

PROPERTY INVESTMENTS UPDATE

To: Performance, Policy and Partnerships Committee

Meeting Date: Tuesday 10 May 2022

From: Michael Day – Group Manager - Finance and Assurance

Approved: Clare Hadley - Chief Executive

Approved Date: Thursday 5 May 2022

Open Agenda: No

Public Excluded Agenda: Yes

Section of the Act	Subclause and Reason under the Act	“Plain English” Reason	When Report Can Be Released
7 (2)	(b)(ii) Would be likely unreasonably to prejudice the commercial position of the person who supplied or who is the subject of the information	Commercial sensitivity of information relating to pending sales.	Redacted version to be proactively released once Sales transactions have been completed.

Purpose and Summary

It has been some years since the last update on Council's overall Investment Property Service, and there have been a number of changes to the portfolio recently with some large property sales. The last update was on the Don Street Development in 2020.

This report provides Council with an update on the current position of the Investment Portfolio. It recommends actions and reclassifications to clarify the purpose and use of the various properties held within the Investment Portfolio service. The report also highlights the significant corrections require to ensure Endowment funds are being correctly used for Municipal purposes only.

Recommendations

That the Performance, Policy and Partnerships Committee:

1. Receive the Property Investments Update.
2. Confirm the reclassification of properties to align with the Long Term Plan (Investment Properties, Strategic Properties and Vacant Land).
3. Note the restrictions on Endowment properties held for Municipal purposes. (Council does not hold any other Endowment restricted Properties within the Investment Property Portfolio).

4. Approve the transfer of \$1,870,500 worth of properties to the recommended Council Activities as per **attachment B**.
5. Confirm the transfer of \$3,303,549 to the Water net debt account to correct the departure from policy for an internal development contribution for the Awarua Development.
6. Approve the transfer of \$6,968,361 of debt from the Endowment Property net debt account to the Don Street development account.
7. Approve the transfer of \$616,064 from the General – Investment net debt account to the Don Street development account.
8. Note the remaining transfers on the Lower Esk and Awarua developments to the General Investment Property net debt account will occur at sale settlement date (Est impact \$3.8 m).

1. Background - Portfolio

1.1. There have been a number of reports that have provided different views on the Investment Property portfolio. Council's original property investment portfolio started in 1879 when the original subdivision set aside one quarter acre for every ten sections to Council for Municipal Endowment. This meant the Crown set these properties aside to be used for Council municipal purposes. Council still hold a small number of these properties to date. As at the last Annual Report Council's Investment Portfolio listed 47 different properties classified via these leasing arrangements. **See attachment A**.

1.2. As per the Council's Long-Term Plan the portfolio is made up of:

- Endowment land
- Strategic land
- Trading land
- Infrastructure land (including Reclamation Endowment land)
- Vacant land

1.3. Upon review of the Investment Portfolio land types, Endowment is a restriction on the land and not an Investment category for Land. Further review identified that within the Investment Portfolio the only Endowment land included is that which is held for Municipal purposes. Historical legal advice clarified that once sold the land funds can be used for any future Council activities relating to Municipal purposes. Given this land has been allocated to the Investment Portfolio it is recommended it remains but is reclassified as Investment Land.

1.4. **Clarification of Net Debt Accounts** - Council holds three types of Net Debt Accounts as part of the Investment Property Portfolio.

1.4.1. General Investment Property Account – This account is for the general administration, operating and sales transactions associated to those properties which do not fit within any of the other account categories.

1.4.2. Endowment Lands Accounts – These accounts are for the sales transactions associated to those properties in the investment portfolio which hold an Endowment status against the title. It is also the account for holding any surplus balances from those sales for distribution under the terms of the Endowment.

- Bluff
- Industrial Property
- Other Property

1.4.3. Development Accounts – These accounts are set up to manage all transactions associated to the various developments, including operational revenues/costs and sales transactions. Generally the source of purchase is either from one of the other account types or via Loans (to be recovered on sale of Development).

- Awarua Development
- Lower Esk Development
- 20 Don Street Development

2. Implications and Risks

2.1. Inconsistent Accounting Treatment:

2.1.1. Different Net Debt account treatments – The four recent development accounts have all been treated differently.

- Clyde Street Development – The Land sold was Endowment property, however the Building and other costs included in the sale and purchase agreement were not. The additional costs were charged against the Endowment Account. The Net proceeds to the Endowment account should be for the Endowment property only and any other transactions should have gone against another source. Based off the land value of \$785,000 the net impact on Endowment account was \$490,234. There is approval on file for the loss but not for the use of the Endowment funds.
- Awarua development has had all historical costs and revenues going directly against a separate net debt account, as it was assumed all costs would be recovered via sale of the development.
- Lower Esk Development has had all costs and revenues going against the General – Investment Property account. As Lower Esk has been in a loss making position since purchase this has continued to reduce the General Net Debt account.
- Don Street Development had initial development costs going against the General Investment account (\$38,724) and to the Endowment net debt account from 2017 until 2019 (\$6,660,329), then once operational from 2019 onwards the transactions have gone directly to a separate Don Street Development net debt account.
- Deveron Street (2/10) Property sales proceeds were allocated to the Don Street Development net debt account. At the time of sale Council owned two sites on Deveron Street, with one being linked to an Endowment Property and one a general investment property. The transfer resulted in further Endowment funds of \$308,032 being allocated against Don Street development and an allocation from General Investment Property funds of \$616,064. It would be proposed to correct both these allocations to give a true picture of the investment into the Don Street Development.

Property Classification

2.1.2. There are properties which are included in the Investment properties' valuation assessment that are used entirely to support Council other services. However, these properties are transferred out to the services from a cost/revenue point of view **see attachment B**. Asset value of the properties is \$1,870,500. The accounting treatment for Investment Properties and Service Properties are different, so it is important to ensure the right classification of these assets are in place.

2.2. Recognition of significant Investment losses:

2.2.1. Endowment Property sales - Previous sales and purchases have been made at market value with purchase and sales transactions going against the various accounts. With the introduction of development projects there are a number of transactions which have or will result in a net loss position to Council. Some of these have recognised the financial loss in the Financial Accounts, but not the cash transaction. There are two large sales transactions to be completed in the current quarter.

- Lower Esk Property Sale - A loan of \$2,354,000 is required to be repaid on sale. Under the sales and purchase agreement the agreed sales figure is \$1,000,000, Council will need to reallocate the balance of the Lower Esk Net Debt account
- Awarua Properties Sale – Development has loans of \$9,105,842 for property purchases, (\$6,893,524 relating to the properties included in the sales and purchase agreement,) with a further at least \$9,093,680 improvements/costs included in the Net Debt to be reviewed upon sale with a majority requiring repayment/reallocation.

2.3. Policy discrepancy:

2.3.1. Awarua Development was charged an Internal Development contribution of \$3,303,549 for the extension of the Branxholme water pipe to the Industrial Subdivision. Council's Development Contribution policy is "not to charge Development Contributions or Financial Contributions". Council can enter into a cost share arrangement with specific Infrastructure extensions for specific purposes, however the Internal Development Contribution does not meet these needs.

3. Financial Implications

3.1. 2021 Investment Portfolio Financial Position

Properties pre recent sales as at 30 June 2021

	Don	Awarua Development	Lower Esk	Other Properties	Total
Assets	\$15,850,000	\$11,800,000	\$445,000	\$11,313,000	\$39,408,000
Net Debt	(\$15,952,519)	(\$18,199,522)	(\$2,354,000)	\$13,295,678	(\$23,210,364)
Net Position	(\$102,519)	(\$6,399,522)	(\$1,909,000)	\$24,608,678	\$16,197,636

3.2. Two pending sales transactions:

- Lower Esk asset sale is \$1,000,000. At final transaction date the proceeds from sale will be required to repay the outstanding loan. Balance remaining on loan is \$1,354,000.
- Awarua Sale proceeds are \$10,200,000. At final transaction date the proceeds from sale will be required to repay the outstanding loan associated to the sold properties against the Awarua Development net debt account. The remaining debt in the account will be for the loans outstanding on the remaining properties. All development and operating costs remaining against the property will either need to be offset by the sales proceeds or written-off to the General Investment Property account.

Properties Post Lower Esk and Awarua Sales

	Don	Awarua Development	Lower Esk	Other Properties	Total
Assets	\$15,850,000	\$3,000,000		\$11,313,000	\$30,163,000
Net Debt prior to distribution	(\$15,952,519)	(\$7,999,522)	(\$1,354,000)	\$13,295,678	\$(12,010,363)
Est distributed on sales		\$5,787,204	\$1,354,000	(\$7,141,204)	
Net Debt to remain	(\$15,952,519)	(\$2,212,318)		\$6,154,474	\$(12,010,363)
Net Position	(\$102,519)	\$787,682		\$17,467,474	\$18,152,637

Includes transactions only up until 30 June 2021 and does not allow for policy discrepancy.

- 3.3. The sales both result in a net positive impact on the Portfolio, however the gains are not enough for either Investment to remove the net debt on those developments. The Awarua development and Lower Esk development will both have negative net debt balances.

Balance of investment property net debt accounts

	Don	Awarua Development	General Investment Properties	Non-Endowment	Endowment	Total Portfolio
Assets	\$15,850,000	\$3,000,000	\$5,885,513	\$24,735,513	\$5,427,487	\$30,163,000
Net Debt Bal	(\$15,952,519)	(\$2,212,318)	(\$1,562,898)	(\$19,727,735)	\$7,717,372	\$(12,010,363)
Balance	(\$102,519)	\$787,682	\$4,322,615	\$5,007,778	\$13,144,859	\$18,152,637

Includes transactions only up until 30 June 2021 and does not allow for policy discrepancy.

4. Legal Implications

4.1. Endowment Land:

- 4.2. There are specific legislative provisions and processes that apply to endowment land. These include sections 140 and 141 of the LGA, as well as section 40 of the Public Works Act 1981. When disposing of endowment land, Council must first publish the intention to sell or exchange the land in its LTP, as well as outline how

the sale funds will be used. Council must also notify the Minister of Land Information and Minister in Charge of Treaty of Waitangi Negotiations, if the Crown was the original donor.

- 4.3. Should Council wish to keep the land, but use it for a different purpose to which it was vested for, it must apply for Ministerial approval?
- 4.4. Invercargill City Council currently owns \$5,427,487 of Endowment land within the Investment Portfolio, the majority of which was originally allocated in the June 1879 Conveyance 12863 Deed 28/690 and further created by the Municipal Corporations Act in 1956. Since 2012, Council has published a list of this land in its LTP, so as to enable any potential changes in use and ownership without a standalone consultative procedure.
- 4.5. As at the end of June 2021 the balance of Council's Endowment Net Debt Account (After adjusting for Don Street movement) is \$7,717,372 giving a total position of \$13,144,859.

5. Options for Committee

5.1. Option 1 (Preferred):

- 5.1.1. Approve the transfer of \$1,870,500 worth of properties to the recommended Council Activities as per **attachment B**.
- 5.1.2. Confirm the transfer of \$3,303,549 to the Water net debt account to correct the departure from policy for an internal development contribution for the Awarua Development,
- 5.1.3. Approve the transfer of \$6,968,361 of debt from the Endowment Property net debt account to the Don Street development account
- 5.1.4. Approve the transfer of \$616,064 from the General – Investment net debt account to the Don Street development account
- 5.1.5. Note the remaining transfers on the Lower Esk and Awarua developments to the General Investment Property net debt account will occur at sale settlement date (Est impact \$3.8m)

5.1.6. Pros:

- Ensures the correct classification of Council's properties ahead of the Annual Report.
- Allows for correct performance reporting against the Strategic Investments
- This option also ensures full alignment with Council Policies.
- Properties remaining in the Investment Portfolio will allow staff to manage according to the LTP levels of service for the Investment Property Activity.
- Debt associated to the 3 Waters Activity will be correctly allocated to that activity.

5.1.7. **Cons:**

- Will lower the currently positive balance sitting in the 3 waters net debt account

5.2. Option 1 may have a rates impact due to the shifting of the pipeline costs from Investment Properties to the water net debt accounts. The extent of that impact is not known at the time of writing this report.

5.3. Option 2:

5.3.1. Approve the transfer of \$1,870,500 worth of properties to the recommended Council Activities as per **attachment B**.

5.3.2. Approve the transfer of \$6,968,361 of debt from the Endowment Property net debt account to the Don Street development account

5.3.3. Approve the transfer of \$616,064 from the General – Investment net debt account to the Don Street development account

5.3.4. Note the remaining transfers on the Lower Esk and Awarua developments to the General Investment Property net debt account will occur at sale settlement date (Est impact \$7.1m)

5.3.5. Approve the departure from the Development Contributions policy for the internal development contribution for the Awarua Development.

5.3.6. **Pros:**

- Ensures the correct classification of Council's properties ahead of the Annual Report.
- Allows for correct performance reporting against the Strategic Investments

5.3.7. **Cons:**

- Debt associated to the 3 Waters Activity will not be correctly allocated to that activity

6. Background- Properties

6.1. Investment Properties Update

6.1.1. **Awarua Development –**

The original Properties were purchased in 2007 with the intent of developing a large industrial land site for future sale and a potential site for disposal of treated sludge from the Clifton Treatment Plant. After initial investigations it was identified the treated sludge option would not be a viable option at this site.

Council purchased the Awarua land in four stages –

- 40-150 Colyer Road – was purchased 31 March 2006 - \$4,020,000
- 167 Colyer Road – was purchased 2 November 2006 - \$385,000

- 1276 Bluff Highway (includes Historic Precinct), 90 Hamilton Road, 99 Awarua Siding Road – was purchased 31 May 2007 - \$4,200,000
- 5 Hamilton Road – was purchased 29 June 2008 - \$900,000

Total purchase price for land - \$9,505,000

Properties were purchased by way of borrowing -**\$9,485,000**

Over the last 15 years of ownership the operating/development costs have resulted in an additional \$9.0m worth of borrowing, as set out below:

The initial couple of years had losses of roughly \$500,000 each year for the interest borrowing costs of the development. - \$1m

In 2008 Council converted the property into a Sharemilking operation. The estimated cost of this conversion was roughly \$1m - \$1m

Once the Sharemilking was in place the operations were running at roughly \$250,000 - \$150,000 loss per annum. The primary reason for this was the 100% dependency on borrowing for the purchase of the properties without enough revenue to cover the interest costs. With the increase in milk prices in recent years the gap has reduced to the point where nearly all of the site cost were covered by the sharemilking operations last year, and in the final year it is looking like close to fully covering the full operating costs. - \$2.2m

Council entered into a marketing arrangement in 2011 via the Council's holding company with these costs adding to debt position of the development. The estimated costs \$1m - 1.5m - \$1.5m

Branxholme pipeline extension begun in 2013 with Awarua Development being charged an internal development contribution of \$3,303,549. - \$3.3m

Total additional costs est - \$9,000,000

Council subdivided and sold (intended to sell) the following pieces of land –

- 40 Colyer Road – sold 31 October 2013 - \$102,000
- 62 Colyer Road – Not sold

Costs associated with developing the property are estimated at roughly \$400,000

Unconditional sale agreement is now in place with settlement scheduled for 1 June 2022. Sales Price \$9,200,000 + \$1,000,000 for time extension for due diligence for:

- 98-150 Colyer Road
- 167 Colyer Road
- 90 Hamilton Road, 99 Awarua Siding Road
- 5 Hamilton Road

This will remove all expenses and revenue for these properties in the future. The revenue includes the sharemilking agreement revenues.

Total sale proceeds from sold properties - \$10,302,000 (\$102,000 already received)

Remaining Properties

- 62 Colyer Road
- 1276 Bluff Highway (known as Historic Precinct)

6.1.2. 62 Colyer Road –



Section 7(2)(h) LGOIMA

Withheld under

6.1.3. 1276 Bluff Highway (Historic Precinct) –

The sale of Awarua excludes the Title upon which the heritage precinct sits – approximately 90 ha. It is proposed to lease to the purchasers those portions of land within that Title currently being used by the dairy farm as milking platform and run-off to provide them with continuance of their farm area. Agreement and terms of the lease are yet to be negotiated.

Council is also undergoing investigation for the proposal of an alternative water source within the greater Awarua area and easements are being negotiated with the purchasers in regard to this prior to settlement. The land at the heritage precinct would be large enough to place a water treatment facility upon if water is found. Two exploration bores have been drilled (in unformed road area) but flow results are not yet available.

6.1.4. Don Street –

Don Street properties were purchased for enhancement of the CBD and a commercial development that would provide a positive contribution towards rates. This is now fully tenanted and currently in an acceptable position income wise. Currently returning in excess of \$500,000 per annum net. Some of the tenants will be renewing their leases and one tenant (small office area) has asked to exit their tenancy earlier while another retail tenant has asked for an extension to their current term prior to determining renewal status.

There is a first right of refusal with one tenant for any office space and potentially the retail space (if not renewed) could easily be converted to office space as well.

If Council intended to sell the property, one of the foundation tenants has first right of refusal of sale.

6.1.5. 20 Spey Street –

The reason for the ownership of this property is the site has a contamination issue. While no remedial action is required it restricts development opportunities. Current tenants are happy with their area. There will be some building maintenance work required in that space which is already budgeted for.

Attachments

1. Annual Report FY2021 Investment Portfolio Properties - Attachment A
2022 05 10 - PPP - Property Investments Update - Attachment A (A3882601)
2. Investment Properties FY2021 Update - Attachment B
2022 05 10 - PPP - Property Investments Update - Attachment B (A3882605)