Wellington City Disaster Resilience Fund
Council workshop
3 December 2024

Background and financial strategy

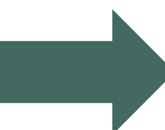
The work on the DRF is part of a broader suite of work that Council has underway to increase its financial resilience

- The Council faces two challenges to its balance sheet and financial resilience:
  - An underinsurance problem – estimated $1.8-2.6bn underinsurance in a 1/1000-year event
  - A diversification problem – 93% of its investment portfolio is exposed to the same kinds of risks
- These challenges were a core driver of the 2024-34 LTP and now the LTP amendment – the Council's financial strategy needs to address these challenges in order to meet the LGA's requirements for prudent financial management
- Under the current LTP, the financial strategy comprises:
  - 225% debt to revenue ratio, with $272m nominated "insurance" headroom (plus additional approx. $500m headroom up to 280%)
  - Establishment of a large ($500m) self-insurance/investment fund using the proceeds of the airport share sale
- The financial strategy under development for the LTP amendment shifts the reliance from an investment fund to debt headroom as the primary way to manage risk:
  - Reduces the debt to revenue ratio to provide a total of $1bn available debt headroom
  - Establishment of a small ($60-70m) self-insurance/investment fund from targeted ground lease sales
- Alongside this, the work on the insurance roadmap is seeking to:
  - Better model and understand our insurance risks
  - Apply better decision-making regarding insurance risk – including whether we transfer or retain this risk
  - Explore alternative risk transfer tools to close more of the insurance gap than can be managed via balance sheet mechanisms alone – e.g. captive insurance vehicle.
- Managing the Council's ongoing insurance exposure will require a range of solutions and active management over time as understanding of risk or risk appetite changes, or as some solutions become more or less viable

Overview of today's session

Introduction

- Alongside work on the insurance roadmap, officers have continued to progress work on the potential creation of a Disaster Resilience Fund (DRF)
- Initial scoping and design work on the key design elements for a potential fund has been completed and we are seeking initial feedback on key choices through this workshop
- There will be further workshops next year for Councillors to provide more detailed feedback and make decisions on the proposed details of the fund



Agenda	
1	Background and financial strategy
2	Purpose of the fund
3	Overview of similar funds of other local authorities
4	Key design choices
5	Next steps

2. Purpose of the fund

Rationale for considering a Disaster Resilience Fund

The establishment of an investment fund potentially provides a different risk profile than other balance sheet measures to support recovery from a significant natural disaster

	Leasehold land	Airport	Debt headroom	Disaster Resilience Fund
Stable period				
Income	✓	✓	N/A	✓
Value / growth	↗	↗	N/A	↗
Liquidity	Medium	Medium/Low	Higher	Higher
Following significant natural disaster				
Income	?	?	N/A	✓
Value / growth	↘	↘	N/A	↗
Liquidity	Lower	Lower	Higher	Higher

Potential objectives for a Wellington fund

The objectives of a fund will drive many of the key design choices for how the fund is managed, what it invests in and how funds are ultimately accessed

Status quo and issues a fund aims to solve

Council's main investment assets are concentrated in the Wellington region. Their value fluctuates with the prospects of the local economy.

In a disaster event, the value of those assets, their income potential and Council's ability to monetise them to support a recovery would be negatively impacted.

Council's insurance coverage does not fully cover large impact, low probability disasters.

Potential objectives for the fund

- Contribute to Wellington City's resilience solution (alongside insurance)
- Create a diversified investment base for the Council
- Provide protection so funds can be accessed only for specific uses (e.g. disaster recovery)
- Maintains an intergenerational asset
- Grow the real capital value of the fund over time
- Minimise any short-term impact on rate payers

While the fund would seek to achieve all these objectives to some degree, there are ***inherent trade-offs between them.***

The key choices on the design of the fund will influence which of these objectives gets greatest emphasis.

Key design questions

1. When and why could the fund be accessed?

The circumstances in which the fund could be drawn down

2. What is the structure and governance of the fund?

The role of Council and others in operating / overseeing the fund

3. What does the fund invest in?

The risk profile and types of assets that the fund invests in, including ESG considerations

4. What happens to investment returns?

The extent to which investment returns are reinvested into the fund or distributed back to Council

5. How would the fund be capitalised?

The capital sources for the initial capitalisation of the fund and options to add capital over time

6. How could the DRF interact with a Captive insurer?

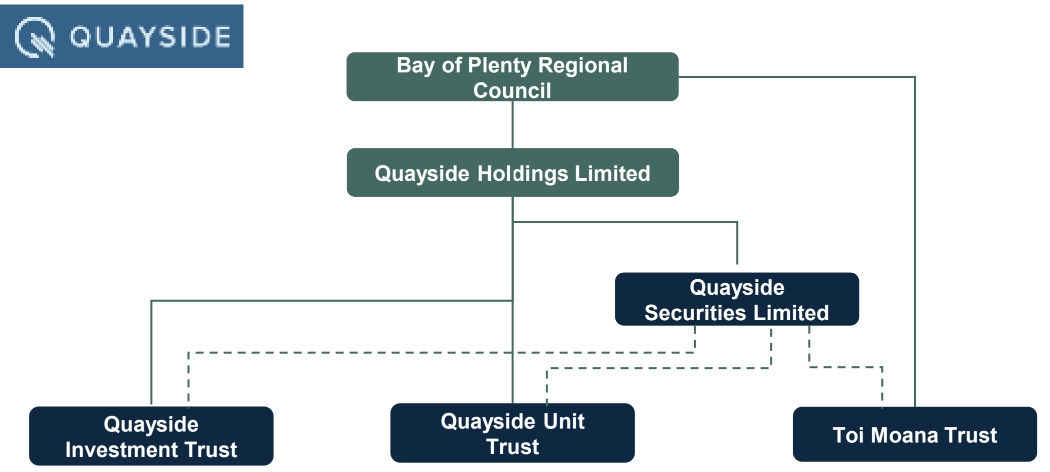
This subject will be addressed later, once the captive feasibility study is completed

3. Overview of similar funds of other local authorities

Case Study: Quayside Holdings (Bay of Plenty Regional Council)

Quayside Holdings is the investment arm of the Bay of Plenty Regional Council.

- Quayside was established in 1991, initially to hold and manage the shareholding in the Port of Tauranga.
- The MV Rena accident in 2011, near Tauranga Harbour, highlighted the need for resilience. The Council responded by choosing to grow and diversify its investments for the future.
- The adjacent table shows what was achieved over the next ~12 years.



Governance: 4 independent directors, 2 Councillor directors, Council CEO

Quayside's purpose *"is to* ***grow*** *a* ***responsible and diversified fund*** *that generates long term returns to support the growth and prosperity of the Bay of Plenty."*

The objectives for Quayside include **growing the value** of its investment fund in **real terms**, providing a **resilient** dividend stream to Council allowing it to deliver benefits to the BOP region, and promoting the **sustainability** of the fund for both **current and future** generations.

Growth in assets over time

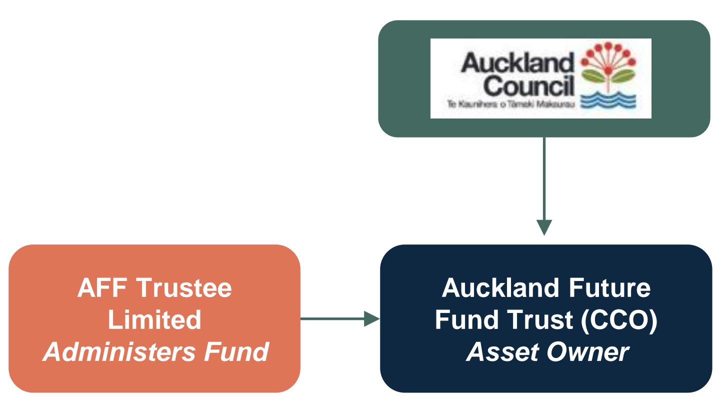
	2010 ⇨	2022
Port	$490m	$2,284m
Other Assets	$71m	$479m
Debt	$(270)m	$(265)m
Net Assets	**$291m**	**$2,498m**
Dividend	$4.5m	$40m
% of general rates	31%	126%

Source: Quayside Holdings Limited Annual Reports and other public disclosures

Case Study: Auckland Future Fund

The Auckland Future Fund was established in September 2024 by Auckland Council, designed to enhance Auckland's physical and financial resilience.

- The Fund is intended to diversify Auckland Council's assets across different sectors and locations
- The Fund will be capitalised with the council's Auckland International Airport shares. The Trustee is able to sell the airport shares to achieve the purposes of the Fund.
- A CCO trust was established to own the assets, and is managed by AFF Trustee Limited with a board of 3 independent directors.



Governance: 3 independent directors (100%)

The draft **Trust Deed** and **Auckland Future Fund Policy** set out two purposes for the Fund:

a) Intergenerational Benefit: *to protect the real value of the Fund over time, so that the Fund can continue to benefit future generations; and*

b) Funding Services/Infrastructure: *to provide a strong return to Auckland Council to fund services and infrastructure.*

The Fund has only recently been established, but key expected metrics are:

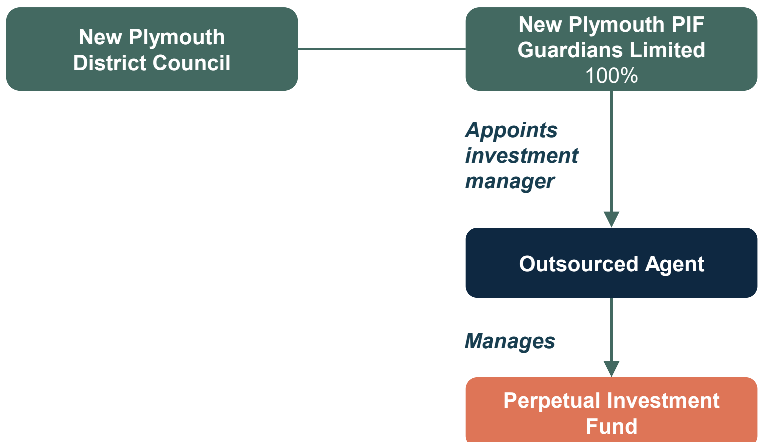
- *The airport shares have an approximate value of $1.3bn*
- *The Fund is expected to provide a net return 7.2% per annum, over time*
- *The Council will take distributions of 5.2% per annum with the intention to maintain the real value of the fund in the long-term*

Source: AFF Draft Trust Deed, AFF Draft Distribution Policy, Auckland Council Meeting 27-06-2024 Open Minute Attachments
Note: Information on this slide based on draft consultation documents, final fund design decisions may have been subsequently updated.

Case Study: New Plymouth Perpetual Investment Fund (PIF)

The New Plymouth PIF was established in 2004 following the sale of the Council's shares in PowerCo.

- The PIF distributes proceeds to offset total rates, while also seeking to maintain/grow the value of the fund (rates offset was $11.4m in 2023/24).
- The principles for management and application of the PIF and investment decision making principles are protected within legislation that was passed in 2023.
- The day-to-day investment is undertaken by an outsourced independent agent and overseen by a fully independent board.



Governance: 100% independent directors

The purpose of the New Plymouth PIF is enshrined in legislation. In addition legislation provides that:

"*The Council must manage and apply the PIF in accordance with the following principles:*

a) *the PIF is a long-term fund which should be managed and applied for the social, economic, environmental, and cultural well-being of current and future communities of the New Plymouth District;*

b) *the PIF should be managed and applied with* ***the intent of maintaining or increasing the real value of its capital****, unless the Council considers, on reasonable grounds, that*

   i. *the PIF can be applied in a way that will achieve a benefit that is better for the well-being of current and future communities of the New Plymouth District than maintaining the real value of the capital of the PIF; and*

   ii. reducing the real value of the capital of the PIF is the best available means of achieving that benefit."

$259m

(2004 opening balance)

$376m

(May 2024 balance)

~$240m

(Distributions to date)

Source: NPDC Annual Reports

Case Study: Environment Southland

As part of its financial strategy, Environment Southland (“ES”) primarily holds two large investments – part ownership of South Port and investment in managed funds

- Consulted in recent LTP on selling down South Port to 51% (now 66%), with consultation focusing on intergenerational capital and diversification.
- The ownership and governance of the managed funds investments are largely done in-house. Previously managed by three Council committees, now under a single committee.
- Currently recruiting for two independent experts to support the investment committee. Fund management provided by external fund managers.
- In addition, ES’s other key assets are leasehold land (primarily held for flood management purposes), council property and a smaller number of CCO investments.

Extracts from ES LTP 2024 – 2034

The managed fund investments are assumed to be allocated between NZ bonds, equities, and cash, as well as international equities to spread risk.

Capital drawdowns from the managed fund have previously been used to reduce rates, by paying for operating costs, responding to disasters or for major projects. The LTP notes that ES no longer has the financial capacity to continue these types of drawdowns given current lower levels of resilience.

Distributions and capital growth

- *Realised investment returns are largely used to reduce the general rate. This is expected to be 3 - 3.5% across bonds and equities*
- *Unrealised investment returns remain in the managed fund to build the investment resilience*
- *Fund value at FY24 of ~$31m*

Source: ES LTP and Annual Reports

4a. Key design choices

1. When and why could the fund be accessed?

2. What is the structure and governance of the fund?

3. What does the fund invest in?

4. What happens to investment returns?

5. How would the fund be capitalised?

1. When and why could the fund be accessed?

Key trade-off: The flexibility to access the fund when genuinely needed vs intergenerational protection over the long-term

More permissive and flexible, definition may be judgement based

Moderately restrictive, access event is tightly defined

Very restrictive access, cannot be drawn down ('perpetual')

Fund access criteria

1. How should an 'access event' be defined?

2. Who makes the decision to access the fund?

3. What are the conditions for access (eg last resort, only if no other funding sources are available)?

How do other funds operate?

New Plymouth District Council

The PIF should be managed and applied with the intent of maintaining or increasing the real value of its capital, unless *"the Council considers, on reasonable grounds, that — the PIF can be applied in a way that will achieve a benefit that is better for the well-being of current and future communities of the New Plymouth District than maintaining the real value of the capital of the PIF; and reducing the real value of the capital of the PIF is the best available means of achieving that benefit."*

- Source: New Plymouth District Council (Perpetual Investment Fund) Act 2023

Auckland Future Fund

Initially considered provision for "exceptional distributions" in response to a major event, but this was removed from drafts in favour of maintaining the real value of the fund. To drawdown (outside regular distributions) requires a resolution approved by 75% of Council and the trustee being satisfied that a drawdown achieves greater benefit (as for the PIF above) and that the distribution is not being sought as "first-resort".

- Source: Auckland Council Meeting 27-06-2024 Open Minute Attachments

Initial thinking

Given the focus on disaster resilience, the fund should have clearly defined provisions for access in a significant disaster scenario, however we need to be careful that the definition does not unduly restrict access when it is required.

We would generally expect access to occur after other avenues have been exhausted, but further work on this is required in the next stage, including the interaction with a potential Captive insurer.

2. What is the structure and governance of the fund?

There are key choices for how the Fund is governed and managed, its level of independence from Council, and ongoing cost. The approach should be fit for purpose given the fund's initial size and scope, with options to transition to more involved models over time as the fund's scale and complexity grows.

No new entity, within Council	**A. Governance and legal form**	**New entity, not within Council**
Council only governance	**B. Role of independent experts**	**Fully independent governance**
Lower protection, more flexible	**C. Intergenerational protections**	**Higher protection, less flexible**
Lower costs (more appropriate for smaller fund)	**D. Costs**	**Higher costs (more appropriate for larger fund)**

Option 1: Internal fund

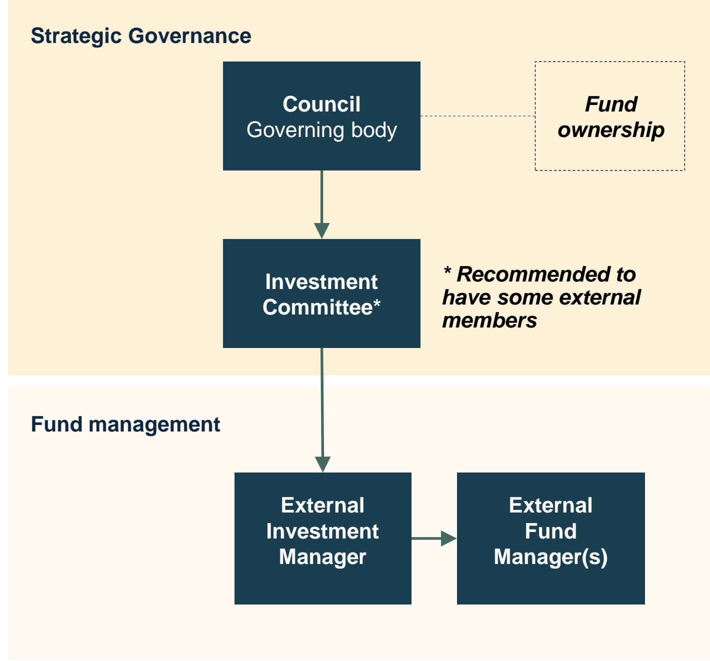
Option 2: Internal fund with governance CCO

Option 3: Full CCO

A. Governance and legal form – potential options

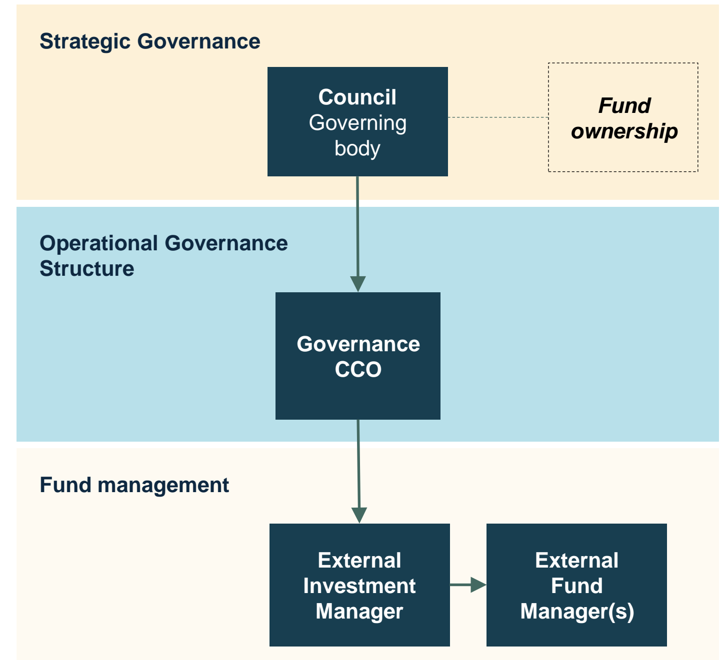
Option 1: Internal fund

(Council asset, Council governance)



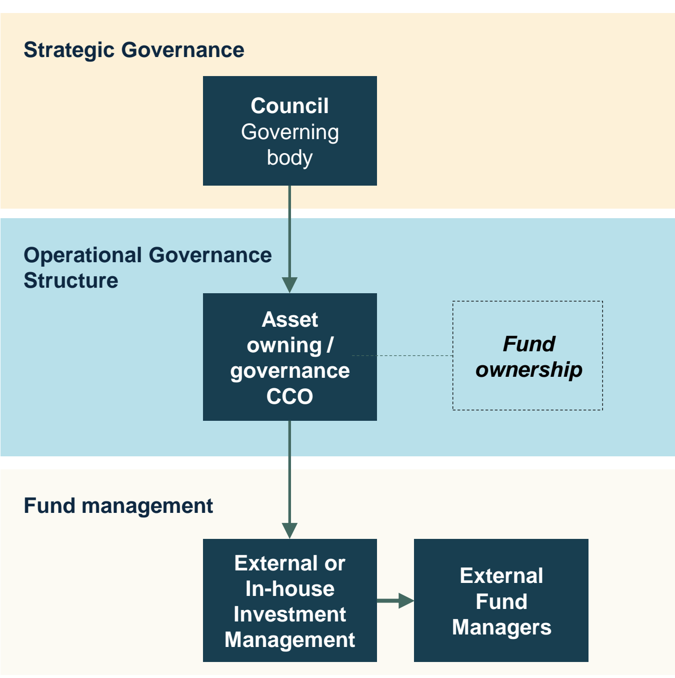
Option 2: Internal fund with governance CCO

(Council asset, CCO governance)



Option 3: Full CCO

(CCO asset, CCO governance)



Legal form

The "Fund" would comprise assets of the Council which are "ringfenced" as the "Fund"

Legal form options

Any newly established CCO could be a **Company, Limited Partnership or a form of Trust.** While there are not significant differences from a structuring perspective, further work needed on accounting, tax and other implications before a recommendation on form can be made

B. Role of independent experts

Independent experts can provide specific expertise and continuity of service, relevant in the oversight of long-term Council assets that are not associated with core Council services.

In all models, we would expect the day-to-day investment management to be provided by an external investment manager who implements the Council's investment strategy.

How do other funds operate?

Council only governance ← **Number of independents** → Fully independent governance

Environment Southland funds
Held by Council

Recent change →

Hawke's Bay Regional Investment
3 independent directors, 2 Councillor directors

Quayside Holdings
4 independent directors, 2 Councillor directors, Council CEO

Auckland Future Fund
100% independent directors

South Taranaki District Council fund
Held by Council

New Plymouth PIF
100% independent directors

South Waikato Investment Fund
100% independent directors

C. Intergenerational protections

Lower protection, more flexibility — ***Stronger protections, less flexibility***

C. Protection mechanisms

1. Council supermajority	2. Strategic Asset	3. Independent governance with entrenched terms *(e.g. beneficiaries, purpose, distributions etc)*	4. Legislation
Require 75% of elected members to change	Provides further protection from access if consultation required to access / use per s97 of the LGA vs. ability to immediately access	Key details (e.g. purpose) are entrenched in governance documents and there is a high threshold for change	Legislation setting out purposes, principles, and requirements for how the Fund is to be managed. Highest form of protection but least flexibility

How do other funds operate?

New Plymouth PIF

Legislation:

- Entrenches purpose
- Geo-fences benefits to current and future communities of NP
- Entrenches principles for managing and applying the fund: Investment decisions made independently and only by persons appointed by Council to do so, on a prudent commercial basis having regard to a number of factors

Separate governing body with full independent board

Quayside Holdings

- Separate investment management entity, with majority independent board
- Terms set by Statement of Expectation and Long-term Plan
- Strategic assets: Majority shareholding in Port of Tauranga
- Quayside ensures it has liquidity to cover two years dividend to Council
- No legislation

D. Cost

Lower cost — *Higher cost*

D. Governance costs

	Option 1: Internal fund (3 independents)	**Option 2:** Internal fund with governance CCO	**Option 3:** Full CCO
Governance	Council Committee with independents	Independent CCO	Independent CCO
People cost estimate	$75,000 p.a.	$150,000 p.a.	$230,000 p.a.
Other costs (e.g. reporting, audit)	$50,000 p.a.	$150,000 p.a.	$200,000 p.a.
Total cost estimate	**$125,000 p.a.**	**$300,000 p.a.**	**$430,000 p.a. + staff costs**
Governance cost estimate*	**~20bps**	**~45bps**	**~65bps**
Investment management cost estimate	**~20 - 150bps depending on management style (active/passive), asset types (e.g. equities/debt), fund scale**		

** Cost estimates are illustrative only and intended to indicate broad order of magnitude. Governance costs expressed in bps assume $65m opening balance.*

There would be the opportunity to **transition** from left to right as the Fund's scale and complexity (e.g. diversity of asset mix) grow.

As governance costs are relatively fixed, the more expensive options become more appropriate for a larger / more complex investment portfolio.

Summary and initial assessment

Option 1

(Internal Fund) is the simplest and lowest cost option that balances trade-offs if the Fund is relatively small

- Simple form and lower cost to govern
- Can provide some independence and intergenerational protection through documented policies and independent governance representation
- Greater risk that protections can be unwound in future

Option 2 and 3

These options are more appropriate as the fund grows in scale and complexity – they provide greater independence and protection, albeit at higher cost

- Involves new CCO entity which is more involved to establish – foundation documents, registrations, appointments
- Purpose, policies and decisions of a separate, independently governed entity are harder to influence or change
- More challenging to transition back to Option 1

4b. Key design choices

1. When and why could the fund be accessed?

2. What is the structure and governance of the fund?

3. What does the fund invest in?

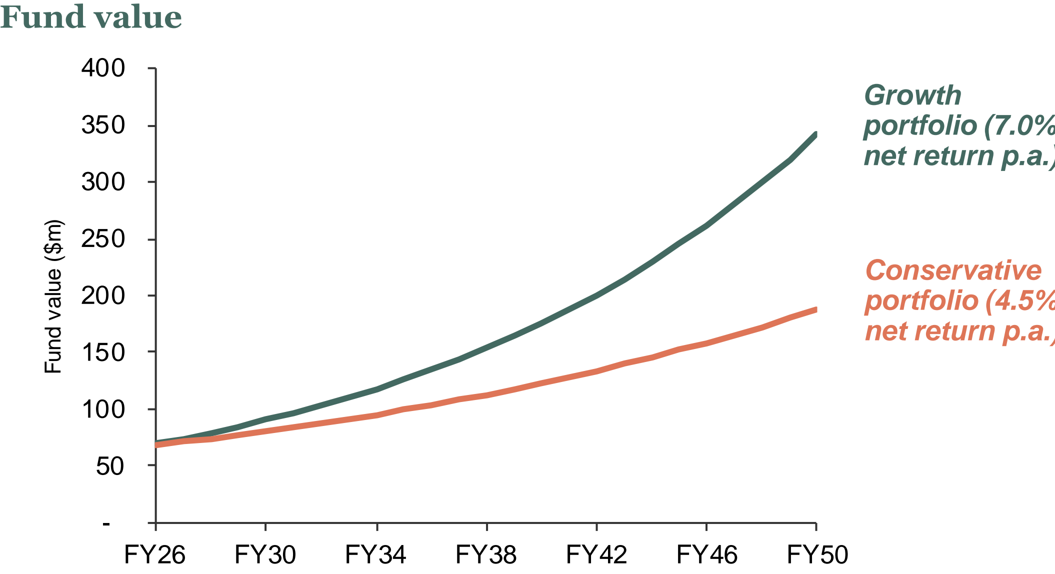
4. What happens to investment returns?

5. How would the fund be capitalised?

3. What does the fund invest in? (1 of 2)

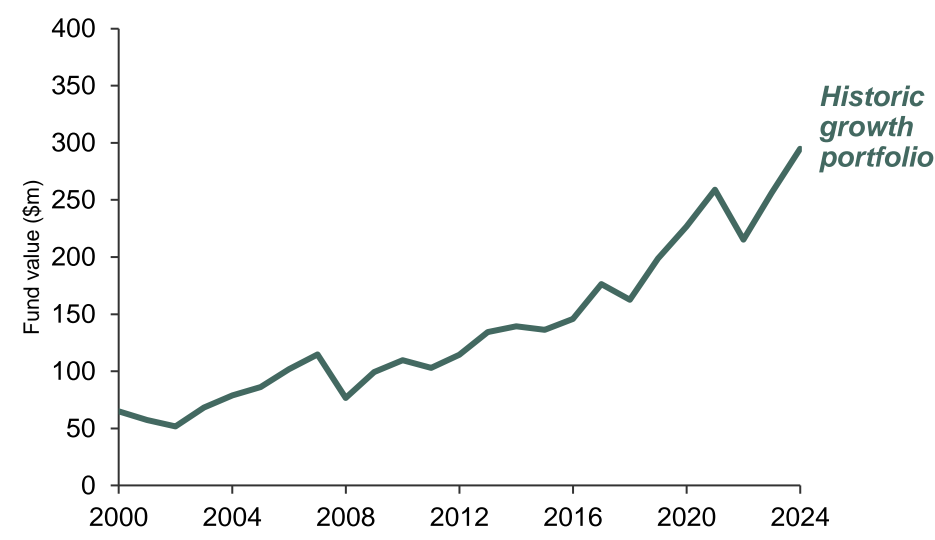
The following model illustrates the potential growth of an initial $60-$70m investment. In practice, financial returns will be volatile year on year. Fund volatility is less likely a concern if the fund is not expected to be accessed in the short term (as it is only needed in a rare disaster situation).

Fund value



Source: LSEG market data. Assumed performance is based on average annual returns achieved by a portfolio split 80:20 between global equities and fixed income for a growth portfolio and 40:60 for a conservative portfolio, less some assumed fund costs. Past performance is not indicative of future returns.

Fund volatility (Historic performance of illustrative portfolio)



Source: LSEG market data. Historic performance is based on total return data for a portfolio split 80:20 between global equities and fixed income (made up of global bonds + cash). Past performance is not indicative of future returns.

How do other funds operate?

Auckland Future Fund

- Delegated to an external investment manager
- Managed per SIPO and relevant policies (eg Responsible Investment Policy)
- Target long-term net return of 7.2% (reviewed periodically)

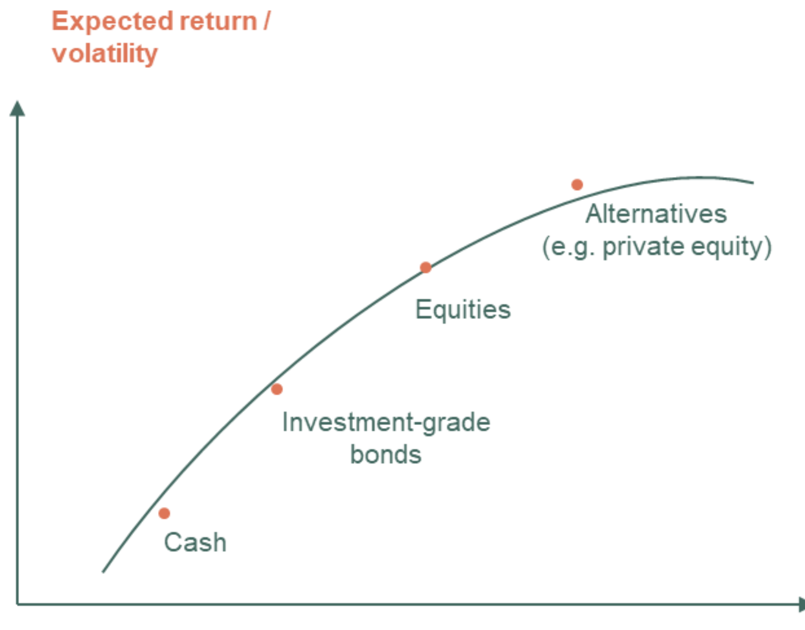
Quayside

- A portion of assets allocated to external fund managers to invest
- In addition, Quayside has a direct investment team involved in property development and private equity
- Target long-term gross return of 7.0%

3. What does the fund invest in? (2 of 2)

Key trade-offs: Long-term growth vs volatility of returns and speed of access (liquidity)

Issue	Key considerations / comments
Risk appetite (growth vs volatility)	A higher expected return is typically associated with higher investment risk and volatility of annual returns. Longer investment horizon could justify higher investment risk in return for higher growth expectation.
Speed of access	If WCC does not need rapid access to the fund's capital (in an emergency), then a wider range of investment options may be appropriate.
Asset allocation	Investment policies set by the Council can influence the types of assets the fund would invest in, including the broad proportion of asset types.
ESG considerations	ESG considerations could be incorporated into the investment policies, including specific sectors that the fund would not invest in.
Management cost	Different asset classes and investment management styles (active vs passive) will have higher/lower ongoing management fees.



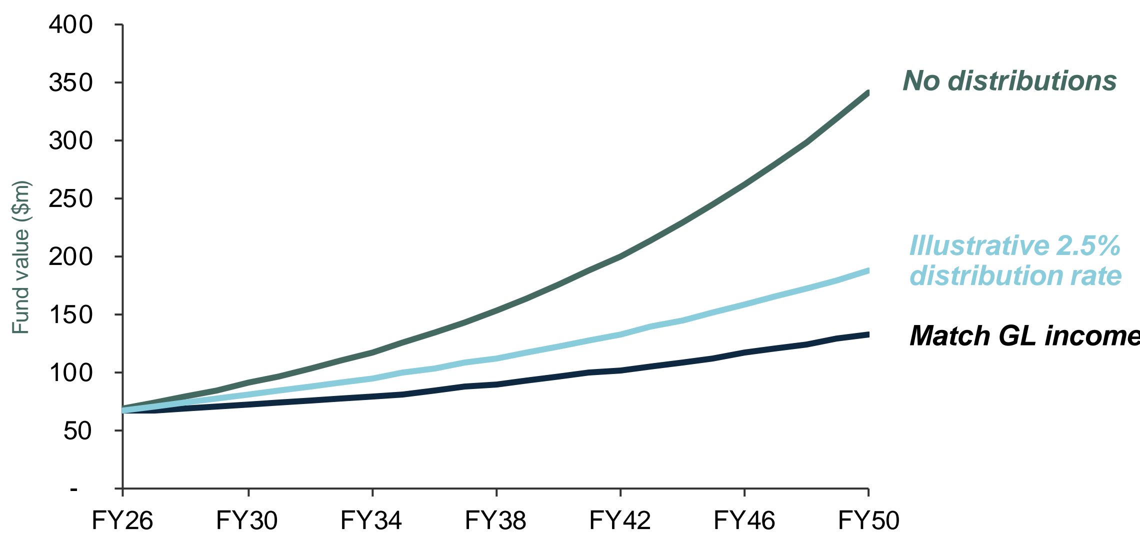
Initial thinking

The fund would be a 'growth' portfolio invested in tradable, diversified assets, likely through other managed funds. Longer investment horizon (focused on recovery from low likelihood major disasters) is expected to offset the risk of year-on-year volatility. Investing in tradable, diversified assets would make the funds more accessible if genuinely needed.

4. What happens to investment returns?

Key trade-off: The long-term growth of the fund's capital (and resilience benefits) vs. distributions to support current ratepayers

- The Fund would be initially capitalised by the sale of selected ground leases which currently provide revenue to Council that offsets rates.
- The distribution policy **could prioritise distributions** (i.e. income to Council)**,** at the expense of **fund growth over time, or vice versa** which may produce lower income than ground leases and could impact rates.
- Other councils have generally adopted a middle ground of some distributions while at least maintaining the real fund value over time.
- The rates impact of the sale of the ground leases (assuming no distributions are made to Council from the fund) would be between 0.6% - 1.8% in 2025/26 depending on the number sold (see next slide for more details).



Source: LSEG market return data, WCC ground lease income projections
Illustrative modelling, for discussion purposes only. Assumes 7% net return p.a.
Match GL income scenario assumes ~$3.2m p.a. distribution for remainder of current LTP period and 3.5% p.a. long-term yield post LTP period.

Initial thinking

The fund should seek to grow its real value over time. With a relatively small fund, careful consideration should be given to any distribution to Council – reinvestment back into the fund to enable growth should be an early priority.

5. How would the fund be capitalised?

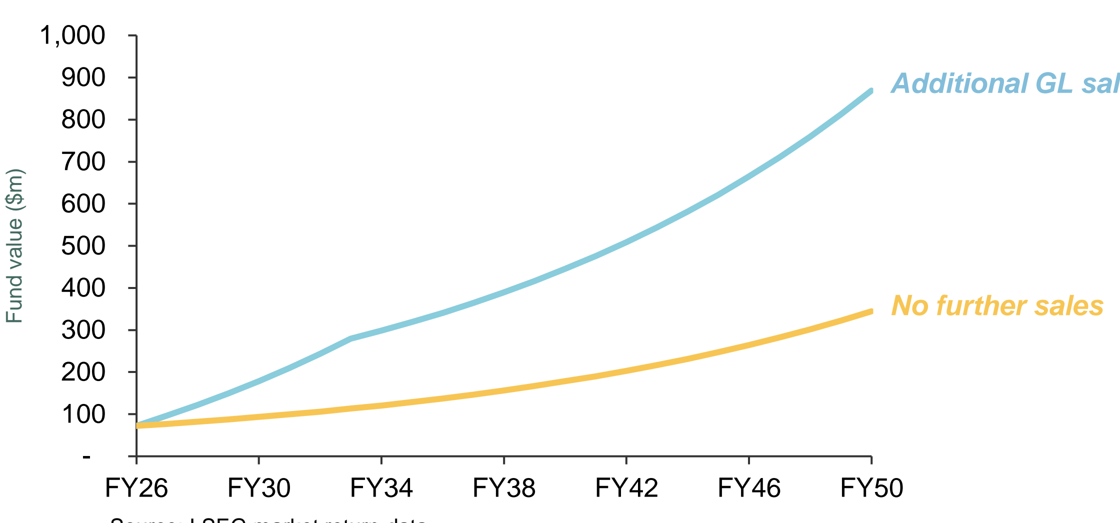
Key trade-off: The long-term growth of the fund vs. ease of implementation (and loss of revenue) from further Ground Lease sales

Contribution sources

- Ground leases with an estimated market value of **~$60m - $70m** have been identified which could be sold by the time the fund has been established and provide the fund's initial capital.
- The value of the remaining ground lease portfolio that could potentially be sold is a further **~$100m - $150m** (excluding those that are unlikely to be sold). Feasibility and timing for sale of this portfolio should be considered

Additional ground lease proceeds make a material difference to future fund value and creates greater efficiency by spreading the operating costs over a larger fund size.

Illustrative modelling impact



Source: LSEG market return data
Illustrative modelling, for discussion purposes only. Assumes 7% net return p.a. GL income assumes 3.5% distribution p.a. post LTP period.

Initial thinking

Additional capitalisation would require further work and would be significantly informed by the Council's view on targeted size of the fund. Additional capitalisation could be achieved through proceeds from other sales, direct transfer of assets, and/or drip fed through Council income sources e.g., extraordinary dividends.

5. Next steps

Next steps

This work connects to two other workstreams – the LTP amendment process and the exploration of a captive insurer

- **LTP amendment next steps:**
  - Advice to Council on the options for consultation (17 Dec). Options will need to be tied to the two key financial issues identified and will likely be combinations of different sized funds combined with different allocations of headroom
  - Consultation on options (April/May)
  - Deliberation and determination of preferred option (May)
  - Briefing and advice to Council on design of preferred fund option (June, combined with LTP adoption)

- **Captive insurer next steps (note timings are very indicative as feasibility study TOR is pending):**
  - Report back to Audit and Risk on captive feasibility study (February)
  - Advice to Council on feasibility study (March/April)
  - Work beyond March/April to be determined

Appendix

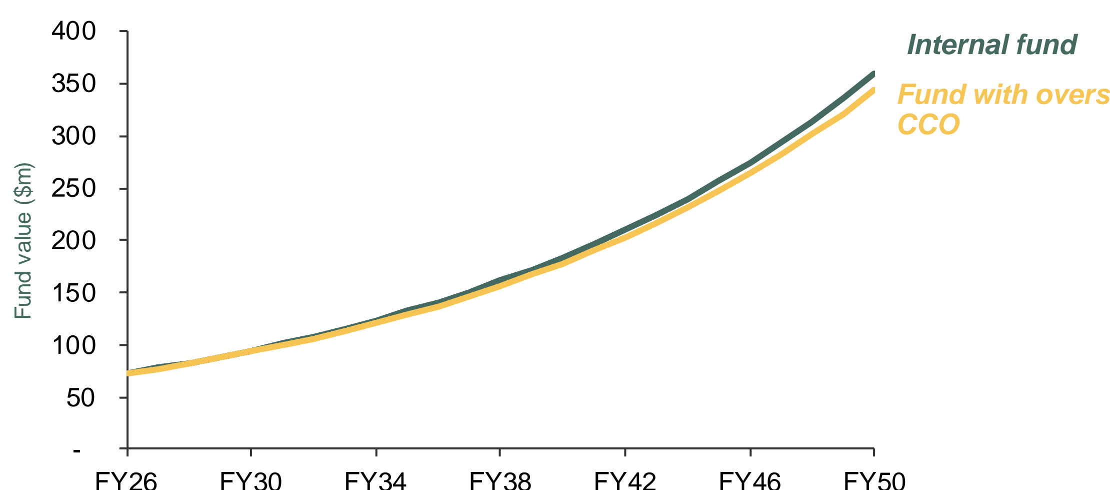
A1. Structure and governance: Tax and balance sheet considerations

Tax issues and implications	Balance sheet implications
• If the fund is an internal fund owned directly by Council (i.e. option one or two), there should not be any additional tax implications from the status quo. Tax will likely be payable within the underlying investments. • If the fund is owned by a separate CCO (i.e. option three) the tax implications will be more complex and will depend on the specific legal structure of the CCO. • E.g. if the fund was held by a discretionary trust the tax treatment will depend on whether the income vests as beneficiary income within the timeframes allowed under the Income Tax Act, or whether the trustee retains the income. To the extent that income is retained by the trustee, it will be subject to income tax at 39%. • Further analysis will be completed in relation to tax implications depending on the preferred design.	• Given the likely initial size of the fund, no material balance sheet/ credit rating implications are expected in the short-term. • We expect a rating agency would generally take a favourable view on Council diversifying its investment base. • To the extent that returns are re-invested into the fund, rather than distributed to Council, this may have a bearing on the LGFA debt-to-total-revenue covenant.

A2. Operational cost and fund size

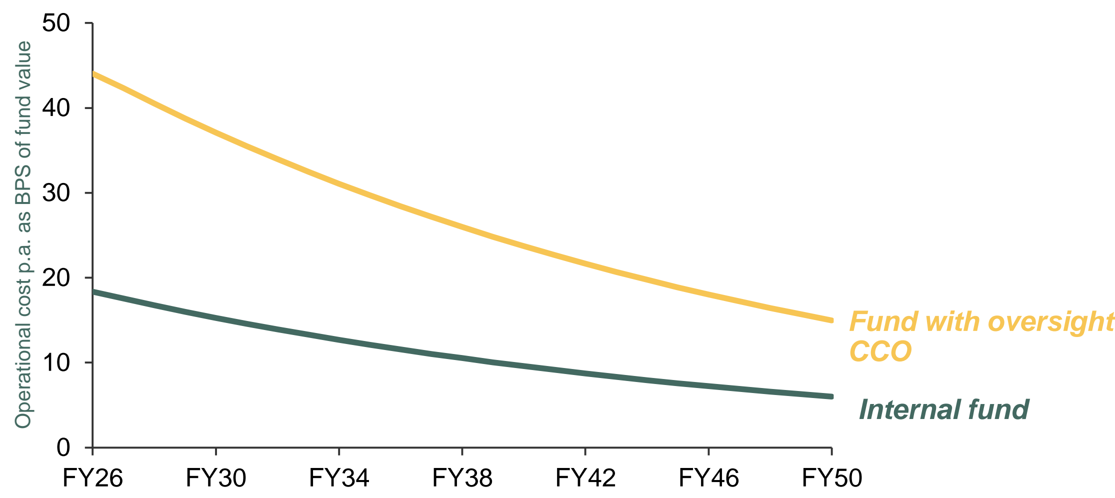
The operational cost of the fund (measured in bps vs fund value) would decrease as the fund grows over time. It might be reasonable to transition from an internal fund (~$125k cost p.a.) to oversight from a separate CCO ($300k cost p.a.) when the fund has greater scale to justify the cost.

Fund value (Growth Portfolio)



Closing Fund Value ($m)			
	After 5 years	After 10 years	After 25 years
Internal fund	95	132	359
Oversight CCO	93	129	344
Difference	1%	2%	4%

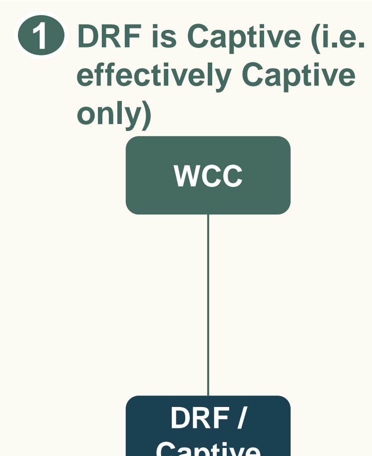
Operational cost as % of fund value



Benchmarks			
	Fund value ($m)	Operational costs ($m)	BPS
Auckland Future Fund	1,303	0.40	3.1
New Plymouth PIF	351	0.24	6.8
HBRIC	433	0.50	11.5
Wellington DRF – internal	60-70	0.13	18-21
Wellington DRF – CCO	60-70	0.30	43-50

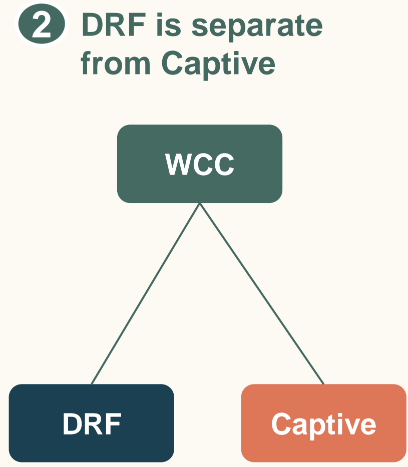
A3. Further information on the DRF and Captive

The DRF and the Captive could both support Council's overall insurance solution but serve different purposes. The choice of how to deploy them requires further consideration following completion of feasibility work on the role and design of the captive.



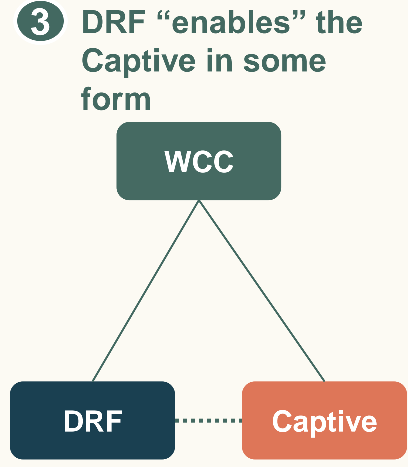
Considerations

The captive is likely to be:
- taxable
- based offshore
- have a more active role in insurance (that would change through time to meet WCC"s insurance objectives)



Considerations

Having the Captive and DRF separate would mean:
- both need to be capitalised independently
- greater future flexibility



Considerations

Consider if the DRF can capitalise Captive:
- e.g. through funds lent from Captive to DRF
- may provide some capital supports

Potentially more complex structure

	DRF	Captive
Form	As per slides	Insurance company (with independent board)
Domicile	NZ	Likely offshore
Purpose	As per slides	E.g. cover first loss for selected risks, and smooth insurance premiums over time – this will be adaptable to insurance conditions of the day
Capital	As per slides	TBD
Investment approach	Long term growth mandate	Requires liquidity
Income stream into vehicle	Investment returns	Premiums from Council & investment returns