - 31.5 reporting in LINZ's annual report.
- 32 LINZ intends to increase transparency by setting out in its annual report the number of tenure reviews completed, tenure review sales, acquisitions of pastoral leases, the net costs of tenure reviews, and the value of land to be transferred to conservation estate.
- 33 The table below shows how the new information in LINZ's annual report would give a more complete and comprehensible picture of the major elements of tenure review:

number of tenure reviews completed	tenure review sales (based on market value of land freeholded to lessees)	acquisitions of pastoral leases (based on market value of pastoral leases)	net cost to Crown of tenure reviews	value of land to be transferred to conservation estate
12	\$65.8m	\$71.6m	\$5.8m	\$8.9m

- 34 The reporting LINZ proposes will clearly show the values and costs involved in tenure review and should improve public understanding of how the process is working.
- 35 Other advantages of the new approach being adopted by LINZ are:
- 35.1 the cost of valuations is lower (because there are fewer of them)
 - 35.2 specification and monitoring costs are lower
 - 35.3 valuations are easily moderated and audited
 - 35.4 there is no room for negotiations with lessees on valuation issues outside of the two market values.
- 36 LINZ will no longer need to specify in detail how valuations are to be prepared. Rather, LINZ will rely on registered valuers to apply relevant standards including the International Valuation Standards 2011, and local implementations of them. The professional regulation regime under the Valuers Act 1948 requires registered valuers to use appropriate standards.
- 37 The use of valuers to determine market values is also consistent with international accounting standards and local implementations of them.
- 38 The value of land earmarked for the conservation estate also needs to be established so the value can be used in the transfer to the Department of Conservation.
- 39 The value of land going to the conservation estate does not need to be embedded in the substance of the tenure review process, and in particular lessees do not need to be involved with it. Rather, this value can be established and reported on at the end of the process and shortly before transfers to the Department of Conservation are made.
- 40 LINZ has adopted the new approach in recent tenure reviews up to the point where substantive proposals are issued under s47 of the CPLA 1998. At that point the substantive proposal (if accepted by the lessee) operates like a contract and LINZ needs to account for the resulting expenditure calculated using the market values.
- 41 If the multi-year appropriation were not recalculated to reflect the market values now being used, LINZ would effectively not be able to progress tenure reviews by issuing substantive proposals as planned.

The current multi-year appropriation

- 42 The current multi-year appropriation in Vote Lands that enables tenure review (Land Tenure Reform Acquisitions) runs from 1 July 2011–30 June 2014. The multi-year appropriation is for \$32.001m (plus cumulative adjustments). As at 31 October 2012 \$38.658m remains.

- 43 The multi-year appropriation was calculated using the old exchange of interests approach. Specifically, it was calculated using the value of the lessee's interests attributable to the land to go to the conservation estate (the values referred to in paragraph 16.3).
- 44 The values needed to calculate appropriations on this exchange of interests basis are no longer being assessed or used in tenure review or asset management. The exchange of interest values are also much lower than the market values now being used to report on and account for tenure reviews.

Changes to the multi-year appropriation

- 45 I consider the multi-year appropriation should be recalculated so it is consistent with the new approach. The appropriation should be calculated to equal the market value of the pastoral leases expected to be purchased over the period of the appropriation. This change would:
 - 45.1 appropriate the sums actually accounted for
 - 45.2 help to make the entire system of conducting, reporting, funding and accounting for tenure reviews consistent and transparent.
- 46 I propose the multi-year appropriation be increased so the unexpended proportion is recalculated using the aggregated value of pastoral leases expected to complete tenure review during the remaining period of the appropriation—an increase of \$284.128m.
- 47 The new approach being adopted by LINZ would see a direct matching increase of \$284.128m in capital receipts as Land Tenure Reform Sales recorded over the same period as the multi-year appropriation.
- 48 There will be no net effect on the Crown's financial position as a result of changes to the multi-year appropriation because the increase will be matched by an increase in capital receipts.

Annual baseline forecasts beyond the multi-year appropriation

- 49 I propose a similar approach to recalculating annual baseline forecasts beyond the life of the multi-year appropriation.
- 50 Baseline forecasts for 2014/15–2016/17 and outyears following the multi-year appropriation are also calculated using the old exchange of interests approach. The current forecast for each of these years is \$10.667m.
- 51 The value of pastoral leases expected to complete tenure review in each of 2014/15–2016/17 and outyears is \$96.114m. I therefore propose an increase to the annual baseline forecasts in each year of \$85.447m over the currently forecast \$10.667m.
- 52 The new approach being adopted by LINZ would see a direct matching increase of \$85.447m in capital receipts as Land Tenure Reform Sales forecast for each of 2014/15–2016/17 and outyears.
- 53 There will be no net effect on the Crown's forecast financial position as a result of changes to annual baseline forecasts because the forecast increase will be matched by a forecast increase in capital receipts.

- 54 The annual baseline forecasts beyond the multi-year appropriation operate essentially as place-holders, in fact I anticipate seeking a new multi-year appropriation when the current one expires.

Financial Implications

- 55 My proposals are fiscally neutral. There is no impact on the Crown's operating or debt position and the proposals will not conflict or interfere with the Budget 2013 process.

Consultation

- 56 Treasury and the Department of Conservation have been consulted. The Department of the Prime Minister and Cabinet has been informed.

Human rights, legislative implications, regulatory impact analysis, and privacy considerations

- 57 The proposals contained in this paper appear to be consistent with the New Zealand Bill of Rights Act 1990 and the Human Rights Act 1993.
- 58 No legislative or regulatory implications arise from this paper.
- 59 No regulatory impact analysis is required.
- 60 This paper has no privacy implications.

Publicity

- 61 Lessees, valuers, and other parties (including environmental groups with an interest in the high country) have an interest in how tenure reviews are conducted, reported and funded.
- 62 LINZ has a communications plan for high country policy matters and this plan is being updated to clearly communicate the new approach described in this paper.
- 63 The plan includes LINZ making publicly available the contents of this paper and the related Cabinet minute.

Recommendations

- 64 I recommend that the Committee:
- 1 **Note** tenure review occurs under Part 2 of the Crown Pastoral Land Act 1998 which allows leases to opt into a process which sees:
 - 1.1 areas most suited to farming being freeholded to the lessee;
 - 1.2 areas with significant conservation values becoming part of the conservation estate;
 - 2 **Note** Land Information New Zealand is adopting a new, simpler and more transparent approach to the way it conducts reports and accounts for tenure review — “the market value approach”;
 - 3 **Note** the market value approach referred to in recommendation 2 is based around two values:

- 3.1 the value of the pastoral lease
- 3.2 the value of the land to be freeholded;
- 4 **Note** the market value approach referred to in recommendation 2 replaces an approach based on the value of the interests exchanged between the lessor and lessee — “the exchange of interests approach”;
- 5 **Note** that the exchange of interests approach relied on complex valuation methods, was difficult to understand, complicated negotiations with lessees, and did not transparently focus on the most important elements of what occurs in tenure reviews;
- 6 **Note** tenure reviews are funded by a three year multi-year appropriation in Vote Lands created in Budget 2011 and that the multi-year appropriation was calculated using the old exchange of interests approach;
- 7 **Note** there are annual baseline forecasts for 2014/15–2016/17 and outyears and that these forecasts were also calculated using the old exchange of interests approach;
- 8 **Note** the multi-year appropriation and annual baseline forecasts should be recalculated to reflect the way Land Information New Zealand is now conducting, reporting, and accounting for tenure reviews;
- 9 **Note** it is desirable that the changes to the multi-year appropriation and annual baseline forecasts should be made sooner than would be possible if changes were considered on the normal timetable for changes to LINZ’s four-year budget plan, and that changes to multi-year appropriations during the life of the appropriation require Cabinet approval (Treasury Circular 2007/05);
- 10 **Agree** that the current multi-year appropriation “Land Tenure Reform Acquisitions MYA” be changed so the remaining balance is calculated using the aggregated value of pastoral leases expected to complete tenure review during the remaining period of the appropriation — an increase of \$284.128m;
- 11 **Agree** that the annual baseline forecasts for Land Tenure Reform Purchases in each of the years 2014/15–2016/17 and outyears be calculated so that the forecast is the aggregated value of pastoral leases expected to complete tenure review during each of those years — an increase of \$85.447m in each year;
- 12 **Approve** the changes to appropriations and annual baseline forecasts in the following table, these changes having no impact on the Crown’s operating balance or debt:

Vote Lands: Minister for Land Information	\$m increase/(decrease)					
	2011/12	2012/13	2013/14	2014/15	2015/16	2016/17 & Outyears
Non-Departmental Capital Expenditure Land Tenure Reform Acquisitions MYA	284.128					
Non-Departmental Capital Expenditure Land Tenure Reform Purchases				85.447	85.447	85.447

- 13 **Note** that the indicative spending profile for Tenure Review Reform Acquisitions/Purchases described above is as follows:

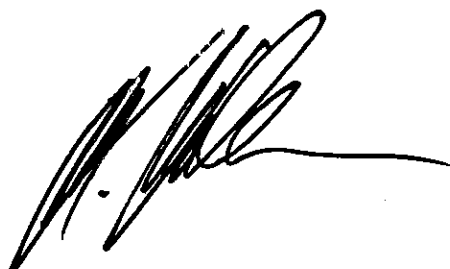
Indicative annual spending profile	\$m – increase/(decrease)				
	2012/13	2013/14	2014/15	2015/16	2016/17 & Outyears
	106.153	177.975	85.447	85.447	85.447

- 14 **Note** that forecast capital receipts are as follows:

Vote Lands Minister for Land Information	\$m – increase/(decrease)				
	2012/13	2013/14	2014/15	2015/16	2016/17 & Outyears
Non-Departmental Capital Receipts Land Tenure Reform Sales	106.153	177.975	85.447	85.447	85.447

- 15 **Agree** that the additional expenditure in the multi-year appropriation from 1 July 2011 to 30 June 2014 be included in the 2012/13 Supplementary Estimates, and in the interim, the additional expenditure be approved under Imprest Supply;
- 16 **Note** the market value approach being adopted by LINZ will involve a total increase in Land Tenure Reform Sales of \$540.469m over the same period as the multi-year appropriation and the annual baseline forecasts, the changes referred to recommendations 10 to 15 are fiscally neutral and will have no net effect on the Crown's financial position;
- 17 **Note** the changes referred to in recommendations 10 to 15 will not affect or interfere with the process for Budget 2013;
- 18 **Note** LINZ intends in its annual report set out the number of tenure reviews completed, tenure review sales, acquisitions of pastoral leases, the net costs of tenure reviews, and the value of land to be transferred to conservation estate;
- 19 **Note** LINZ has a communications plan for high country policy matters and this plan is being updated to clearly communicate the new approach described in this paper;

20 **Agree** that LINZ make the contents of this paper and the accompanying Cabinet minute publicly available.

A handwritten signature in black ink, consisting of several overlapping loops and a long horizontal stroke extending to the right.

Hon Maurice Williamson
Minister for Land Information

30/ 1 / 2013