

TO: PERFORMANCE, POLICY AND PARTNERSHIP COMMITTEE

**FROM: MICHAEL DAY – GROUP MANAGER FINANCE AND ASSURANCE
ANDREW CAMERON – GENERAL MANAGER
INVERCARGILL CITY HOLDINGS LIMITED**

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MEETING DATE: TUESDAY 9 FEBRUARY 2021

IN COMMITTEE

Reason for Exclusion:

Local Government Information and Meetings Act 1987 –

(7) Other reasons for withholding official information:

(2) (i) enable any local authority holding the information to carry on, without prejudice or disadvantage, negotiations (including commercial and industrial negotiations);

INVERCARGILL CITY HOLDINGS LIMITED – UNCALLED CAPITAL

SUMMARY

Council has a number of levers to provide direction to and to control the activities of Invercargill City Holdings Limited. Council approves a statement of intent for Invercargill City Holdings Limited and may provide a letter of expectation if further direction is required. In addition Council appoints the directors to Invercargill City Holdings Limited and other companies within the group.

This paper addresses issues that have arisen with respect to the additional level of the uncalled capital held by Council in Invercargill City Holdings Limited. In particular, actions that have occurred since this was last considered by Council in 2015 and proposed steps to be taken to clarify the understanding of these issues.

RECOMMENDATIONS

That the Performance Policy and Partnership Committee

- 1. Receive the report “Invercargill City Holdings Limited – Uncalled Capital”**
- 2. Endorse the report for presentation to Council with the following recommendations:**
 - a. Confirms that the value of its uncalled shares in Invercargill City Holdings Limited remain at \$100,000,000 (\$100 million).**
 - b. Notes that Invercargill City Holdings Limited external borrowing is effectively capped at \$100,000,000 (\$100 million) by the uncalled capital issued.**

- c. Expects that Invercargill City Holdings Limited total borrowing will be within the debt cap of \$100,000,000 (\$100 million) set by the uncalled capital unless explicitly authorised by Council to do otherwise.
 - d. Confirms it is appropriate that Invercargill City Holdings Limited use part of the proceeds of the sale of Invercargill City Forests Limited to repay the \$30,000,000 (\$30 million) debt currently held by Council and lent to Invercargill City Holdings Limited.
 - e. Purchases a further \$15,500,000 worth of shares in Invercargill City Holdings Limited; that Invercargill City Holdings Limited will use these funds to repay the loan from Council for ICHL to purchase shares in Invercargill Central Limited (\$13,500,000) and ICHL will purchase a further \$2,000,000 of shares in Invercargill Central Limited.
 - f. Notes that Invercargill City Holdings Limited will report back to Council once it has completed its review of the subsidiaries with further options and guidance regarding the subsidiaries and the uncalled capital.
3. Recommend a redacted public version of the report is released at the next Performance, Policy and Partnership Committee meeting.

IMPLICATIONS

1.	<i>Has this been provided for in the Long Term Plan/Annual Plan?</i> No
2.	<i>Is a budget amendment required?</i> No
3.	<i>Is this matter significant in terms of Council's Policy on Significance?</i> No
4.	<i>Implications in terms of other Council Strategic Documents or Council Policy?</i> N/A
5.	<i>Have the views of affected or interested persons been obtained and is any further public consultation required?</i> No

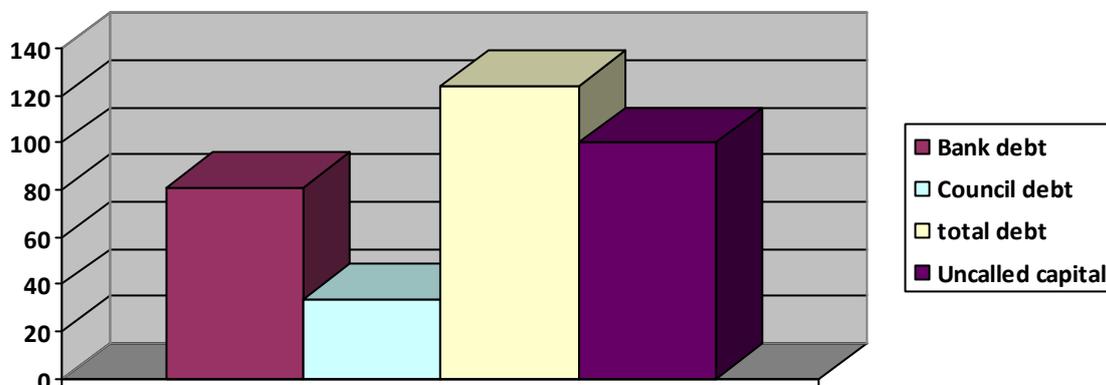
SUMMARY

The last time Council increased the uncalled capital in Invercargill City Holdings Limited (ICHL) was during discussions for the Aniwhenua purchase. In December 2014 Council resolved:

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 not willing to consider an extension of its uncalled capital support in the future for investments concerning alternative energy joint ventures and smart meters.

This capped ICHL's ability to borrow from external entities at \$100,000,000. Currently ICHL has borrowed \$124.5 million:

- \$80.8 million externally under its facility with BNZ (rising to \$95.3 million by December 2021)
- \$30 million from Council for Electricity Invercargill Limited (EIL) (Aniwhenua)
- \$13.5 million (+ another \$2 million to come) from Council for Invercargill Central Limited (ICL)



ICHL proposes to reduce its total debt from \$124.5 million to less than \$100 million, within the uncalled capital. This will also enable ICHL to remain with the parameters set by its Treasury Policy:

ICHL must maintain committed funding facilities of at least 100% or \$5.0 million (whichever is the lesser) of its projected debt requirements. This provision shall be revised if debt exceeds \$100.0 million.

BACKGROUND – ICHL BORROWING

As noted in 2014, uncalled capital was used by ICHL to support its borrowing. The use of uncalled capital ensures that ICHL receives the benefit of Council’s credit rating.

Uncalled capital are shares that have been issued to Council but have not been paid. ICHL can call on payment for those shares at any time. The effect is support by Council for debts up to \$100,000,000 (\$100 million) of ICHL. How Council should address this “support” for the purposes of its own borrowing will be the subject of a further paper.

The uncalled capital effectively provides a cap on the external borrowing of ICHL. ICHL precludes its subsidiaries from borrowing in their own right, thereby placing a cap on the borrowing for the group.

In October 2015, Council approved a major transaction for the purchase of the Aniwhenua Hydro-Electric Power Scheme (Aniwhenua). EIL’s share of that purchase was \$29.5 million. The ICHL shareholders resolution recorded:

- N. The Company needs to borrow/fund the Pylon Shareholder Advance by funds to be borrowed from Westpac Banking Corporation secured under the Debenture Trust Deed and the uncalled capital in the Company held by the Council.

As at 30 September 2015, ICHL’s outstanding debt was \$72.8 million. On 17 December 2015 ICHL’s facility was increased to \$90 million. It was a condition of this increase that ICHL’s uncalled capital be \$100 million.

In January 2016, Council approved the issue of \$30,000,000 of bonds for lending to ICHL. The shareholders resolution approving that transaction noted:

- F. Background paragraph N of the Resolution provided for funds to be borrowed from the Westpac Banking Corporation (Bank). As part of the security documentation for the borrowing of the funds the bank has required that EIL, Pylon, ICPL and ICFL, be Guarantors/Obligor's under the Revolving facility Agreement in the sum of NZ\$120,000,000 (\$120 million) on the terms contained in such document.

Council resolved to approve the borrowing by ICHL and on-lending to EIL. The effect of this was that ICHL was not required to use the additional external funding approved in December 2014 for the Aniwhenua purchase.

In 2019, Council resolved to invest \$25 million in Invercargill Central Limited (ICL) through ICHL. This was funded by the purchase of 25 million shares in ICHL.

In 2020, Council resolved to invest up to \$46 million (a further \$21 million) in ICL. Following receipt of "shovel ready" funds, Council reduced this investment to \$40.5 million (a further \$15.5 million).

At this stage only \$13.5 million of additional funds has been invested as a result of further investment by the government through the "shovel ready" fund. This investment is currently funded by way of loan to ICHL. [REDACTED]

[REDACTED] Council and O'Donnell CBD Limited both have obligations to invest further funds in the event of cost blowouts or funding shortfalls. S7(2)(i)

SALE OF FOREST ESTATE

ICHL resolved to sell the Invercargill City Forests Limited (ICFL) forest estate in 2019. The sale has been agreed, subject to final Overseas Investment Office approval. It is estimated that ICFL will receive approximately \$38 million after tax from the sale.

ICFL currently has around \$25 million in loans from ICHL and these will be repaid immediately. ICHL and ICFL will then assess the most tax effective way to deal with the remaining funds in ICFL. It is most likely that ICFL will be liquidated and the funds returned to ICHL.

It has always been ICHL's intention, and preference, to use the sale of the forest estate to repay the loan from Council for Aniwhenua.

OPTIONS

ICHL borrowing capped at \$100 million

This is the Officers' and ICHL's preferred option.

For ICHL borrowing to remain within the \$100 million cap set by the uncalled capital it must:

1. Repay the current \$30 million loan from Council
2. Council must convert the \$13.5 million loan to equity
3. Purchase a further \$2 million shares in ICHL when required

This would leave ICHL with approximately \$72 million of debt, increasing to \$88 million by the end of 2021.

ICHL external borrowing increases

Increasing ICHL uncalled capital would enable an increase in the external borrowing by ICHL to enable repayment of the loans from Council.

To be comfortable, the uncalled capital would have to increase to \$115.5 million.

Leave the loans as they are

Leaving the loans as they are is implicitly increasing the borrowing of ICHL beyond the uncalled capital. With ICHL expected to have access to the Local Government Funding Authority shortly, there is no benefit in Council borrowing to on lend to ICHL, other than increasing its borrowing capacity beyond the uncalled capital.

There is a downside in Council lending funds to ICHL in terms of the management and responsibility for the debt. Council and ICHL have different risk appetites and tolerances which may be reflected in the hedging policies of the entities. Further responsibility for the debt not clearly understood or managed.

Preferred option

The preferred option is that ICHL borrowing is capped at \$100 million.