

Background

The initial consultation period for this proposal ran from Saturday 27 September until Friday 10 October 2014. Hearing of submissions to the proposal occurred on Monday 20 and Tuesday 21 September 2014. Council met to consider submissions on 21 September 2014.

After seeking public input to the proposal, but prior to Council hearing submissions, Invercargill City Holdings Limited (ICHL) informed the Council that Electricity Invercargill Limited was no longer intending to invest in a 50% share of OtagoNet. This led to a significant change in the amount of future uncalled capital that may be required by ICHL and also a significant change in what was required as Option 3 in the original consultation proposal. The original consultation proposal is attached as an appendix to this document.

The submission process further highlighted that there had been a degree of confusion surrounding the proposal and what the uncalled capital could be used for. Due to the change in circumstance and the uncertainty surrounding the proposal, Council determined to extend the consultation period and release this clarification document.

*Extended
Consultation*

Options being considered

Three options are now being considered by Council:

Option 1 - Status Quo. No further shares are taken up and the Council's contingent liability remains at \$67,650,000.

Option 2 - A further 32,350,000 shares are taken up at \$1.00 each. This will increase Council's contingent liability to \$100,000,000.

3 options

Option 3 - A further 32,350,000 shares are taken up at \$1.00 each. This will increase Council's contingent liability to \$100,000,000. Also, Council determines that it is willing to consider an extension of its uncalled capital support in the future, up to a further \$30 million, for investments including smart meters outside of Electricity Invercargill Limited's network and alternative energy joint ventures.

Section 82A of the Local Government Act requires Council to analyse the reasonably practicable options for the proposal. The three options above are considered the favoured reasonably practicable options.

*Unfavoured
option*

A further option was considered at a staff level and was not included in the original consultation proposal considered and adopted by Council. This option is that Council could borrow the funding needed and lend it to ICHL. Staff determined that this option was not favourable. The reasons for this determination were that if Council did borrow the funding and loan it to ICHL liability would be absolute on ratepayers and, unlike uncalled shareholdings that may never be called; the loan would immediately have a financial impact on the Council and its ratepayers. A further reason was that it would not be practicable to add a percentage (interest) to the loan to ICHL as ICHL would be able to borrow at the same borrowing rate that is available to Council. Using uncalled shareholdings to assist ICHL in obtaining its funding is more cost effective to both Council and ICHL than having Council borrow the money and then lend it to ICHL. For these reasons, wherever practicable, it is preferable to avoid Council borrowing at this stage.

Having considered the reasons assessed by staff, Council has determined that Council borrowing the funding and lending it to ICHL is not a favoured option.

What happens if Council decides on Option 1?

No further uncalled shareholding is taken up by Council. Council's contingent liability remains the same as it is now. This will have an immediate impact on ICHL and its currently approved activities and investments. ICHL's bank has approved funding on the basis that Council would increase their uncalled shareholding in ICHL. If this increase was not approved, it is likely that some of the currently approved ICHL activities, would need to be delayed, scaled back or potentially even stopped. Approved current activities include the Invercargill Airport terminal upgrade and the Electricity Invercargill Limited substation project.

Option 1

What happens if Council decides on Option 2?

Council's contingent liability increases to \$100,000,000. The \$32,350,000 uncalled shareholding would be used by ICHL to secure funding lines with its bank for investments that have already been approved by ICHL and Council. Council has approved the investment of \$13,000,000 in the Invercargill Airport terminal upgrade and an investment of \$9,500,000 in OtagoNet, which has increased Electricity Invercargill Limited's shareholding in OtagoNet to 27.7%.

Option 2

The \$32,350,000 allows for the extra security as required by ICHL's bank. This "buffer" is best explained by using a comparison to an individual's mortgage with the bank. When you want to buy a house, you provide a deposit and ask the bank to lend the extra required. Although the bank only lends 80 or 90% of the total house value, they take security over the entire house. The situation is similar with ICHL's investments, although they only need approximately \$22,500,000 the bank requires the extra security to lend up to this amount.

What happens if Council decides on Option 3?

Option 3 covers the same uncalled shareholding as Option 2. Council's contingent liability increases to \$100,000,000. It would also mean that Council approves in theory the ability to further increase its uncalled shareholding in ICHL by another \$30,000,000. ICHL has not requested that Council take up the further \$30,000,000 in uncalled shares at this time, but would like Council to consult on this option so that should it be needed in the future it is available to be taken up without further consultation. The proviso is that Council would need to determine, at the time of any request from ICHL, if circumstances had

Option 3

materially changed from the current situation. If circumstances, for example the financial environment in which Council operates, had materially changed, further consultation would need to be undertaken prior to agreeing to uptake the further uncalled shares.

Note: Option 3 has **changed** from the original proposal. The original proposal asked for an increase of \$132,350,000 in uncalled shares, this has reduced to \$32,350,000 with the option of increasing that by a further \$30,000,000 should it be required for further investments by Electricity Invercargill Limited at a future date.

The type of investment that Electricity Invercargill Limited may require the future uncalled shareholdings for include smart meters outside of Electricity Invercargill Limited's network and alternative energy joint ventures.

Where does Invercargill City Forests Limited fit?

Some members of the community have been discussing the impact of this proposal on Invercargill City Forests Limited and there has been some misinformation regarding Invercargill City Forests Limited using the uncalled shareholdings as security to invest in further forestry activities. **This proposal does not impact on Invercargill City Forests Limited.** Neither Council nor ICHL have received any proposal for further investments in Invercargill City Forests Limited that would require the use of the uncalled shareholding as a security.

*Invercargill
City
Forests
Limited*

How do I tell Council what I think?

Council has extended the consultation period and would like to hear what you think of the options available. Submissions must be received by Council no later than 5.00 pm on Friday 14 November 2014.

*Make a
Submission*

Submissions must:

1. Be in letter form, clearly showing the submitter's name, address and contact phone number. (A submission form is available on Council's website, www.icc.govt.nz to assist you with making a submission)
2. Be clearly labelled SUBMISSION – Uncalled Capital and addressed to the Chief Executive, Invercargill City Council.
3. Indicate whether the submitter wishes to be heard by the Council in support of his / her submission. The Hearing will take place on 26 November 2014. (Note – the substance of the submission should be in writing. Verbal presentations should be restricted to five minutes.)
4. Be received by 5.00 pm on Friday 14 November 2014.

Submissions can be:

Posted to: Invercargill City Council
Submission – Uncalled Capital
Private Bag 90104
INVERCARGILL 9840

Delivered to: Help Desk, Invercargill City Council, 101 Esk Street, Invercargill

Emailed to: policy@icc.govt.nz



Consultation Document for Proposal to Increase Council's Uncalled Shareholding in Invercargill City Holdings Limited

1. PROPOSAL FOR CONSULTATION

Invercargill City Holdings Limited has asked the Council to increase its uncalled shareholding from the current level of \$67,650,000 to \$200,000,000. The Council has decided to consult on a proposal to allow the increase in uncalled shareholding as it wants to better understand the community's views before making its decision.

2. REQUEST FROM INVERCARGILL CITY HOLDINGS LIMITED

The proposal to increase Council's uncalled shareholding in Invercargill City Holdings Limited is attached. You can submit or comment on the proposal as a whole or any individual area.

3. PLACE FOR INSPECTION AND OBTAINING COPIES

The proposal to increase Council's uncalled shareholding in Invercargill City Holdings Limited may be inspected at the Help Desk of the Invercargill City Council, 101 Esk Street, Invercargill, at the Bluff Service Centre, and at the Invercargill Public Library.

4. CONSULTATION PERIOD

- *Community Clinic*

Council staff and Directors from Invercargill City Holdings Limited will be available to answer questions and explain the proposal at a Community Clinic to be held on Monday, 29 September from 4.00 pm to 6.00 pm in the Committee Room, First Floor, Civic Administration Building, 101 Esk Street, Invercargill. Submission forms and comment forms will be available at this meeting and Council staff will be available to assist you with completing either a submission or a comment.

5. SUBMISSION PERIOD

Submissions are invited on this proposal. Submissions must be received by Council no later than 5.00 pm on Friday 10 October 2014.

Submissions must:

1. Be in letter form, clearly showing the submitter's name, address and contact phone number.
2. Be addressed to the undersigned and clearly labelled SUBMISSION - Uncalled Capital .
3. Indicate whether the submitter wishes to be heard by the Council in support of his/her submission. The Hearing will take place on 20 October 2014. (Note - the substance of the submission should be in writing. Verbal presentations should be restricted to around five minutes.)
4. Be received by 5.00 pm on Friday 10 October 2014.

Submissions can be:

Posted to: Invercargill City Council
Submission - Uncalled Capital
Private Bag 90104
INVERCARGILL 9840

Delivered to: Help Desk, Invercargill City Council, 101 Esk Street, Invercargill

Emailed to: policy@icc.govt.nz

If you do not wish to make a formal submission, but would still like to comment on the proposal, you may email comments to policy@icc.govt.nz or post a comment on the Invercargill City Council's Facebook page.

Consultation document for proposal to increase Council's uncalled shareholding in Invercargill City Holdings Ltd

Proposal for consultation

Invercargill City Holdings Limited has asked the Council to increase its uncalled shareholding from the current level of \$67,650,000 to \$200,000,000. The Council has decided to consult on a proposal to allow the increase in uncalled shareholding as it wants to better understand the community's views before making its decision.

Request from Invercargill City Holdings Ltd

Invercargill City Holdings Limited is a Council Controlled Organisation. A Council Controlled Organisation is a company in which a council, or councils, hold 50% or more of the voting rights and can appoint 50% or more of the directors. Invercargill City Council owns 100% of Invercargill City Holdings Limited and appoints all directors. Invercargill City Holdings Limited is a company registered under the Companies Act 1993 to provide reasonable returns to its shareholder (Invercargill City Council). It oversees the following subsidiary companies:

- *Invercargill City Forests Limited* - That operates a successful forestry business undertaking forestry planting, silviculture and harvesting.
- *Invercargill City Property Limited* - That manages the sales and development of the Awarua estate and other properties.
- *Electricity Invercargill Limited* - That operates a successful electricity distribution network and metering service in the Invercargill and Bluff areas and invests in the infrastructure, electrical and energy sectors.
- *Invercargill Airport Limited* – That provides airport services at the Invercargill Airport.

Certain shares the Council holds in Invercargill City Holdings Limited are “unpaid”. This means that the issue price for the shares has not yet been paid. This issue price will become payable only when 'called' by Invercargill City Holdings Limited, under procedures set out in the company's constitution. This unpaid shareholding is often described as "uncalled capital", because it allows Invercargill City Holdings Limited to support investments of its subsidiary companies.

At present, the Council's potential liability for the unpaid shareholding is a contingent liability in the sum of \$67,650,000. Invercargill City Holdings Limited has approximately \$60,000,000 of debt that is associated with the Electricity Invercargill Limited purchase of OtagoNet in 2002, operations of Invercargill City Forests Limited, the runway resealing and lengthening at Invercargill Airport and the general debts of Invercargill City Holdings Limited.

Invercargill City Holdings Limited has requested that the Invercargill City Council increase its uncalled shareholding in Invercargill City Holdings Limited from the current amount to \$200 million. Invercargill City Holdings Limited has advised that 32,350,000 of the shares are to be utilised by Invercargill City Holdings Limited as security for the funding lines with the bank for current approved activities. Earlier this year Council approved the investment of \$13,000,000 in the Invercargill Airport terminal upgrade and the initial investment of \$9,500,000 in the purchase of OtagoNet. The bank has advanced funding for these items on the proviso that Invercargill City Holdings Limited increases its uncalled capital at the next possible occasion. The further 100,000,000 shares are to be utilised for security for potential major future investment by Electricity Invercargill Limited and would only be required in the event that such a transaction is approved. Future investment opportunities currently identified include the investment in up to 50% of OtagoNet, participation in alternative energy joint ventures and smart meters. OtagoNet is an electricity lines distribution company that operates in the wider Otago region. OtagoNet is currently owned by Electricity Invercargill Limited in conjunction with The Power Company Limited.

Options considered by the Council

The three options being considered by Council are:

- Option 1 -** Status Quo. No further shares are taken up and the Council's contingent liability remains at \$67,650,000.
- Option 2 -** A further 32,350,000 shares are taken up at \$1.00 each. This will increase Council's contingent liability to \$100,000,000.
- Option 3 -** A further 132,350,000 shares are taken up at \$1.00 each. This will increase Council's contingent liability to \$200,000,000.

The Council has considered what, if any, other options it might have to help support Invercargill City Holdings Limited. It is satisfied that there are no other reasonably practicable options in the circumstances. This is in large part due to sections 62 and 63 of the Local Government Act 2002.

Section 62 provides that a local authority (Council) must not give any guarantee, indemnity or security in respect of the performance of any obligation by a council controlled trading organisation (Invercargill City Holdings Limited).

Council's advisors agree that there is no breach of section 62 in this case as the uncalled shares do not amount to the Council giving security in respect of the performance of an obligation by Invercargill City Holdings Limited. If the shares are being used as security, then it is Invercargill City Holdings Limited that is using them as security, not the Council.

Section 63 establishes restrictions on lending to council-controlled trading organisations and provides that a local authority must not lend money, or provide any other financial accommodation, to a council-controlled trading organisation on terms and conditions that are more favourable to the council-controlled trading organisation than those that would apply if the local authority were, without charging any rate or rate revenue as security, borrowing the money or obtaining the financial accommodation.

As Council is restrained from lending money or providing security to Invercargill City Holdings Limited, Council has determined that the three options listed above are the only reasonably practicable options for addressing this issue.

Analysis of the Council's options

The advantage of the status quo (Option 1) is that Council's contingent liability remains at \$67,650,000. The disadvantage of the status quo is that the borrowing capability of Invercargill City Holdings Limited is curtailed and this will have implications on its ability to respond to future investment opportunities in a timely manner. It will also affect Invercargill City Holdings Limited's ability to support projects that have already been approved by the Council, being the Invercargill Airport terminal upgrade and the initial investment of \$9,500,000 in the purchase of OtagoNet. If this option is followed, we will breach the bank's requirements and it is likely that these projects will either stop, be scaled back or be delayed.

The advantage of increasing the uncalled shareholding by \$32,350,000 (Option 2) is that Invercargill City Holdings Limited will be able to meet the bank's requirement of increasing its uncalled capital. This is necessary as the bank has advanced funding for the Invercargill Airport terminal upgrade and the initial investment of \$9,500,000 in the purchase of OtagoNet on the proviso that Invercargill City Holdings Limited increases its uncalled capital at the next possible occasion. The disadvantage is that the borrowing capability of Invercargill City Holdings Limited is curtailed and this will have implications on its ability to respond to future investment opportunities in a timely manner.

The advantage of increasing the uncalled shareholding by \$132,350,000 (Option 3) is that Electricity Invercargill Limited will be able to respond to future investment opportunities in a timely manner. These investment opportunities will most likely require approval by either Invercargill City Holdings Limited or in the case of a major transaction, the Invercargill City Council. In some circumstances, the Invercargill City Council may also choose to undertake a public consultation process before approving a major transaction. The disadvantage of increasing the uncalled shareholding is that Invercargill City Council may triple its potential liabilities. If the full \$200,000,000 were to be called, Council would most likely need to borrow money which would then be repaid via rates. This could potentially significantly increase rates both in the short and long term. It could also significantly affect Council's ability to incur additional debt (borrow more money), which could constrain other Council activities.

Although increasing the uncalled shareholding has a high potential financial impact, this risk is extensively mitigated through controls that are in place for the operation and management of each of the parties involved. Electricity Invercargill Limited has a Board of Directors who monitor financial performance every month and report this to Invercargill City Holdings Limited. Invercargill City Holdings monitor all of their subsidiary companies on a monthly basis, including Electricity Invercargill Limited. Invercargill City Holdings Limited then report to the Invercargill City Council on a six monthly basis. Invercargill City Holdings Limited would only call in the unpaid shares in the event of significant financial difficulty. It is extremely unlikely that these difficulties would not be foreseen by either the professional Boards of Directors at the companies, or by the Elected Representatives of the Invercargill City Council. Appropriate measures could then be put in place to reduce the risk of the unpaid capital being called. If any potential financial or regulatory issue was to arise, Directors would act quickly to protect the value of the asset and to ensure there was no adverse impact on revenue flowing to ratepayers. These measures could include the sale of Electricity Invercargill Limited assets. The electricity sector is characterised by highly liquid assets. This means that a suitable buyer for assets would be easily found, should the need arise.

If assets are required to be sold due to financial or regulatory difficulties there is potential for a loss of dividend being paid to the Invercargill City Council. The total amount of dividend lost would be dependant on which asset is sold and the sale price of the asset.

As at 30 June 2014 the Invercargill City Holdings Limited Group has assets of approximately \$200,000,000, which is relative to the \$100,000,000 of uncalled capital as proposed by Option 2. Any further increase in uncalled capital would be represented by an increase in the value of the assets.

Council's suggested option

The suggested option to cover all eventualities in the document is Option 3. Council believes that the inherent risk in increasing the contingent liability can be adequately mitigated, and that the benefit of having the uncalled capital available outweighs any residual risk. Council believes that by making further uncalled capital available to Invercargill City Holdings Limited, Council is enabling prudent investment in assets that will benefit the current and future interests of the community.

In summary, Council is consulting on taking up the 32,350,000 shares for current approved activities, and the possibility of taking up the further 100,000,000 shares if required prior to 2018.

This will mean that:

- Council will immediately increase its uncalled shares in Invercargill City Holdings Limited by \$32,350,000.
- The remaining \$100,000,000 of uncalled shareholding would not be taken up immediately, but would be available for Council to take up without further consultation on that matter should Electricity Invercargill Limited require it for an approved future investment.
- If Council takes up all of the offered shares, Council's contingent liability will increase to \$200,000,000.

Inconsistency of Council's proposal with its Financial Strategy

Council is required to prepare a Financial Strategy as part of its Long Term Plan. A Financial Strategy outlines our key financial issues and signals the financial intentions of Council including any limits on rates and debt. If Council was to make a decision to increase its uncalled shareholding in Invercargill City Holdings Limited, it would be making a decision that is inconsistent with the financial strategy contained within its 2012-2022 Long Term Plan. Section 80 of the Local Government Act 2002 establishes specific requirements that Council must clearly identify when making an inconsistent decision.

Council has identified two areas of inconsistency between the proposal and the financial strategy. There is an inconsistency with the statement regarding securities and there is potential for inconsistency with the limits on rates and borrowings, should the worst case scenario, as outlined above, be realised.

Securities Borrowing

The Financial Strategy included in Council's 2012-2022 Long Term Plan contained the following paragraph:

"Securities Borrowing

Council has unpaid capital as a security over the borrowings of Invercargill City Holdings Limited and does not anticipate this security arrangement changing. If required in the future, Council would consider utilising rates as a security."

The proposal would result in a change to the security arrangement, in that Council would have a higher level of unpaid capital.

Discussion of the uncalled shares in a part of the Long Term Plan dealing with Council's securities for its borrowing was inappropriate. The wording in the Long Term Plan is confused and Council was advised during the 2014/15 Annual Plan process that it would be prudent to amend it when an opportunity arises.

Council intends to consider removing this statement when developing the financial strategy for inclusion in the 2015-2025 Long Term Plan. Any discussion on the uncalled capital will be included in those sections of the Long Term Plan that relate to Invercargill City Holdings Limited or to the Council's potential liabilities.

Limits on rates and borrowings

Within the Financial Strategy, Council has set a limit on both rates and borrowing. Council has set a maximum limit on rates of 60% of total Council revenue and has also set a maximum limit on rates increases at the Local Government Cost Index plus 3%. Council has set a borrowing limit of 15% of assets. Should the uncalled shares be 'called' by Invercargill City Holdings Limited, it is anticipated that Council would breach these maximum limits. As explained earlier in this document, Council believes that it is extremely unlikely that all uncalled capital would be 'called' and, even if it were, there are various steps in mitigation that it could take. Council would need to review its financial strategy should this occur. At this stage, Council does not consider that it needs to amend its financial strategy, but will include reference to the implications of this potential liability in its 2015-2025 Long Term Plan.

Consultation Period

Community Consultation Clinic

Council staff and Directors from Invercargill City Holdings Limited will be available to answer questions and explain the proposal at a community consultation clinic to be held on Monday, 29 September between 4.00 pm and 6.00 pm in the Committee Room, First Floor, Civic Administration Building, 101 Esk Street, Invercargill. Submission forms and comment forms will be available at this meeting and Council staff will be available to assist you with completing either a submission or a comment.

Making a Submission

Submissions are invited on this proposal. Submissions must be received by Council no later than 5.00pm on Friday 10 October 2014.

Submissions should clearly show the submitter's name, address and contact phone number. (Submission forms may be obtained from all Council offices and libraries and on the Council's website www.icc.govt.nz).

Submissions can be:

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Emailed to: policy@icc.govt.nz

If you do not wish to make a formal submission, but would still like to comment on the proposal, you may email comments to policy@icc.govt.nz or post a comment on the Invercargill City Council's Facebook page.

Hearing of submissions

Council intends to hear those submitters who indicate that they wish to speak to their submission on Monday, 20 October 2014. Please ensure that if you wish to be heard in support of your submission you clearly indicate this on the submission form and give a daytime phone number. Providing Council with an email address gives us another way of ensuring we can contact you with the time that you will be heard.