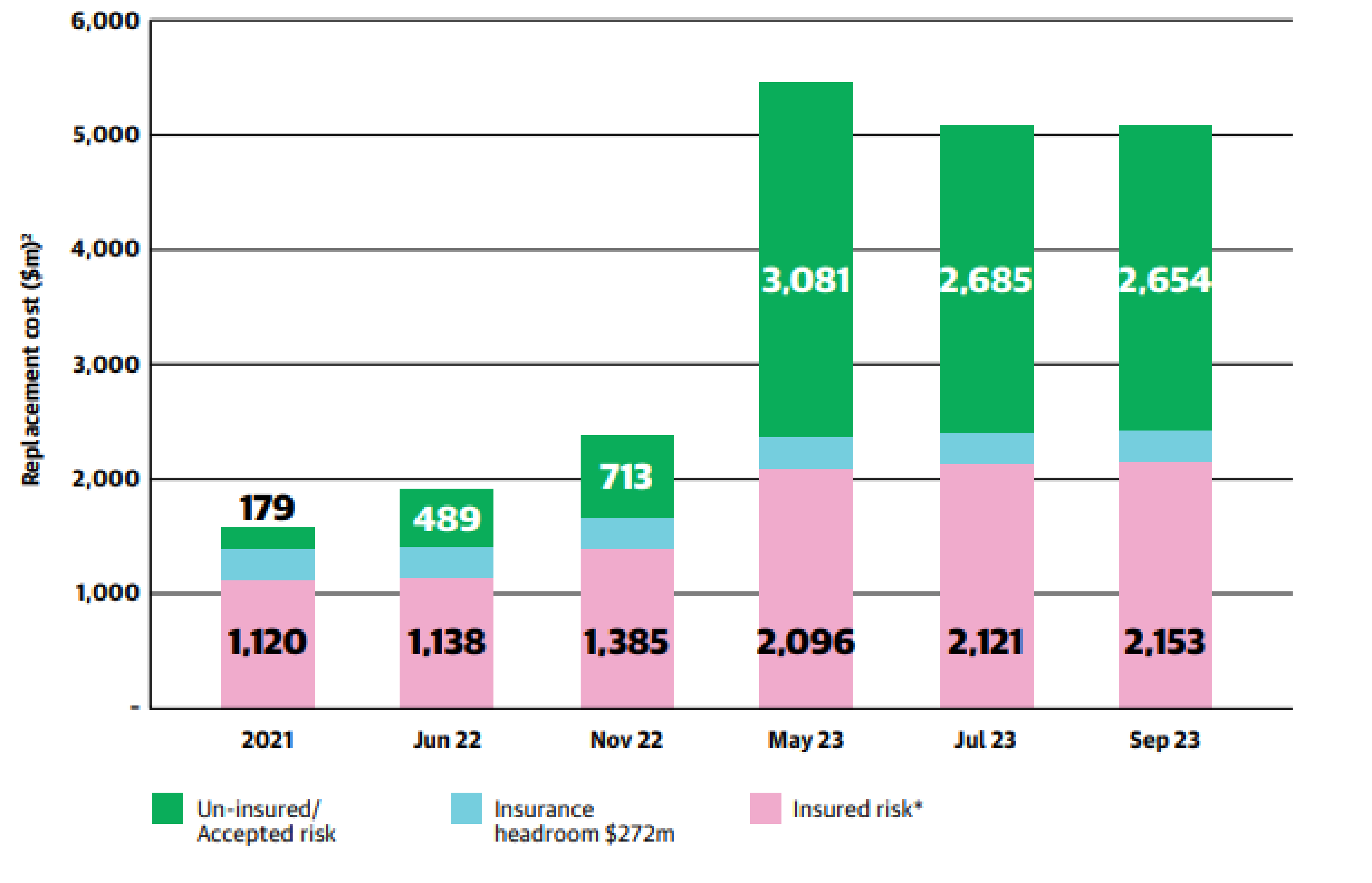
Absolutely Positively Wellington City Council
Me Heke Ki Pōneke

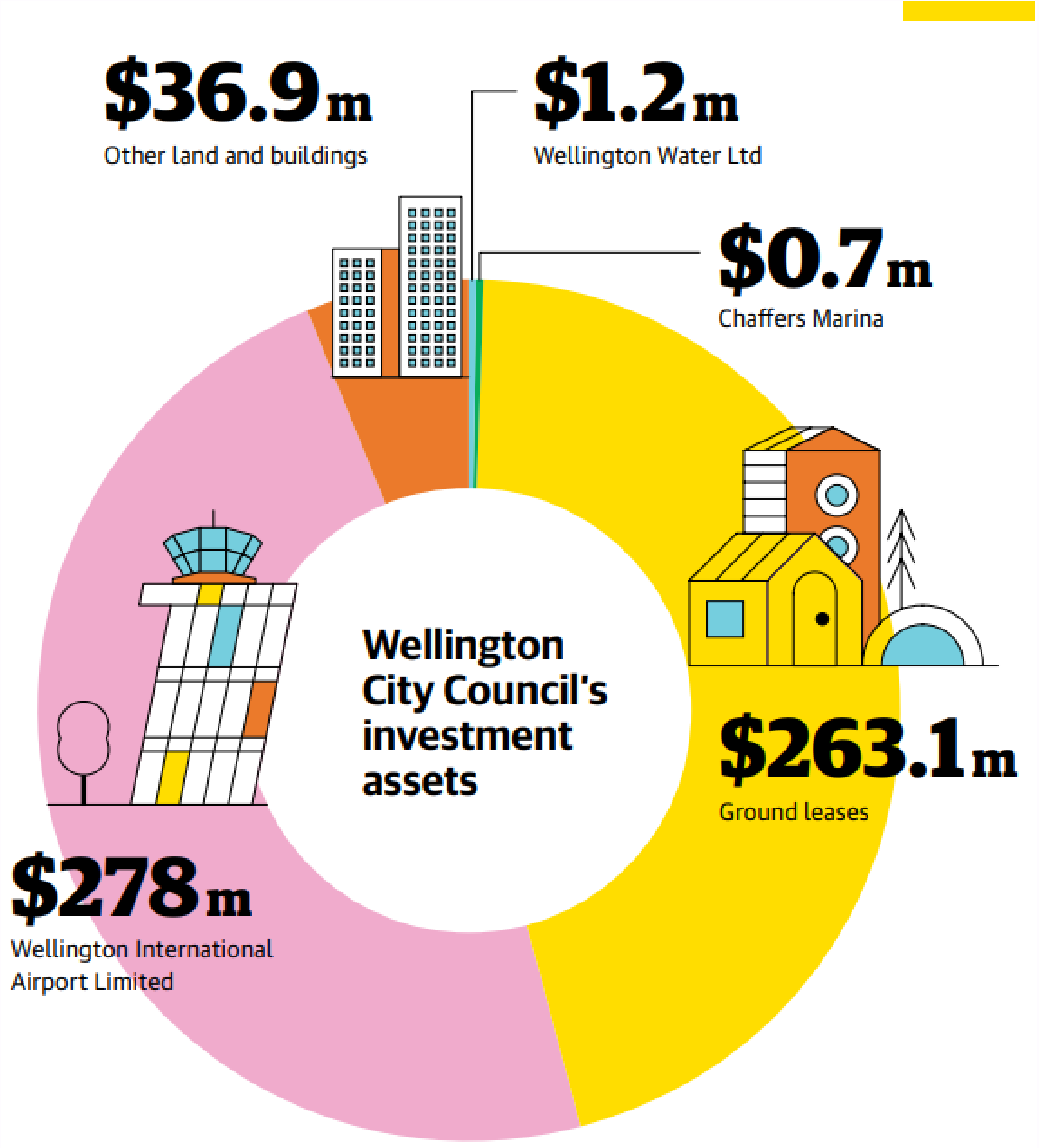
WIAL share sale & PIF establishment

Council briefing – 23 May 2024

Financial risk 1: significant, growing underinsurance



Financial risk 2: an undiversified portfolio



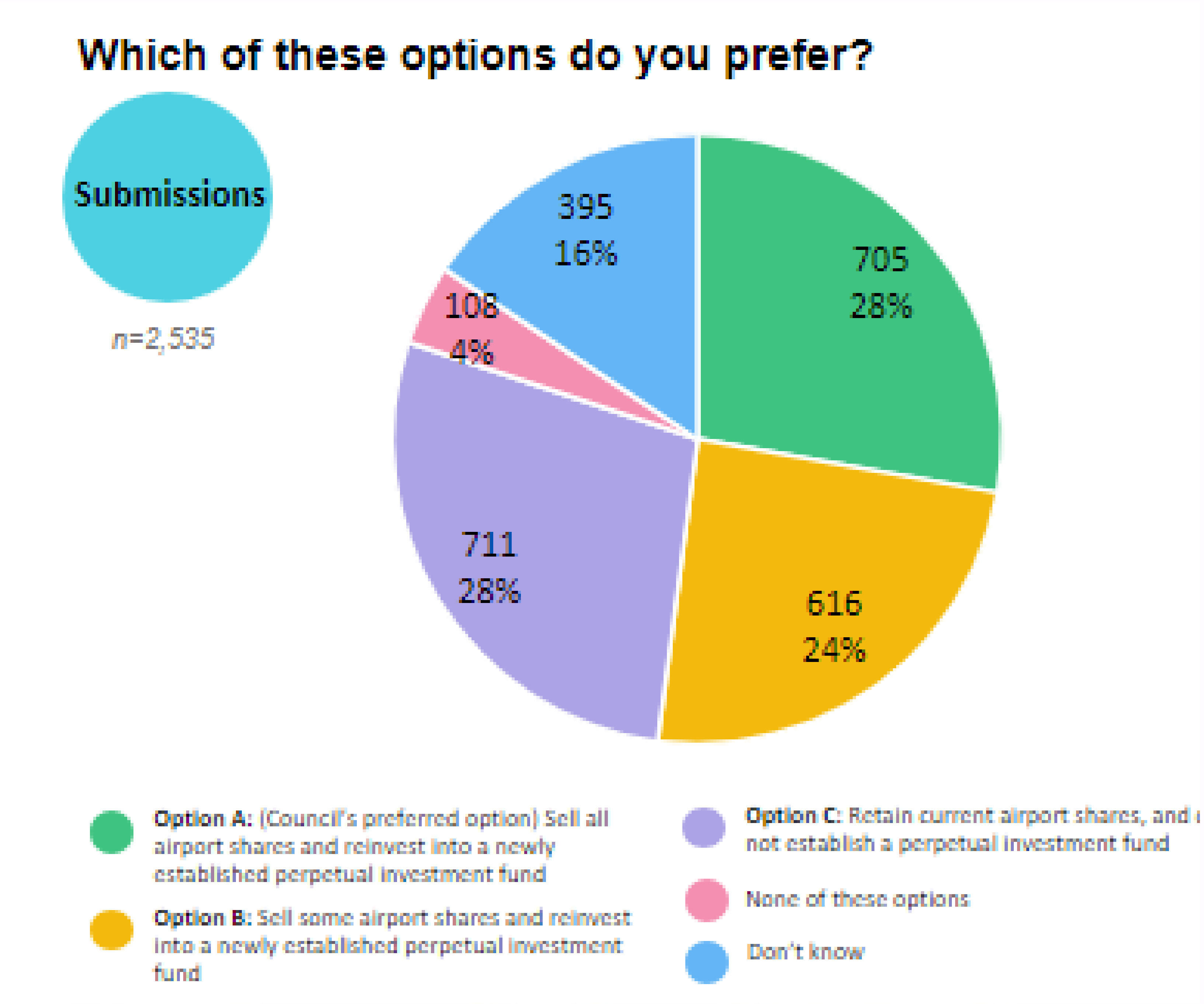
Council's preferred consultation option

- In the 2024/34 LTP consultation document, Council's preferred option was for a full sale of its 34% WIAL shareholding to establish a perpetual investment fund to address these risks

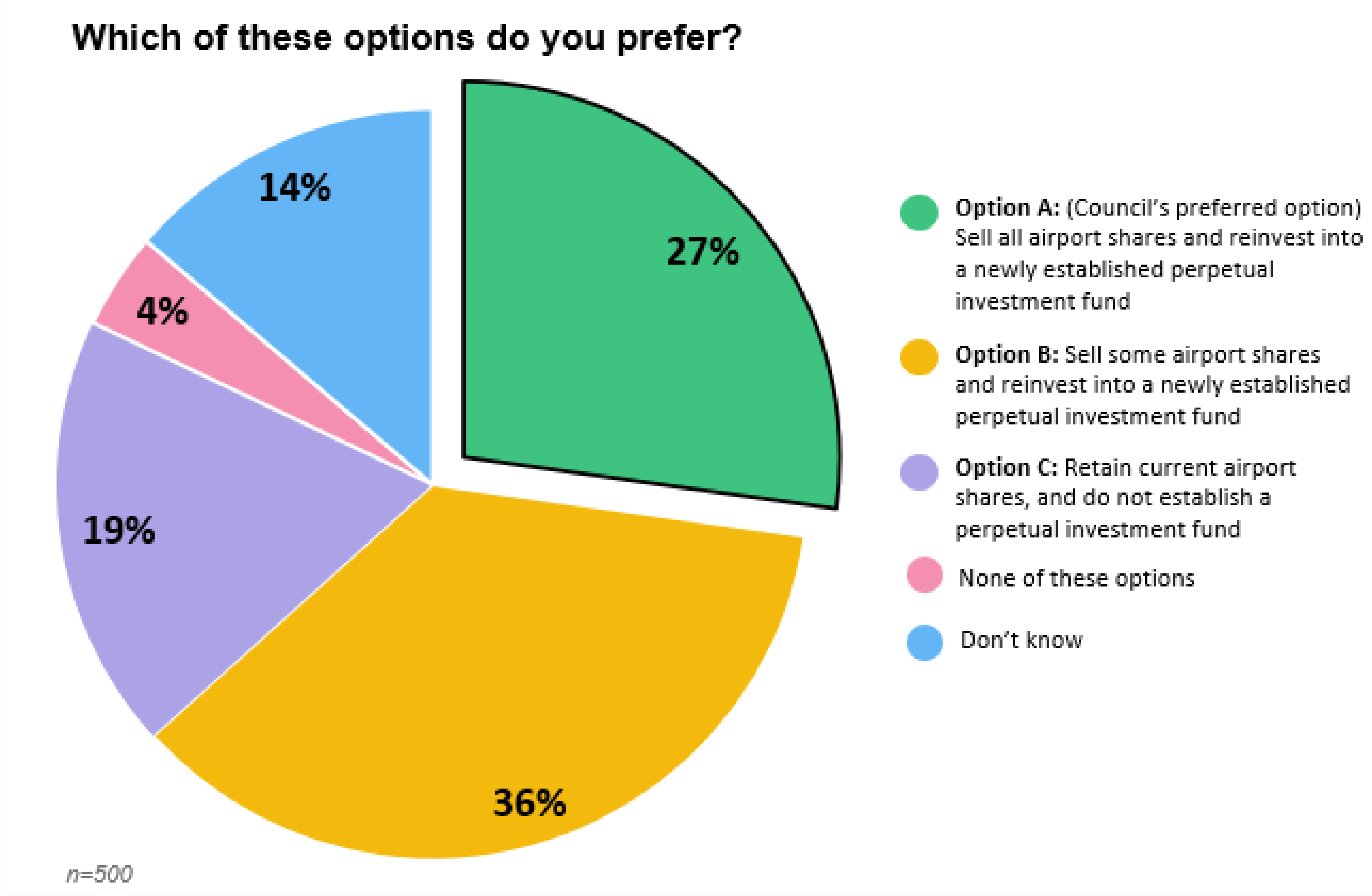
- Under the preferred option:

  - $500m (midrange estimate) sale of WIAL shares, with assumed $8m cost of sale (leaving a $492m starting fund balance)
  - $50m ground leases also sold in years 5-10 (specific leases not identified)
  - 7% return modelled, with 5% returned to Council via a dividend stream and 2% reinvested in the fund to grow over time
  - Dividend/reinvestment allocation matches forecast WIAL dividend for 10 years, so Council no worse off from a revenue perspective
  - PIF remains publicly owned fund, investing in diversified assets, with an ESG focus, to improve the resilience of the Council's investments

Consultation feedback supports WIAL sale/PIF: submissions



Consultation feedback supports WIAL sale/PIF: representative survey



A PIF funded by a full sale has significant benefits

- Meets the requirement of the LGA (s101) to manage the Council’s finances prudently for current and future generations

- A fund established via a full sale addresses the risks that the Council currently faces and delivers against the Council’s financial strategy and debt limits

- Best meets the LGA wellbeing requirements and s14 principles that the Council is required to give effect to in performing its role, in particular:

  - Ensure prudent stewardship of resources, including planning for future management of assets
  - Take account of the interests of future, as well as current, communities
  - Give effect to its identified priorities and outcomes in an efficient and effective manner
  - Assess the expected returns from investing in a commercial activity and satisfy itself that the returns outweigh the risks
  - Have regard to the views of its communities

- Responds to concerns raised by credit rating agencies and external financial advice

  - **Standard and Poor’s** – the Council’s uninsured assets expose the Council to financial risk, and that the increasing difficulty in obtaining traditional insurance means the Council should consider alternative options
  - **KPMG** – the level of risk exposure the Council has, through its underinsurance, would be an unacceptable risk for most governing bodies. Establishing a PIF via a full share sale would be economically prudent given the risks the Council is facing

Funds in a PIF can be well protected

- If the Council agreed to establish a PIF following consultation, there would be a formal process to establish the fund and put the necessary protections in place to ensure the fund was only used for its intended purpose(s).

- We would bring back an implementation plan setting out the steps involved, timeframes and future Council decision points. Key stages in implementation could include:

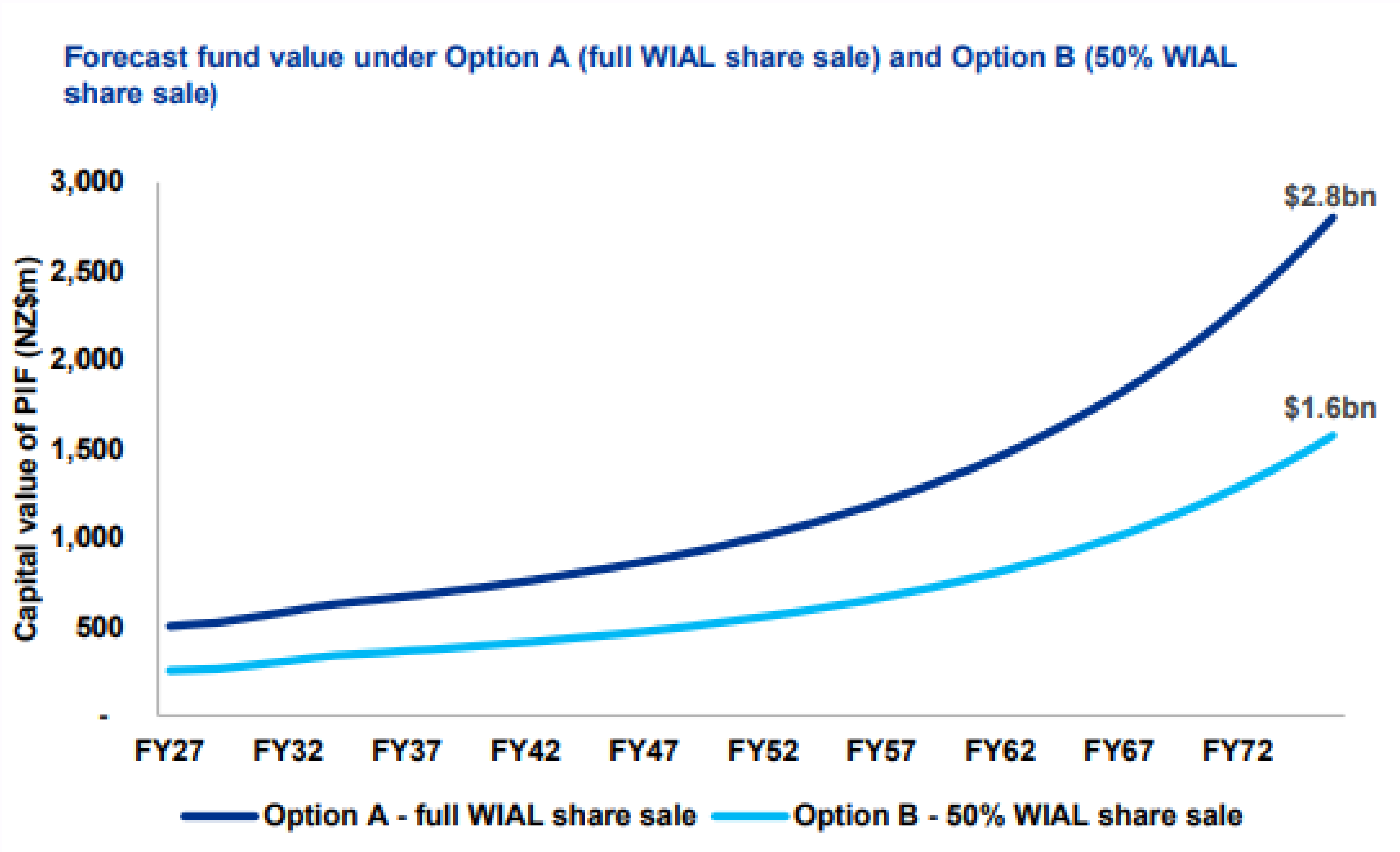
  - **Establishing a new entity/unit to manage the fund** – the new entity could be a unit of Council, new CCO, Council-owned holding company, or Trust, and Council would be involved in establishing the governing documents

  - **Appointing an investment manager and setting the investment strategy** – this process would enable the Council to set the investment priorities (e.g., any ESG requirements)

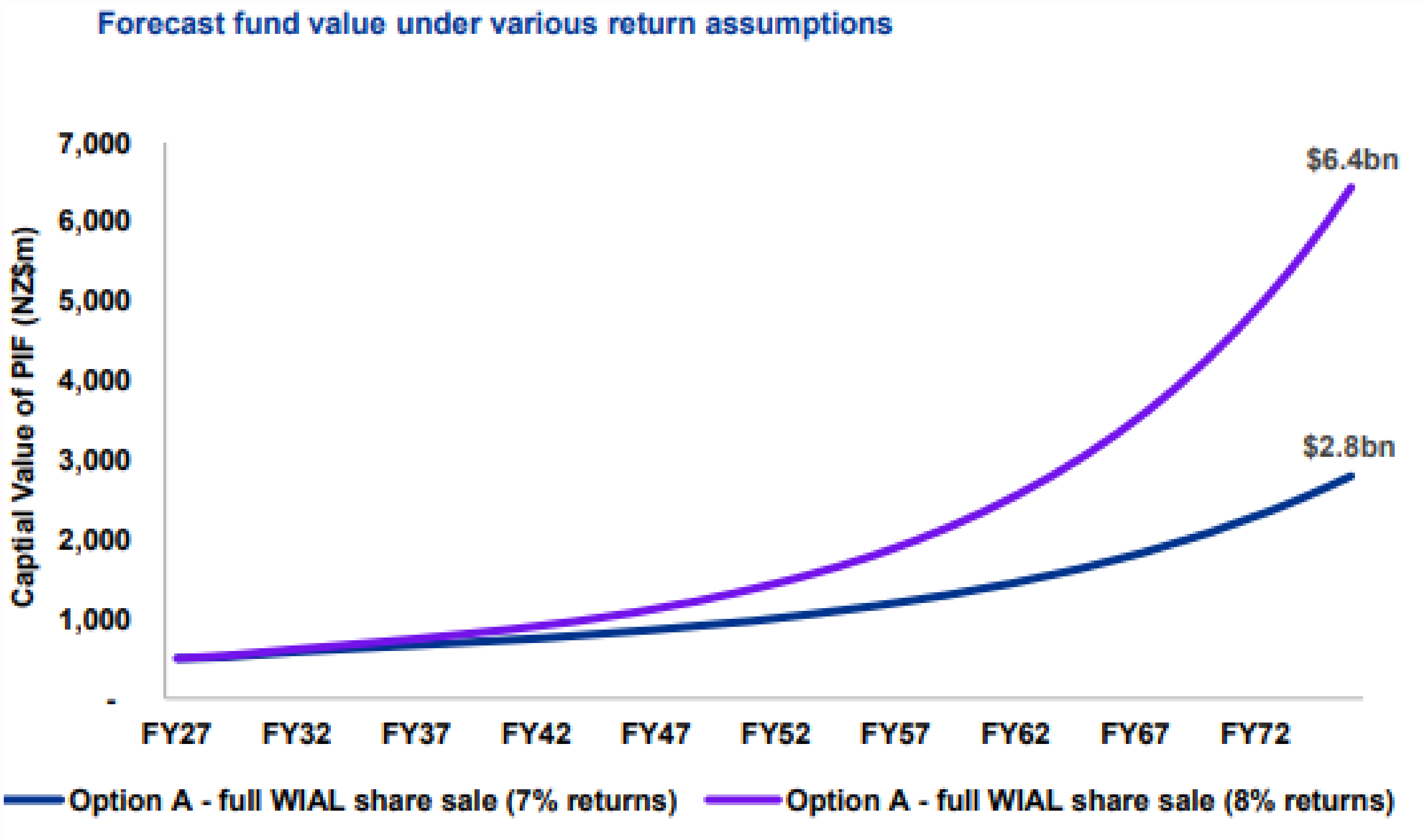
  - **Exploring legislative protection** – this would set principles for managing the fund, and safeguards for withdrawals

  - **Reflecting the fund in Council's policies and reporting requirements** – a fund would likely be identified as a strategic asset in the Council's significance and engagement policy and would have legislative and regulatory reporting requirements like other managed funds

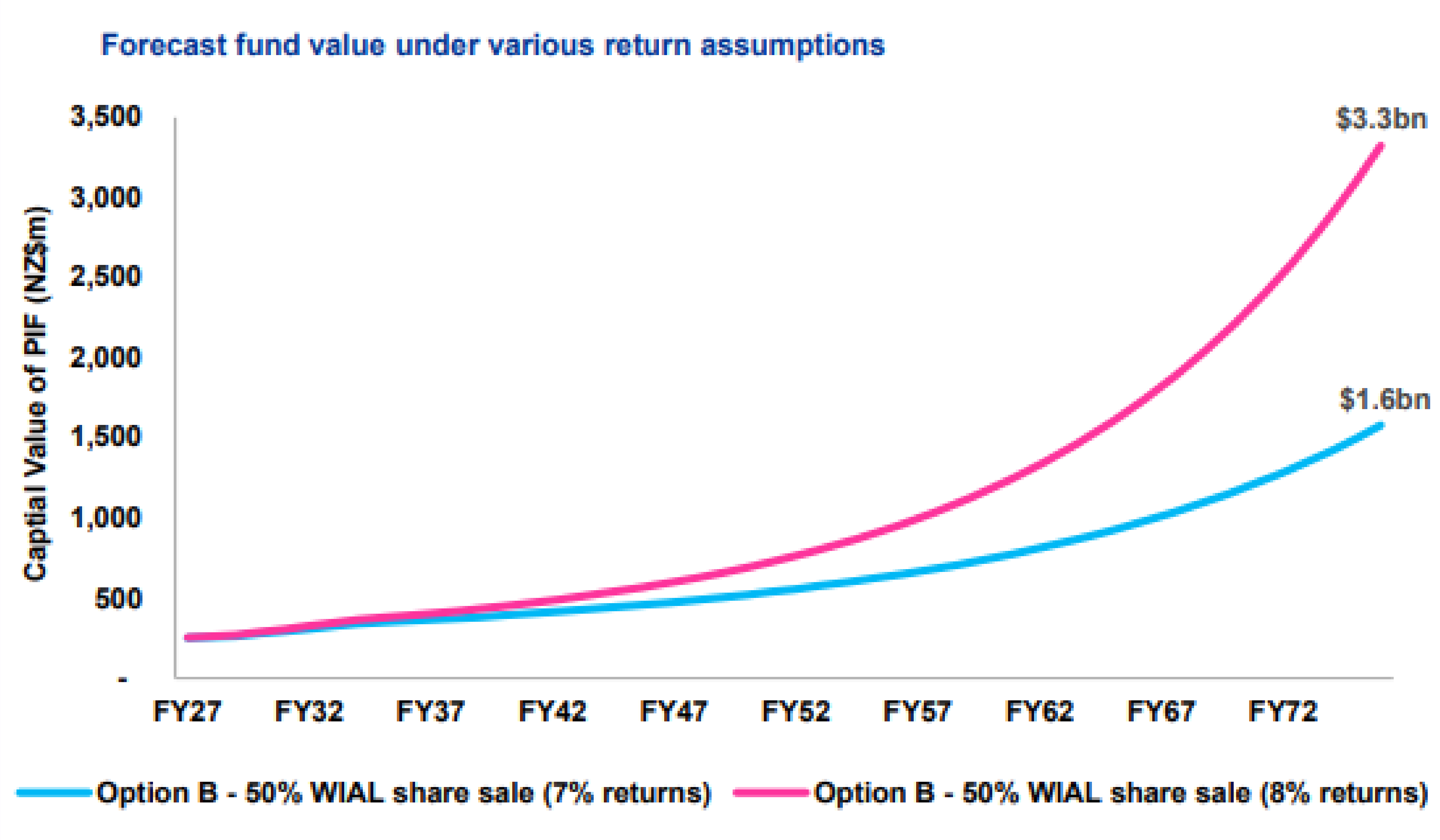
Fund value: full vs. partial sale (7% return)



Fund value: full sale (7% and 8% return)



Fund value: partial sale (7% and 8% return)



Wellbeing and LGA principles assessment – refer accompanying handout

Selecting an alternative option

- If the Council decided to proceed with a partial sale or no sale, it would need to be cognisant of the risks of these alternatives and consider if/how these could be mitigated.

- Under either of these scenarios the Council's alternative option is to carefully manage the Council's debt (via changes to the financial strategy) so that it has capacity to react to:

  - A significant event, which requires insurance proceeds and/or
  - Circumstances where the Council faces financial risk (e.g., where dividend revenue is compromised like COVID)

- If the Council decided to proceed with a partial or no sale, this would be subject to an audit assessment of financial prudence (it is currently unclear what the audit outcome would be)

  - Legal advice indicates that 'no sale', without significant cuts to debt, would not be prudent
  - It is not clear how a partial sale, combined with other adjustments to the financial strategy, would be assessed from an audit perspective

- Standard and Poor's have also noted that they will be looking at Wellington City Council's outlook or credit rating if the Council changes its financial strategy.

Pathway for partial sale

- If the Council resolves to undertake a partial WIAL sale (i.e., at least 50%) and establish a PIF, we recommend the Council takes the following steps in adopting the LTP:
  - Agree to a change in financial strategy and confirm a new debt-to-revenue ratio of 215% to increase the Council's future ability to borrow to supplement the value of the fund
  - Note that the Council would breach the revised debt-to-revenue ratio in years 2 and 4
  - Note the risks associated with this option (below)

- In pursuing a partial sale, there are significant risks, which the Council would need to be aware of and accept including:
  - **The sale of a smaller shareholding will be difficult and may not ultimately succeed** – there will be less market interest in the sale of a smaller shareholding and the Council will not achieve maximum value from the shares sold. If the Council chose this option, we would need to take further independent advice on a sale strategy and will bring the advice back to the Council before proceeding further.
  - Due to its smaller size and growth rate, the **PIF will not address the Council's financial and balance sheet risks** as was originally intended through the full sale

Pathway for no sale

- If the Council resolves not to sell the WIAL shares or establish a PIF, it will need to take the following steps in adopting the LTP:
    - Agree to undertake an LTP amendment (by December 2024) seeking feedback on a change of financial strategy, a new debt reduction strategy, and possibly reductions in levels of service
    - Commit to reducing debt by a minimum of $450m over 10 years (with the consultation process to determine details of reductions)

Summary

- The Council faces serious financial risks, confirmed by ratings agencies and external financial advice
  - Council is carrying underinsurance risk of $2.6B which will continue to grow
  - Council does not have enough long-term borrowing capacity to achieve its objectives
  - Investment portfolio is highly undiversified with all assets exposed to the same risks
- A perpetual investment fund established via a full WIAL sale would address these risks:
  - grow to between $2.8B - $6.4B within 50 years based on a 7-8% return and
  - generate a dividend for Council equal to the WIAL forecast dividend for 10 years of the LTP
- A full WIAL sale is financially prudent and has significant benefits over other options:
  - Meets the requirement under the Local Government Act 2002 to manage the Council's finances prudently (for current and future generations)
  - Addresses the risks that the Council currently faces
  - Responds to concerns raised by credit rating agencies and external financial advice
  - Delivers against the Council's financial strategy and debt limits
- The LTP budget currently assumes a full WIAL sale – pursuing a partial sale or no sale will have significant implications for the budget and the Council's financial strategy
  - Partial sale would require a reduction in the Council's debt-to-revenue ratio to 215%, and further advice on the sale process and implications given the risks of a partial sale
  - No sale would require an immediate LTP amendment and a commitment to a minimum of $450m reduction in debt over 10 years
- A PIF would have appropriate protections to ensure funds are only used for their intended purpose (e.g., recovery from a natural disaster)
- Consultation feedback shows support for a share sale/PIF establishment

Questions?

Wellbeing and LGA principles assessment

	Full sale	Partial sale	No sale
Wellbeings			
Social wellbeing	✓	? / ✓	✗
Economic wellbeing	✓	? / ✗	✗
Environmental wellbeing	✓	✓	✗
Cultural wellbeing	✓	✓	✗
Section 14 LGA principles			
Give effect to priorities and outcomes in an efficient and effective manner	✓	? / ✗	✗
Take into account interests of future, as well as current, communities	✓	? / ✓	✗
Assess the expected returns from investing in a commercial activity and satisfy itself that the returns outweigh the risks inherent in the activity	✓	? / ✗	✗
Ensure prudent stewardship of its resources, including by planning effectively for the future management of its assets	✓	? / ✓	✗
Have regard to the views of its communities	✓ ?	✗ ✓	✓ ✗

Previous Council established PIFs

01

New Plymouth District Council – Perpetual Investment Fund[1]

- **Established: 2004**
- **Managed by: Mercer New Zealand Limited**
- **Size: $351m**

The New Plymouth District Council (NPDC's PIF) was created to help offset rates for local ratepayers within the New Plymouth district. It was established using funds from the sale of NPDC's shares in Powerco.

- The PIF is overseen by New Plymouth PIF Guardians Limited (NPG), a council-controlled organisation (CCO) of NPDC. The CCO has an independent board of directors providing commercial expertise. Mercer New Zealand Limited manages the fund, and monitoring and review is completed by NPG.
- On the 28th June 2023, Parliament passed the 'New Plymouth District Council (Perpetual Investment Fund) Bill'. The Act sets out the principles for managing the fund, while dictating safeguards to ensure that independent financial managers make best-practice investment decisions to maintain or increase the value of the fund.

02

Dunedin City Council – Waipori Fund[2]

- **Established: 1999**
- **Managed by: Dunedin City Treasury Limited**
- **Size: $97m**

The Waipori Fund was established using proceeds from the sale of the Waipori electricity generation assets. The fund is a diversified investment portfolio comprising both fixed interest deposits and equity investments.

- The Fund is managed by Dunedin City Treasury Limited on behalf of Council, using the Statement of Investment Policy and Objectives (SIPO) approved by Council. The SIPO defines the primary objectives of the fund to be:
  - Maximise its income, subject always to a proper consideration of investment risk; and
  - Grow the Fund's base value, while maintaining an agreed cash distribution to Council.

The DCC maintains its Waipori Fund policy of divestment from fossil fuels, and a policy of formal opposition to offshore oil and gas.*

03

Hawke's Bay Regional Council – Future Investment Fund[3]

- **Established: 1999**
- **Managed by: Jarden and Mercer**
- **Size: $67m**

In 2018, the HBRC consulted with its constituents on options concerning its holding in Napier Port. The HBRC completed a partial sell-down of a 45% ownership of Napier Port via an initial public offering, with the proceeds raised used to form the Future Investment Fund. The Future Investment Fund totalled $67m as at 1 July 2023.

- The Fund is held by HBRC and the Hawke's Bay Regional Investment Company Limited (a CCO), in compliance under the HBRC's SIPO. The Councils three principle investment objectives include:
  - To increase the region's wealth and prosperity through the investment portfolio.
  - To increase asset values within the investment portfolio.
  - To protect asset values so future generations can also benefit from the investment portfolio.