KPMG

Wellington City Council

Balance Sheet Review Phase Three

—

March 2024

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Scope – Phase three

Prepare an Options Analysis report for WCC in relation to the sale of its 34% shareholding in Wellington International Airport Ltd ("WIAL"), covering the following three options:

1) Retain the current shareholding; or

2) Full sale of the shares; or

3) Partial sale of the shares.

The Options Analysis report will reference the requirements of the Local Government Act, in particular the clauses relating to policies of significance and the content of consultation documents. It is expected to be a concise document which will include the following:

- A comparison of the respective pros and cons of each option, assessed in accordance with a criteria agreed with WCC which will include risk mitigation implications (earthquake, climate events etc).
- Historical and forecast dividend returns from the WIAL shareholding, along with the associated costs of ownership.
- Comparison of the above dividend returns to the potential returns arising from a Perpetual Investment Fund based on historical returns from similar funds (noting the inherent volatility of such returns).
- A brief summary of the current position in relation to Ground Leases, noting that there is no requirement to consult the public.
- Potential next steps, process and timeline for the sale of shares and formation of a Perpetual Investment Fund.

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Private and confidential

1 March 2024

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By email: Barbara.Mckerrow@wcc.govt.nz and Andrea.Reeves@wcc.govt.nz

Dear Barbara and Andrea,

Balance Sheet Review – Phase Three FINAL

Thank you for the opportunity to support the Wellington City Council (the "Council" or "WCC") as it considers options to address its balance sheet constraints.

Our work has been performed in line with the scope of our All of Government Consultancy Services Order (CSO) dated 27 January 2023 and CSO variation dated 21 November 2023, and is based on information provided by the Council or collected from publicly available sources.

Our work has focused on further exploring the capital recycling options identified in Phase Two Part A of our work.

Please don't hesitate to contact us if you have any questions.

Kind regards

Alton Pollard
Director

Stephanie Ward
Partner

Executive Summary

Adverse financial market forces, increasing balance sheet needs, and an increasingly challenging insurance environment have decreased WCC's balance sheet resilience. The Council is seeking to build balance sheet resilience and enhance risk management through diversification of its investment assets. To achieve these aspirations, the Council is consulting on the establishment of a Perpetual Investment Fund (PIF) using funds from the sale of the Council's minority shareholding in Wellington International Airport Limited (WIAL). WCC also intends to apply the proceeds of selected ground lease disposals to the PIF when such opportunities arise.

The Council is facing a myriad of challenges as it looks to plan for the future. Action is required to ensure long-term financial resilience.

Rates increased 12.3% in the 2023/24 Annual Plan

The Council expects to pay close to 50% more in finance costs in 2023/24 than in the previous year

Many assets cannot be fully insured and WCC is exposed to significant losses in the event of a natural disaster

Wellington City's population is forecast to grow 26% between 2021 – 2054[1] and prudent financial planning is required to accommodate this expected growth

What is the Council proposing?

The Council is proposing to sell its 34% shareholding in WIAL and the sale of selected ground leases and recycling capital into a PIF. Establishing a PIF will diversify the Council's investment portfolio by asset type and location, alleviate some financial burden, and reduce the its exposure in the event of a major natural disaster.

Establish a PIF with proceeds from the sale of WCC's 34% minority shareholding in WIAL and the sale of selected ground leases

Establishing a PIF would help to mitigate some of WCC's challenges. Key PIF benefits:

Reduces geographic concentration of WCC's assets.
Many of the Council's investment portfolio assets are infrastructure assets in the Wellington region. This means that assets are exposed to the same risk in the instance of a disaster event. Recent weather events across New Zealand and the release of the new National Seismic Hazard model have highlighted the significance of this risk.

Enhances asset liquidity.
A PIF would ensure that the Council has the ability to liquidate some of its investment assets should the Council need to mitigate any losses arising from natural disasters or assist in recovery efforts at short notice.

Generates diversified returns and revenue streams.
The WIAL shareholding provides variable financial returns from a single asset, however, a PIF allows access to a wide range of investments that can be aligned with favourable ESG outcomes and potentially generate more resilient revenue streams for WCC.

Allows flexibility in managing insurance challenges.
Diversifying capital from WIAL and ground leases into a PIF affords the Council flexibility to consider options for managing the challenge of securing insurance for its investment portfolio which is concentrated in the Wellington region.

[1]Sense Partners | Population Forecast

How can WCC increase balance sheet resilience?

WCC's asset base is exposed to great risk due to Wellington's geographic and seismic profile. Assets and projects currently underway face unsatisfactory insurance coverage.

The insurance market is reducing its exposure to Wellington, making it more difficult and expensive to obtain insurance.

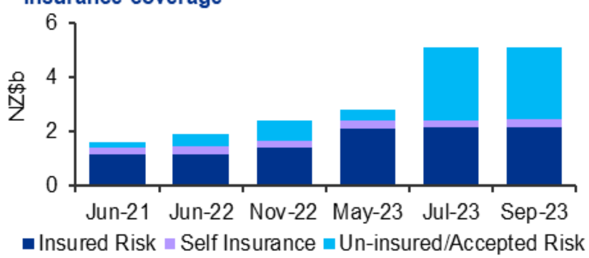
Building and infrastructure revaluations have increased the cost to replace assets, causing premiums to increase.

The release of the new National Seismic Hazard Model has further increased the Probable Maximum Loss from a major event.

Recent weather events in NZ have highlighted the impact climate issues can have on NZ cities and residents, increasing premiums paid.

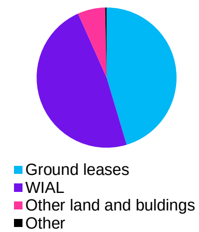
All of these challenges in the insurance market have led to WCC assuming a greater level of accepted and uninsured risk, as shown below.

Insurance coverage



A review of the Council's balance sheet found that the Council's investment portfolio is concentrated around infrastructure and property assets in the Wellington region.

The investment portfolio effectively has two main assets (WIAL shares and ground leases), and is highly exposed to disruptive events such as the COVID-19 pandemic or natural disasters. When such events occur, WCC is unable to quickly liquidate assets to provide remediation or relief.



WCC's investment portfolio lacks liquidity and geographic diversity.

In order to increase balance sheet resilience, the Council is looking to introduce assets into its investment portfolio that:

- Reduce **geographic concentration** meaning not all assets are subject to the same disaster risks and returns are decoupled from the performance of Wellington CBD;
- Increase **liquidity**;
- Reflect the Council's **risk tolerance**;
- Better achieve **ESG objectives** set by the Council;
- Introduce **new revenue sources**; and
- Improve **intergenerational wellbeing** through the building of investment wealth and reduced reliance on future borrowing or rates increases.

What does it mean to apply an ESG lens when investing?

Applying an ESG lens means taking environmental, social, and governance factors into account when making investment decisions. There are a range of ESG investing approaches as outlined in Appendix 1.

The Council's preferred option to diversify its investment portfolio is through the establishment of a Perpetual Investment Fund (PIF) with an ESG lens.

A PIF would diversify the Council's asset base and could provide the opportunity for liquidity in the instance of a significant natural disaster (albeit only as a last resort). Councils across Aotearoa have successfully established PIFs to diversify investments. See Appendix 3 for some examples.

What is a PIF?

A Perpetual Investment Fund (PIF) is an investment fund that is intended to continue forever. When there is no fixed investment horizon, investments are able to be less time-bound and more objective-focused.

Noting the myriad of balance sheet constraints already facing the Council, the only feasible way to capitalise a PIF at this time is by recycling capital currently invested in other investment assets (namely WIAL and ground leases).

In order to capitalise a PIF, the Council proposes selling its 34% stake in Wellington International Airport Limited (WIAL).

Council Objective*	WIAL	PIF
Generates financial returns for the Council	✓	✓
Reduces geographic concentration of investments	✗	✓
Enhances liquidity of investment portfolio	✗	✓
Reflects the Council's risk tolerance	✗	✓
Targets ESG objectives set by the Council	✗	✓
Improves intergenerational wellbeing	✗	✓

**Objectives are considered in the context of the Council's entire investment portfolio and not on a standalone basis.*

Accepted risk is the risk on insured assets that sits above the loss limit on the policy, or results from policy ventilation.
Un-insured risk is the risk on assets which are not currently insured on the policies.

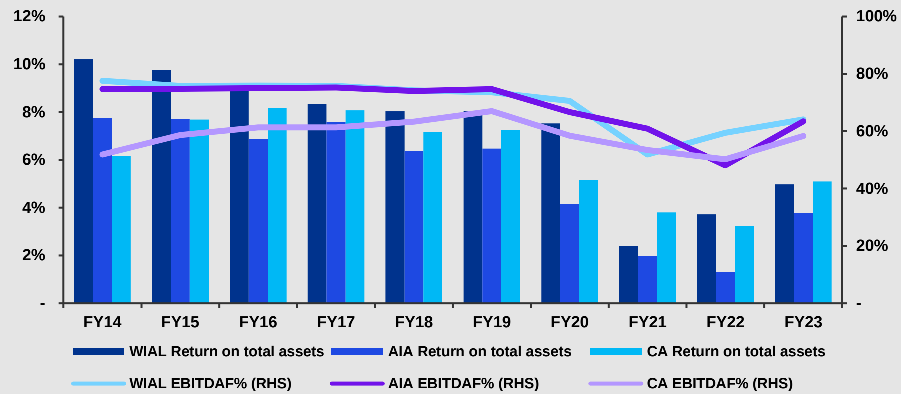
Why WIAL and the ground lease portfolio?

The Council's current investment portfolio lacks diversity as it is largely linked to infrastructure and property in the Wellington region. The sale, or partial sale, of WCC's investment in WIAL and selected ground leases present an opportunity to generate significant cash proceeds that could be recycled to achieve diversification, strategic alignment and potentially greater returns for ratepayers.

The Council's investment portfolio lacks diversity

- 93% of WCC's investment assets are tied up in WIAL and ground leases[2].
- These assets are concentrated by asset type, liquidity and geography.
- Opportunities exist for diversification of WCC's investments to protect the Council's investment revenues in the case of an unforeseen event.

WIAL comparative financial performance[1]

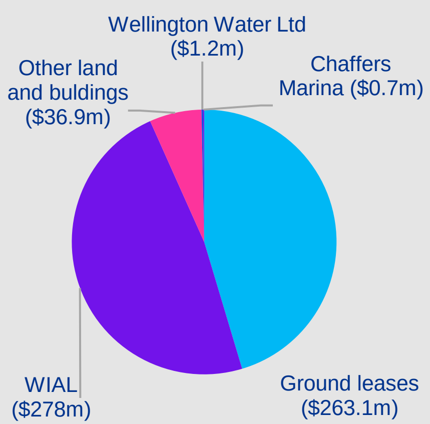


EBITDAF[4] performance

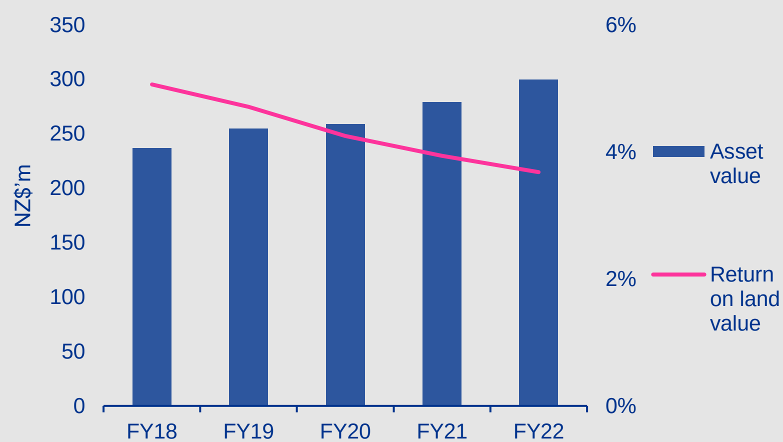
The chart to the left shows annual return on total assets and EBITDAF% on revenue, calculated as EBITDAF divided by revenue, for Auckland, Wellington and Christchurch airports.

WIAL has generated relatively stable returns across most of the ten year period, however in FY21 was heavily affected by the impact of COVID-19 on tourism and international travel.

WCC's investment assets[3]



Ground lease portfolio return on land value



$500m

Book value of WCC's WIAL shareholding was $278m at 30 June 2023, however, market value could be higher. Recent WIAL broker reports suggest WCC's 34% shareholding could have a market value of around $500m (approximate midpoint).

The Council continues to monitor ground leases in the portfolio identified as opportunities to recycle capital. Specific leases have been identified due to the timing of their lease cycles and the ability to negotiate favourable terms with parties interested in the leases.

[1] Wellington International Airport (WIAL), Auckland International Airport (AIA), and Christchurch Airport (CA) Annual Reports.
[2] Value proportions based on book value per WCC Annual Report for FY23.
[3] Wellington City Council Annual Report 2022-2023.

[4] Earnings before interest expense, taxation, depreciation, and fair value adjustments.

Establishment of a Perpetual Investment Fund (PIF)

Why a PIF?

Recycling capital into a PIF will improve balance sheet resilience and risk management. A PIF would also allow for greater control over investment strategy whilst generating regular returns to the Council.

In establishing a PIF, the Council will select an investment fund manager to administer the portfolio and oversee the investment strategy. This strategy may include the following considerations.

Geographic diversification
A PIF diversifies a significant amount of the Council's asset base out of the Wellington region.

Risk tolerance
A PIF allows for the Council to invest in line with its risk appetite.

Liquidity
A PIF increases the liquidity of the Council's investment portfolio.

New revenue streams
A PIF may introduce new revenue streams such as dividend or interest income to offset rates.

Intergenerational wellbeing
A PIF can build investment wealth and reduce reliance on future borrowing.

ESG objectives
The Council can instruct its fund manager to target ESG investments.

How would a fund manager oversee a PIF to achieve the Council's goals?

1. A professional investment fund manager would likely be appointed to managed the fund. A fund manager would work with the Council to implement a Statement of Investment Policy and Objectives (SIPO) and the agreed upon Strategic Asset Allocation included in the SIPO.
2. A SIPO sets out the investment governance and management framework, philosophy, strategies and objectives of a managed investment fund or portfolio. The fund manager would determine appropriate asset allocations to ensure that liquidity and diversification benefits are realised in accordance with the SIPO. Governance provisions would be established to ensure the objectives of the PIF are substantiated and endure through future Councils.
3. The SIPO would also outline the formula used for payments to Council. Payment protocols would be structured on a sustainable basis, which over the long term allows the real capital of the PIF to be maintained for successive generations. A SIPO helps to maintain transparency in the investment process for all stakeholders.

The previous Council decided against consulting on the sale of WIAL shares in the development of the 2021 LTP. **The deterioration of the Council's insurance position and lack of diversification necessitates reconsidering the composition of WCC's investment assets.**

Why is WIAL no longer aligned with WCC's investment objectives?

Influence
Due to the nature of the minority holding, WCC's influence over decisions making at WIAL is limited.

WIAL's Capital Expenditure Plan
Additional capital contribution may be required for airport Capex, which has been deferred during the COVID-19 pandemic. If WIAL requires additional equity for its capital program, WCC will likely either need to inject capital or incur a dilution in ownership.

Dividends
WIAL dividends have resumed in FY23; however, for the two years prior, WIAL did not pay dividends. As the WIAL dividend is usually one of WCC's income sources, WCC was required to draw additional debt totalling c.$50m in order to compensate for the missing income, to avoid increasing rates. It is possible that returns from WIAL may continue to be volatile due to WIAL's proposed capital expenditure program. WIAL has delivered a $20.4m dividend in FY23, which when compared to FY23 book value would be a 6.7% cash return.

The Council's shareholding in WIAL has historically provided variable dividends and capital appreciation, however recycling capital into a PIF is economically prudent given the circumstances the Council is facing.

What is the Council proposing?

WCC's financial constraints have been a key consideration during recent Council meetings and throughout the development of the 2024-34 LTP. The Council is proposing that a PIF be established using capital currently invested in WIAL. This will improve risk management and mitigate some of the Council's financial constraints.

While there is no silver bullet that will solve all of the challenges the Council is currently encountering, the establishment of a PIF will enable investment asset diversification which is likely to enable greater flexibility and stability in the instance of a disaster, such as a significant seismic event.

The perpetual nature of the fund would be designed to protect the investment for future generations, building intergenerational wealth. This aligns with the Council's vision of "Pōneke, where people and nature thrive", and enhances Wellingtonians' current and future prosperity.

A full share sale is proposed by the Council to enable maximum diversification of investment assets. The other options being consulted on through this process are a partial sale of the airport shares and the full retention of the WIAL shareholding. No one option completely meets every requirement, and there are pros and cons to each option.

WCC's Objectives

The Council considers that diversifying its investment portfolio by establishing a PIF will help it meet a range of objectives including:

- Diversification of investment risk by geographic location, asset type and liquidity.
- Alignment with the Council's long-term strategic vision.
- Enhance the Council's ability to manage risk.
- Compliance with the Council's prudent stewardship obligations under the Local Government Act 2002.

Options to be considered	Diversifies investment risk	Aligns with strategy and governance	Enables greater risk management	Impact on rates	Impact on Council debt	Impact on Council Levels of service	Capital released for reinvestment into a PIF	Value of retained ownership
Option A Sell WIAL shares and establish a PIF	YES	YES	YES	NO IMPACT	NO IMPACT	NO IMPACT	YES	NO VALUE
Option B Partial sale of WIAL shares and establish a PIF	YES	YES	YES	NO IMPACT	NO IMPACT	NO IMPACT	YES	~$250m[1,2]
Option C Retain WIAL Shareholding	NO	NO	NO	NO IMPACT	NO IMPACT *however, borrowing may increase if dividends are not paid due to unforeseen events*	NO IMPACT	NO	NO CHANGE *retain 34% shareholding*

[1]Midpoint value of analysed broker reports
[2]Under the assumption that half (17%) of the Council's shareholding is sold

Option A – Sell WIAL shares and establish a PIF

Should the Council sell its 34% stake in WIAL?

AT 100% SALE: $500m[1] RAISED − $8M[1] SALE COSTS = $492M PROCEEDS TO BE INVESTED

Under Option A, the Council would look to sell its 34% shareholding in WIAL and use the proceeds from the sale to invest in a PIF.

The sale of the entire shareholding would unlock significant capital to reinvest in a way that is aligned with the Council's long-term vision while enabling greater risk management. Subsequent investment of WIAL proceeds into a PIF would support the Council in achieving its long-term growth ambitions.

This option would diversify WCC's geographic risk exposure which is currently concentrated in the Wellington region. A PIF offers WCC the ability to invest a part of the recycled capital in assets in new markets.

In the event of a natural disaster in Wellington, the Council might lose revenue from the majority of its investment assets. Recycling the capital invested in WIAL into a PIF will improve risk management by moving some capital away from a hazard-prone area, whilst also establishing a more diversified asset base. In the event of a disaster, the Council could access a portion of the PIF to fund a response at short notice.

Capital accumulated in the PIF would be 'ring-fenced', meaning the funds are designated for the PIF and cannot be used for any other reason (i.e. to pay down debt). Investment returns generated by the PIF would look to exceed the return of the Council's current investment portfolio.

While the receipt of WIAL dividends will cease under this scenario, the Council would be relieved of any potential future need to contribute capital or face a share dilution in response to WIAL's planned growth programme. The Council would also forgo any future increases in WIAL's value as the outlook for international travel improves.

It is also worth noting that the forecast WIAL dividends are higher than those received historically and may be subject to variability due to factors such as tourist demand and capital expenditure requirements.

For modelling purposes, we have assumed that WIAL could generate around $500 million; however, this would need to be tested in market. For modelling purposes it is assumed that returns generated through a PIF will be 7% per annum based on comparable investment fund's historical returns.

WCC's favours this option

Selling the Council's 34% shareholding in WIAL and using the proceeds to establish a PIF is the preferred option as it:

- ✓ Diversifies the Council's investments in multiple ways, including; geographically and by asset class
- ✓ Raises significant capital to invest in a PIF
- ✓ Makes the investment portfolio relatively more liquid
- ✓ Is better aligned with Council strategy than retention
- ✓ Reduces risk exposure in the event of a hazard and allows the Council to improve risk budgeting
- ✓ May mitigate the need for significant rates rises in the longer term
- ✓ Can be drawn upon should a natural disaster occur

Sell entire WIAL shareholding and establish PIF

2024 – 2034 LTP years	FY24/25	FY25/26	FY26/27	FY27/28	FY28/29	FY29/30	FY30/31	FY31/32	FY32/33	FY33/34	TOTAL
Annual estimated return from PIF	**-**	**-**	**$34.5m**	**$35.2m**	**$35.9m**	**$36.6m**	**$38.0m**	**$39.5m**	**$41.0m**	**$42.5m**	**$303.0m**
Cash proceeds to WCC from PIF	-	-	$24.6m	$25.1m	$25.6m	$26.1m	$27.2m	$28.2m	$29.3m	$30.4m	**$216.5m**
WIAL forecast dividend	$10.3m	$14.6m	-	-	-	-	-	-	-	-	**$24.9m**
Total income received by WCC[2]	**$10.3m**	**$14.6m**	**$24.6m**	**$25.1m**	**$25.6m**	**$26.1m**	**$27.2m**	**$28.2m**	**$29.3m**	**$30.4m**	**$241.4m**
Compared to LTP Forecast WIAL Dividend	*$10.3m*	*$14.6m*	*$18.9m*	*$22.0m*	*$24.6m*	*$28.0m*	*$29.1m*	*$29.2m*	*$29.4m*	*$30.0m*	***$236.1m***
Impact on income	*No impact*		$5.7m	$3.1m	$1.0m	($1.9m)	($1.9m)	($1.0m)	($0.1m)	$0.4m	**$5.3m**
Impact on rates	*No impact*							N/A	N/A	N/A	

Option	Diversifies investment risk	Aligns with strategy and governance	Enables greater risk management	Impact on rates	Impact on Council debt	Impact on Council Levels of service	Capital released for reinvestment in PIF	Value of retained ownership
Option A Sell entire WIAL shareholding and establish a PIF	YES	YES	YES	NO IMPACT	NO IMPACT	NO IMPACT	YES	NO VALUE

[1]Appoximate midpoint value of recent WIAL broker reports. Sale costs are indicative for modelling purposes only.

[2] Forecast WIAL dividends received in FY25 and FY26. No dividends received post-sale. The PIF is assumed to generate a total of 7% return per annum (for modelling purposes). 5% of the 7% return is paid to the Council, the remaining 2% remains in the PIF. $492.5m received (sale of shareholding for midpoint value of analysed broker reports ($500m minus 1.5% sale costs). The Council is forecasting to divest $50m of selected ground leases over the forecast period. This amount is allocated pro rata ($10m per annum) over the final five years of the forecast and invested directly into the PIF.

Option B – Partial sale of WIAL shares and establish a PIF

AT 50% SALE: $250M[1,2] RAISED − $4M[3] SALE COSTS = $246[1,2]M PROCEEDS TO INVEST + $250M[1,2] VALUE OF RETAINED OWNERSHIP

Should the Council sell some of its 34% stake in WIAL?

Under this option, a portion of WCC's shareholding in WIAL would be sold, with the proceeds being used to invest in a perpetual fund. The Council would retain some of its shareholding.

This Option allows for the continued receipt of relatively stable dividend payments, albeit in smaller amounts proportionate to WCC's lesser stake. The option of a partial sale would also diversify WCC's direct investment risk exposure, mitigating geographical and liquidity risks.

The efficacy of diversification would be limited, when compared to Option A, as this option is only a partial sale of the shareholding. Moreover, a partial sale releases less capital for investment in a PIF than Option A. As such, the strategic impacts of this option are less prominent.

As WCC is currently a minority shareholder, a partial share sale is unlikely to significantly change WCC's control (or lack thereof) over airport operations or financial performance.

As in Option A, capital accumulated in the PIF would be 'ring-fenced', and investment returns generated by the PIF would look to exceed the return of the Council's current investment portfolio.

Figures presented below relate to a sale of half of WCC's shareholding in WIAL (sale of a 17% stake in WIAL). A placeholder sale price of $250m has been used for modelling purposes, which is an indicative estimate only, based on an approximate midpoint of recent WIAL broker reports.

Under this option it is forecast that returns generated using reinvested proceeds and retained dividends would positively impact Council income compared to retention. This is in addition to the growth in the value of the PIF over the forecast period post-sale.

A partial sale poses less of a solution to the risk management issues faced by WCC than a sale of the entire shareholding, and will require further action by WCC to address this. Moreover, it reduces any perceived benefits of retaining WCC's shareholding in WIAL.

A minority sale is a viable option **but not WCC's favoured option**

Partial sale of WIAL shareholding and establish a PIF

2024 – 2034 LTP years	FY24/25	FY25/26	FY26/27	FY27/28	FY28/29	FY29/30	FY30/31	FY31/32	FY32/33	FY33/34	TOTAL
Annual estimated return from PIF	**-**	**-**	**$17.2m**	**$17.6m**	**$17.9m**	**$18.3m**	**$19.4m**	**$20.5m**	**$21.6m**	**$22.7m**	**$155.1m**
Cash proceeds to WCC from PIF	-	-	$12.3m	$12.6m	$12.8m	$13.1m	$13.8m	$14.6m	$15.4m	$16.2m	**$110.8m**
WIAL forecast dividend	$10.3m	$14.6m	$9.5m	$11.0m	$12.3m	$14.0m	$14.6m	$14.6m	$14.7m	$15.0m	**$130.5m**
Total income received by WCC[4]	**$10.3m**	**$14.6m**	**$21.8m**	**$23.6m**	**$25.1m**	**$27.1m**	**$28.4m**	**$29.2m**	**$30.1m**	**$31.2m**	**$241.3m**
Compared to LTP Forecast WIAL Dividend	*$10.3m*	*$14.6m*	*$18.9m*	*$22.0m*	*$24.6m*	*$28.0m*	*$29.1m*	*$29.2m*	*$29.4m*	*$30.0m*	***$236.1m***
Impact on income	*No impact*		$2.9m	$1.6m	$0.5m	($0.9m)	($0.7m)	$0.0m	$0.7m	$1.2m	**$5.2m**
Impact on rates	*No impact*							*N/A*	*N/A*	*N/A*	

Option	Diversifies investment risk	Aligns with strategy and governance	Enables greater risk management	Impact on rates	Impact on Council debt	Impact on Council Levels of service	Capital released for reinvestment in PIF	Value of retained ownership
Option B Partial sale of WIAL shares and establish a PIF	YES	YES	YES	NO IMPACT	NO IMPACT	NO IMPACT	YES	~$250m[1,2]

[1]Appoximate midpoint value of recent WIAL broker reports.
[2]Under the assumption that half (17%) of the Council's shareholding is sold.
[3]Sale costs are indicative only.

[4]Forecast WIAL dividends received in FY25 and FY26. Beginning in FY27, half of forecast WIAL dividend received. The PIF is assumed to generate a total of 7% return per annum (for modelling purposes). 5% of the 7% return is paid to the Council, the remaining 2% remains in the PIF. $246.25m received (sale of shareholding for midpoint value of analysed broker reports ($250m minus 1.5% sale costs). The Council is forecasting to divest $50m of selected ground leases over the forecast period. This amount is allocated pro rata ($10m per annum) over the final five years of the forecast and invested directly into the PIF.

Option C – Retain full WIAL shareholding

NO CHANGE

The third option is to retain the Council's full shareholding in WIAL.

Until now, the Council has elected to retain WCC's shareholding and maintain the status quo. If this option was to be favoured, WCC would retain future dividend payments as a revenue stream. The Council will also capture any appreciation in the value of its shareholding in WIAL. In FY23, the Airport delivered one of its largest dividends of around $20m to WCC, and WIAL dividends are forecast to grow over the next ten years.

However, retention of the WIAL shareholding fails to mitigate any of the risks identified in the review of the Council's current investment portfolio. This option provides no diversification in geography, liquidity or asset class within the portfolio. In comparison to the establishment of a PIF, this option fails to generate new revenue streams or afford flexibility in managing insurance challenges.

Due to WIAL's exposure to the global economy and economic downturns, the Council is not guaranteed to receive any dividends from WIAL. This was demonstrated through the COVID-19 pandemic, where WIAL paid no dividends, resulting in an additional $50m of Council borrowings. Similarly, in the event of a natural disaster, dividend payments may stop once again. In this situation, a PIF would offer liquidity to the Council when required.

Additional capital may be required from WCC for WIAL's planned Capex programme. Capex has been deferred during the COVID-19 pandemic. If WIAL requires additional equity for its Capex program, WCC will either need to inject capital or it will have a dilution in ownership. Any expected Capex may also result in WCC receiving no dividend. This may result in WCC needing to further increase borrowings.

WIAL may be a significant piece of infrastructure for the greater Wellington region; however, due to the nature of WCC's minority holding, WCC's influence over decision making at WIAL is limited.

It is becoming more evident that maintaining the status quo is not feasible. Adverse market forces, challenging balance sheet needs and unsatisfactory insurance cover are directly related to the asset holdings in its investment portfolio. Retention of the shareholding fails to resolve current issues and will leave the Council needing to investigate alternative solutions before these issues become insurmountable.

Should the Council do nothing?

WCC could retain its full shareholding, but this does not address any of the constraints WCC is currently facing and therefore is **not WCC's favoured option**

Retain full WIAL share ownership

2024 – 2034 LTP years	FY24/25	FY25/26	FY26/27	FY27/28	FY28/29	FY29/30	FY30/31	FY31/32	FY32/33	FY33/34	TOTAL
Annual estimated return from PIF	-	-	-	-	-	-	-	-	-	-	-
Cash proceeds to WCC from PIF	-	-	-	-	-	-	-	-	-	-	-
WIAL forecast dividend	$10.3m	$14.6m	$18.9m	$22.0m	$24.6m	$28.0m	$29.1m	$29.2m	$29.4m	$30.0m	**$236.1m**
Total income received by WCC	**$10.3m**	**$14.6m**	**$18.9m**	**$22.0m**	**$24.6m**	**$28.0m**	**$29.1m**	**$29.2m**	**$29.4m**	**$30.0m**	**$236.1m**
Compared to LTP Forecast WIAL Dividend	*$10.3m*	*$14.6m*	*$18.9m*	*$22.0m*	*$24.6m*	*$28.0m*	*$29.1m*	*$29.2m*	*$29.4m*	*$30.0m*	***$236.1m***
Impact on income	*No impact*										
Impact on rates	*No Impact*										

Option	Diversifies investment risk	Aligns with strategy and governance	Enables greater risk management	Impact on rates	Impact on Council debt	Impact on Council Levels of service	Capital released for reinvestment in PIF	Value of retained ownership
Option C Retain WIAL Shareholding	NO	NO	NO	NO IMPACT	NO IMPACT *however, borrowing may increase if dividends are not paid due to unforeseen events*	NO IMPACT	NO	NO CHANGE retain 34% shareholding

Key milestones and steps required to establish a PIF

Summary of relevant WCC milestones:

October 2021
›F&PC Balance sheet review

November 2022
›S&P places WCC on "Negative Watch"

April - May 2023
›**External Balance Sheet Review Phase 1**
›Community Outcomes
›Long Term Priorities

September - October 2023
›**External Balance Sheet Review Phase 2**
›Citizens' Assembly hui
›Review of rating policies

9 November 2023
›**Council voted to explore selling its stake in WIAL to establish a PIF**

12 April – 12 May 2024
›Formal Community Consultation

May 2024
›Council hearings (9 May) and deliberations (30 May)

30 June 2024
›Formal Adoption of the 2024-34 Long Term Plan Consultation

July 2024 - onwards
›Possible sale of WIAL shareholding and identified ground leases for the establishment of a PIF.

Sale of selected ground leases
Capital in ground leases identified for divestment may be applied to the PIF. Capital released from ground leases in the future may be used from time to time to add to the PIF.

Should the Council elect to choose either Option A or Option B following consultation, there are a number of steps in the process of selling the WIAL shareholding and establishing a PIF. What key steps are required?

Sale of the shareholding in WIAL

Should the Council elect to sell the shareholding it would likely need to appoint an investment bank to oversee the sales process. This would include creating a pitch and information memorandum pertaining to the shareholding, valuation of the shareholding, and identifying and negotiating with potential buyers to facilitate a sale. An investment bank charges fees as compensation for overseeing the sale process.

Establishment of an organisation responsible for the PIF

The Council would need to establish an organisation that is responsible for the management of the PIF's operations and managing the Council's PIF in line with its agreed upon mandate and governance structures in place. This would require Council to:

– Undertake community consultation via a Special Consultative Procedure on the creation of an organisation or entity that would be responsible for running the PIF. This consultation would include options on what kind of organisation this would be (e.g. a CCO or other options), how it would be set up, its roles and responsibilities, and the nature of its relationship with the Council.

– Subject to Council decisions following consultation, undertake detailed design of the organisation/entity and its establishment/governing documents. This design would be in line with the organisation's purpose and responsibilities set by the Council.

– Depending on the form of the organisation chosen, undertake process to appoint governing body, followed by the governing body appointing senior management.

Appointment of an outsourced Investment Fund Manager

The organisation established would appoint an independent investment firm or fund manager to manage the PIF at arm's length. The investment fund manager would design the architecture of the PIF and the underlying investment strategy. The investment fund manager is mandated to invest the funds in the PIF, gained from the sale of the WIAL shareholding and ground leases, in line with agreed upon governance frameworks such as the Statement of Investment Policies and Objectives (SIPO).

The Council estimates that this process may take up to 24-36 months from the decision to sell the shareholding, due to the legislative requirements and consultative procedures required.

01
Appendices

What could an ESG-focused PIF look like?

There are methods that the Council could seek to follow when establishing an ESG-focused PIF. Below is a table adapted from [RIAA's Responsible and Ethical Investment Spectrum]() that maps out the various approaches to responsible investing.

Approach	Traditional Investment	Responsible & Ethical Investment						
		ESG Integration	Exclusionary/negative screening	Norms-based screening	Corporate engagement and shareholder action	Positive/best-in-class screening	Sustainability-themed investing	Impact Investing
Method	Providing limited or no regard for environmental, social, governance and other ethical factors in investment decision-making	Explicitly including ESG risks and opportunities into financial analysis and investment decisions based on a systematic process and appropriate research sources	Excluding certain sectors, companies, countries or issuers based on activities considered not investable due principally to unacceptable downside risk or values misalignment	Screening of companies and issuers that do not meet minimum standards of business practice based on international norms and conventions; can include screening for involvement in controversies	Executing shareholder rights and fulfilling fiduciary duties to signal desired corporate behaviours – includes corporate engagement and filing or co-filing shareholder proposals, and proxy voting guided by comprehensive ESG guidelines	Intentionally tilting a proportion of a portfolio towards solutions; or targeting companies or industries assessed have better ESG performance relative to benchmarks or peers	Specifically targeting investment themes e.g. sustainable agriculture, green property, 'low carbon', Paris Agreement or SDG-aligned	Investing to achieve positive social and environmental impacts – requires measuring and reporting against these, demonstrating the intentionality of the investor and underlying asset/investee and (ideally) the investor contribution
Intention		Avoids harm						
				Benefits stakeholders				
						Contributes to solutions		
Features and Outcomes	Delivers competitive financial returns							
		Manages ESG risks						
				Contributes to better system stability and economic sustainability				
						Pursues opportunities and creates real-economy outcomes		

[RIAA – Responsible Investment Spectrum]()

WIAL option analysis and assumptions

WCC did not receive dividends from WIAL during COVID-19, bringing to light the return generated from this investment. Any divestment from WIAL would be reinvested into a PIF, which has the potential for greater returns than is currently received from their WIAL shareholding.

WCC has received a dividend forecast from WIAL from FY24 to FY34.

Having not received a dividend in FY21 and FY22, WCC received a dividend of ~$20m in FY23 and is forecast to receive a similarly large dividend in FY24.

Dividends are forecast to decrease in FY25 and gradually rise up to $30m in FY34. The average dividend over the ten-year period is forecast to be $23.3m as shown in the chart below.

As was the case during the COVID-19 pandemic, WCC's receipt of dividends from WIAL is subject to other influences. Events which may impact on WIAL's dividends include climate change, natural disasters and capital expenditure plans to develop the airport.

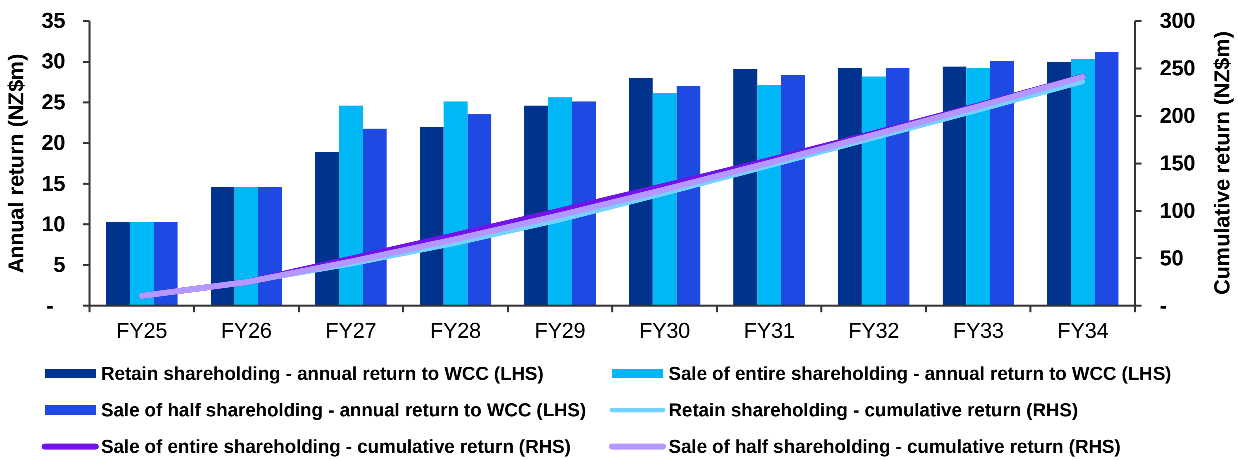
PIF returns will be variable, however we have assumed that any reinvestment made from the proceeds of the sale of the WIAL shareholding will produce a return equal to or greater than the average return currently received from WIAL.

Analysis has been based on the sale of WCC's shares in WIAL ($500m has been assumed for modelling purposes) and the forecast dividend from FY24 to FY34 ($23.3m). Note that returns in the chart below exclude capital gain from improved airport valuations.

WCC has agreed to establish a PIF with any sale proceeds as its preferred option in part due to the ability to better achieve social or environmental outcomes. For this reason, WCC has stipulated that a PIF must sit within ESG parameters set by the Council. However, return and growth of the PIF is most important for resilience.

The chart below illustrates the potential returns from a PIF in Options A and B against the forecasted WIAL dividend returns.

Financial comparison - WIAL dividends vs. shareholding sale scenarios



Assumptions

The following assumptions have been made throughout this process, which apply to all options unless it is clear that the assumption relates to one or more options only:

- A transaction will not proceed if the Council's expectations are not met.
- The Council is fully entitled to exit or walk away from any transaction for any reason prior to a transaction being concluded.
- Forecast dividends have been provided by WIAL.
- Shareholding is to be sold in the 2026/27 financial year.
- The proposal document discusses a transaction date estimate of FY27. The Council reserves the right to move this proposed date as required in response to changing conditions and in order to protect value.
- WCC would receive the forecast dividend from WIAL in the 2025 and 2026 financial year under Option A and B.
- WCC's share of WIAL has been valued at $500m – this is an approximate midpoint of broker estimates.
- Sale costs have been estimated at 1.5% of the value of shareholding sold for modelling purposes. Sale costs for a transaction may be higher or lower than assumed.
- All proceeds raised from the sale, after costs of the sale are paid are invested into a PIF.
- The PIF is forecast to generate a total of 7% return per annum for modelling purposes. This is broadly based on KiwiSaver returns over the past 10 years assuming a balanced/growth investment strategy (see Appendix 4), noting that this is also similar to the average returns achieved to date by the NPDC PIF.
- The PIF is forecast to return 7% return per annum (for modelling purposes), 5% of the 7% return is paid to the Council, and the remaining 2% remains in the PIF.
- The Council is forecasting to divest $50m of selected ground leases over the forecast period. This amount is allocated pro rata ($10m per annum) over the final five years of the forecast and invested directly into the PIF.
- WCC receives half of the forecast WIAL dividends under Option B.
- No adverse tax consequences arise.
- The Council retains the ability to establish the appropriate structures to manage a transaction and the possibility of creating new holding entities or corporate structures as required.
- For the purpose of modelling, the Council has assumed a 17% stake in WIAL will be sold under Option B. The actual percentage that would be sold could be more or less.
- The preferred option in this proposal document is for the Council to sell its entire shareholding in WIAL and use the funds to establish a Perpetual Investment Fund.
- Financial assumptions used in this document are based on current information to date. In particular, valuations and cost of sale assumptions are based on an market information and recent transactions. These are estimates based on best information and will be subject to change.
- A transaction is subject to all applicable regulatory approvals, including foreign investment and competition approvals.
- All options in this proposal document have the potential to impact any current or future shareholders in WIAL. Any transaction is subject to the Council's considerations in respect to potential impacts on shareholders.

Previously established Perpetual Investment Funds

The following are selected examples of how other public agencies have chosen to invest proceeds following the sale of assets.

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**

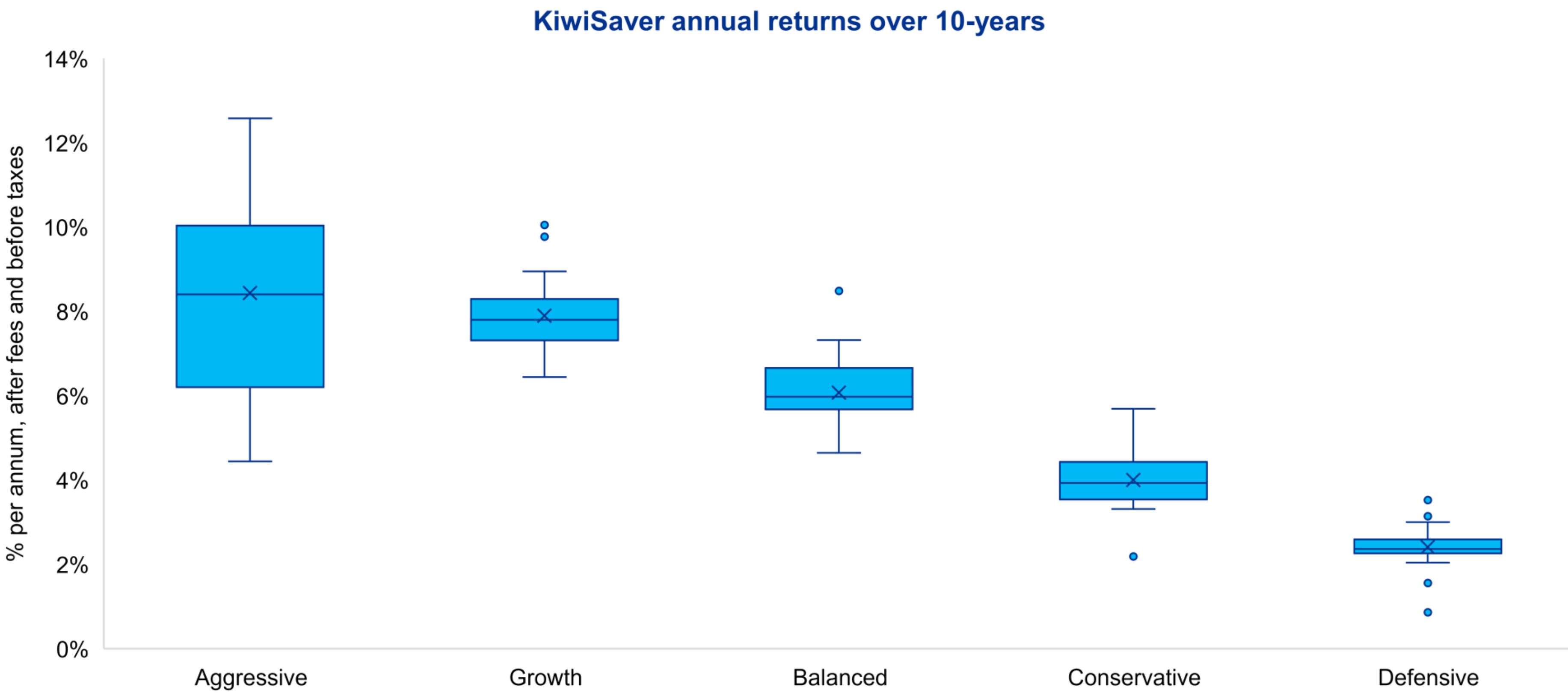
In 2018, the HBRC consulted with its constituents on options concerning its holding in Napier Port. The HBRC completed a partial sell-down of a 45% ownership of Napier Port via an initial public offering, with the proceeds raised used to form the Future Investment Fund. The Future Investment Fund totalled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

[1] Council controlled organisations (npdc.govt.nz)
[2] Dunedin City Council – Annual Report 2022/23
[3] Investment Strategy – HBRC 2021-2031 LTP

KiwiSaver Returns

The table below shows the returns of KiwiSaver funds over the past 10 years (where the fund was established 10 or more years ago).

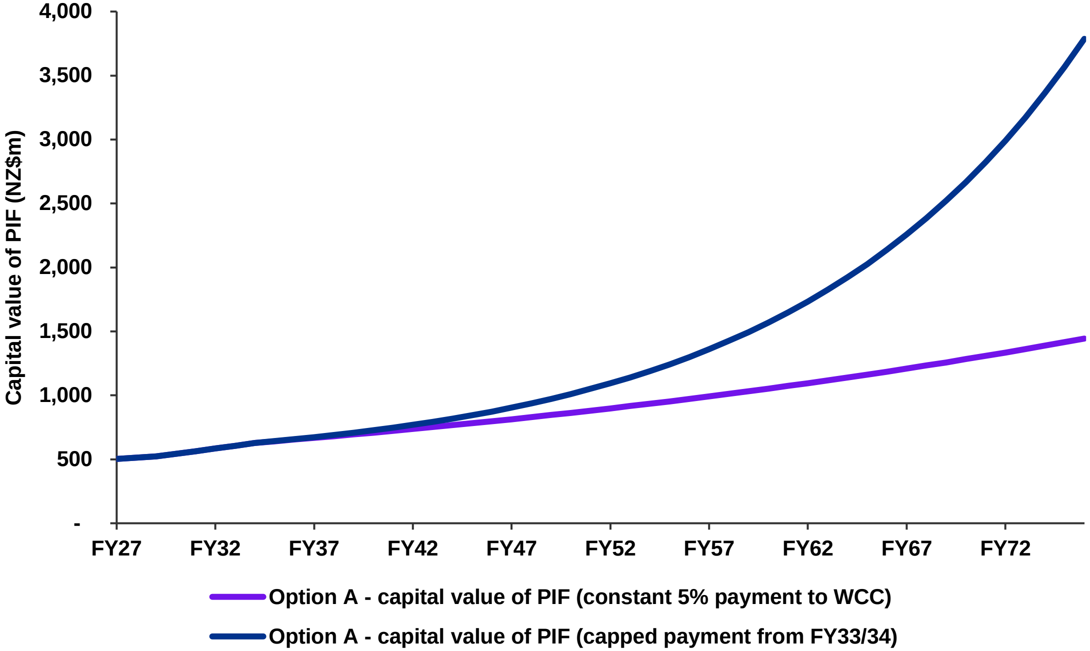


Potential PIF Growth

How the Council chooses to treat investment returns will impact the growth in the capital value of the PIF over time. The table and chart below show the forecast accumulation of capital value in the PIF under two different reinvestment policies, both based on our Option A scenario.

Option	Scenario/Year	FY26/27	FY27/28	FY28/29	FY29/30	FY30/31	FY35/36	FY45/46	FY55/56	FY65/66	FY75/76
A	PIF Capital Value – base case assumption that 2% of 7% PIF return is reinvested in PIF	**$502.4m**	**$512.4m**	**$522.6m**	**$543.1m**	**$564.0m**	**$654.5m**	**$797.8m**	**$972.5m**	**$1,185.5m**	**$1,445.2m**
A	PIF Capital Value – annual payment to WCC is capped from FY33/34 onwards at $30.5m	**$502.4m**	**$512.4m**	**$522.6m**	**$543.1m**	**$564.0m**	**$657.4m**	**$874.0m**	**$1,299.9m**	**$2,137.8m**	**$3,786.1m**

Financial comparison – Forecast capital value of PIF over 50-year period under reinvestment scenarios



Greater reinvestment rate leads to accelerated growth

By implementing a cap on the payment returned to the Council, a larger portion of the PIF's earned return can be reinvested. A greater reinvestment rate would speed up the compounding process, leading to a faster growth rate of the Council's PIF from the implementation period onwards. Accelerated growth of the PIF would ultimately assist in boosting WCC's financial security and potentially alleviate future financial burdens.

Growth in the Council's PIF under different scenarios

The chart to the left shows the outcome of the assumptions summarised in the table above.

Two scenarios are displayed, related to the forecast capital value of the Council's PIF based on the Council's reinvestment choice.
The scenarios are described below:

1. The first scenario uses the base case assumption that the PIF is forecast to return 7% per annum, with 5% of the 7% return paid to the Council, and the remaining 2% reinvested in the PIF. Under this scenario, the PIF grows to **$1.5bn** after 50 years.

2. The second scenario uses the base case assumption until FY33/34. From FY34/35 onwards, the payment to WCC is capped at $30.4m, with all returns above this level reinvested in the PIF. The annual amount of $30.4m is based on the forecast WCC payment for FY33/34. Under this scenario, the PIF grows to **$3.8bn** after 50 years.

The second scenario assumes that $30.4m is deemed by the Council in FY34 to be an adequate payment to WCC to support its services to the Wellington region, but also allows for the reinvestment of PIF returns in a way that supports the Council in achieving its long-term growth ambitions.

The implementation of a capped payment has been used as a means for comparison to visualise the impact of a greater reinvestment rate on forecast PIF growth. The quantum of the fund begins to materially diverge as the compounding of returns takes effect. Should WCC choose to cap the payment to WCC and reinvest a greater proportion of the PIF's returns, the PIF is forecast to outgrow the base case by more than $2bn over the period.

Glossary of terms

Capex	Capital expenditure
CCO	Council-controlled organisation
DCC	Dunedin City Council
ESG	Environmental, Social and Governance
FYXX	Financial year ending 20XX
HBRC	Hawke’s Bay Regional Council
LGFA	New Zealand Local Government Funding Agency
LTP	Long-term plan
NPDC	New Plymouth District Council
NPG	New Plymouth PIF Guardians Limited
PIF	Perpetual investment fund
SIPO	Statement of Investment Policy and Objectives
S&P	Standard and Poor’s
WCC	Wellington City Council
WIAL	Wellington International Airport Limited

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