

# ADOPTION OF CITY BLOCK WEST CONSULTATION DOCUMENT

**To:** Council

**Meeting Date:** Tuesday 12 September 2023

**From:** Rhiannon Suter, Manager – Strategy, Policy and Engagement  
Andrew Cameron, Chief Risk Officer

**Approved:** Patricia Christie - Acting Group Manager - Finance and Assurance

**Approved Date:** Thursday 7 September 2023

**Open Agenda:** No

**Public Excluded Agenda:** Yes

## Reason(s) for the Public Excluded

Section of the Act	Subclause and Reason under the Act	"Plain English" Reason	When Report Can Be Released
S7(2)	(h) to enable any local authority holding the information to carry out, without prejudice or disadvantage, commercial activities.	At present these are draft numbers and need to be finalised with the other ICL shareholders	Report will be released publicly prior to consultation with reaction without the draft consultation document to avoid confusion with the final published version

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## Purpose and Summary

This report provides Council with options for the funding of City Block and the consultation document for the City Block West consultation for adoption. This incorporates options for the financial restructure of City Block, options for Esk Street West/ Wachner Place, along with an update on CCTV and link to the CCTV policy consultation.

## Recommendations

That Council:

1. Receive the report "Adoption of City Block West Consultation Document"
2. Note the recommendations from the Infrastructure Committee for the preferred options for Wachner Place/ Esk Street West
3. Confirm the preferred option for funding for City Block:
  - a. Option 1 - \$10m Share Purchase by ICHL and \$8.55m increase in loan by Council
  - OR**
  - b. Option 2 - \$25m Share Purchase by ICHL and no increase in loan by Council
4. Adopt the City Block West Consultation Document
5. Note the plan for consultation to take place between 14 September and 14 October 2023 with hearings to take place on 24 and 25 October 2023, with proposed decision on 31 October 2023.
6. Delegate to the Chief Executive/Acting GM Finance and Assurance the authority to make changes as necessary to the City Block West Consultation document prior to publication.
7. Note Council will receive and hear submissions, deliberate and make the decision on both the ICL financial restructure and the Esk Street West/Wachner Place investment. Infrastructure Committee will receive submissions, hear, deliberate and make the decision on the CCTV policy.

## Background

Consultation is required on a number of City centre related issues. The Infrastructure Committee considered and gave direction on preferred options for Wachner Place/ Esk Street West on 5 September 2023. These have been incorporated into the consultation document. The Committee also reviewed and adopted the CCTV policy for consultation.

This will be the fourth consultation on funding for City Block, following:

- \$25 million confirmed in 2019 – "Your Money for City Block"
- \$15.5 million confirmed in 2020 – "Extra Money for City Block"
- \$30 million (\$7.5 million longer term investment and \$22.75 million short term loan funding) confirmed in 2022 – "Next Steps for City Block"

In January 2023 Council agreed subject to negotiation with the other funders to extend the short term loan from December 2023 for up to a further three (3) years.

In June 2023 Council considered a request from the Invercargill Central Limited (ICL) Board to convert an amount of \$10m of the current debt facility to equity. It was noted in that meeting that Community Trust South (CTS) had advised that it would not be able to convert any debt to equity. ICL was negotiating with other debt funders around the possibility of them taking part in the debt to equity conversion. The amount of \$10m was premised on both Crown Regional Holdings Limited (CRHL) and O'Donnell CBD Limited (O'Donnell) allowing a total of \$30m debt to be converted to equity. ICL has since been informed that CRHL will not participate in a debt to equity conversion unless CTS also participate. O'Donnell has agreed to fund up to \$10m.

The Invercargill Central Limited (ICL) Board have requested Council give consideration to restructuring of the financial arrangements of ICL in order to ensure the solvency of the operation and financial sustainability for the medium to long term. ICL needs to restructure to remain a viable entity.

Options for consultation on the financial restructure for City Block are presented below.

## Issues and Options

### Analysis

City Block has cost \$180.4m to develop and the asset is now valued, when fully complete, at approximately \$78.5m

The total value of share equity (\$94.3m) and loans (facilities of up to \$90m) funding City Block is currently up to \$184.34m. Of this \$43.2m is held by Invercargill City Holdings Limited (ICHL) as share equity and a loan facility of up to \$31.45m provided by Council.

The O'Donnell Family (O'Donnell CBD Limited) have contributed \$27.7m in equity and Geoff Thomson \$3.94m. HWR Finance Ltd (HWRF) has granted a loan facility to the project of up to \$28.55m. In addition, Community Trust South and Provincial Development Unit have provided loan funding of \$20m and \$10m respectively. Crown Regional Holdings Limited has also purchased \$19.5m of shares in ICL, which was a result of the Shovel Ready Funding application made by Council following the impact of Covid-19.

### Invercargill Central Limited

#### Debt and Equity Structure

\$ million

	Debt	Equity
Invercargill City Council	31.45	-
Invercargill City Holdings Limited	-	43.20
O'Donnell Family	-	27.70
Geoff Thomson	-	3.94
Community Trust South	10.00	-
Provincial Development Unit	20.00	-
Crown Regional Holdings	-	19.50
HWR Finance	28.55	-
	<u>90.00</u>	<u>94.34</u>

### Share equity

ICHL's original \$43.2m shareholding investment has been assessed for 'fair value' for financial reporting purposes both at 30 June 2022 and 2023. At 30 June 2022 ICHL impaired its share equity investment to \$500,000. The fair value of the share investment at 30 June 2023 is approximately \$0.03 per share.

Council, when asking ICHL to initially invest in ICL, equity had always intended that it would be a long-term investment primarily for social and economic purposes rather than

commercial, and the reduction (loss) in share value would not be realised unless or until the shareholding is sold. It is anticipated that the shareholding will increase in value over time.

### **Debt**

HWRF and Council currently provide ICL with a \$60m debt facility (Council \$31.45m and HWRF \$28.5m). HWRF have requested Council take over this debt facility.

It was never the intention of either Council or HWRF to provide debt funding to ICL on a long term basis. The significant increase in interest rates over the last 12-18 months and increase in costs of construction due to Covid-19 meant that the required levels of bank funding can no longer be obtained. To allow completion of the project, Council and HWRF stepped in and provided the \$60m debt facility.

HWRF, as a commercial entity has alternative uses for its funds and Council is better placed to manage the full debt facility.

### **Significance**

Council is consulting with the community as it considers these changes to be significant and of importance. Purchase of shares by ICHL does not require Council consent however the purchase is being completed at the request of Council.

Increasing the debt facility limit to ICL does not immediately impact Council. The issue for Council is that the increase in the debt facility increases the exposure of Council to a failure by ICL. This is reflected in the assessment of the potential impairment of the current loan.

Council committed to consult at the time of previous engagements should further funding be required.

These issues are significant in relation to Council's Significance and Engagement Policy.

### **Options**

This report speaks only to the options for the funding of City Block, given the Infrastructure Committee has already received and given direction on the other options for consultation.

Option 1 reflects the current status of the parties. The other option reflects the potential funding required to ensure the viability of ICL. Both options enable ICL to operate from a cash perspective if the following also occurs:

- CTS and CRHL agree to extend their loan terms from 10 to 15 years;
- CTS and CRHL agree to the loans having the same current fixed interest rates, 4% and 3% respectively;
- CRHL agree to loans being interest only until year 10 with repayment over the next five years.

In Option 1 ICL would be operating at a loss until 2028. Council's loan to ICL would peak at \$39m and be \$25m in 2036.

In Option 2, if other considerations remain the same, ICL would be making a loss until 2027. Council's loan to ICL would peak at \$34m and be \$17m by 2036.

Both of these options only leave approximately \$1m in headroom before ICL would be required to call on the \$4m from Invercargill City Holdings Limited and/or other funders. Currently Level 1 of the development, restaurant and commercial tenants, equates to around \$750k per annum reduction in the forecast for each year that it is not tenanted. ICHL is in a position to be able to meet this call if required in the future.

### **Option 1**

- Existing debt and equity holders will be offered to purchase shares in ICL. ICHL and O'Donnell CBD Limited have signalled that they will participate in this purchase equally to ensure that ICL receives \$20m of additional share equity. The purchase price for the shares to be determined.
- Council will increase its loan facility to ICL from \$31.45m to \$40m and extend the term to 15 years with interest only repayments. The Council loan will be secured by a first mortgage security over the land and buildings.

ICL will use the \$20m received from the issue of shares and a further drawdown from Council facility to fully repay the HWRF debt facility.

Should only ICHL and O'Donnell CBD Limited participate in the share purchase, this will result in ICHL having purchased \$53.2m equity and Council holding a debt facility of up to \$40m.

Option 1 would result in Council increasing its loan facility to ICL by \$8.55m to \$40m and ICHL investing a further \$10m in ICL shares taking ICHL's total investment to \$53.2m. O'Donnell CBD Limited would increase its shareholding by \$10m taking its investment to \$37.7m. HWRF would have no further interest in ICL.

At present Council is considering the financial reporting treatment of the loan to ICL at 30 June 2023 and whether it is impaired. The restructuring of the loan as proposed would require this impairment assessment to be reconsidered.

This option has the following implications:

Based on current forecasts:

- ICL will be able to repay the loans to Community Trust South and Provincial Development Unit when they fall due.
- ICL will also be able to service all its debt from projected operating cashflows.

It may limit the ability of ICHL to fund other potential projects on behalf of Council as ICHL will fund the purchase of the shares from its own cashflows/reserves.

Provides Council with a relatively higher forecast cash flow from interest repayments from ICL as a result of the increased loan facility, compared to option 2. However, as with any loan there is a potential risk that ICL will not be able to continue financing the interest payments and principal repayments (when due) from revenue and may need additional equity contributions from shareholders in the future.

It would have a marginally positive impact on Council's maximum borrowing limit compared to option 2 (due to the interest income), putting Council in a stronger position to potentially fund future projects itself.

There would be no impact on rates.

## Invercargill Central Limited - Option 1

### Debt and Equity Structure

\$ million	Current		Option 1		Debt	Equity
	Debt	Equity	Debt	Equity		
Invercargill City Council	31.45	-	8.55	-	40.00	-
Invercargill City Holdings Limited	-	43.20	-	10.00	-	53.20
O'Donnell CBD Limited	-	27.70	-	10.00	-	37.70
Geoff Thomson	-	3.94	-	-	-	3.94
Community Trust South	10.00	-	-	-	10.00	-
Provincial Development Unit	20.00	-	-	-	20.00	-
Crown Regional Holdings	-	19.50	-	-	-	19.50
HWR Finance	28.55	-	(28.55)	-	-	-
	90.00	94.34	(20.00)	20.00	70.00	114.34

At 31 August 2023 ICL has drawn down \$26.68m of the Council debt facility and \$25.37m of the HWRF debt facility.

### Option 2

- ICHL will purchase \$25m of additional share equity. The purchase price for the shares to be determined.
- Council will maintain its current loan facility of \$31.45m and extend the term to 15 years with interest only repayments. The Council loan will be secured by first mortgage security over the land and buildings.

ICL will use the \$25m received from the issue of shares and a further drawdown from the Council facility to fully repay the HWRF debt facility.

This will result in ICHL holding \$68.2m equity and Council holding \$31.45m debt. This would result in ICL becoming a Council Controlled Trading Organisation (CCTO) as ICHL would hold more than 50% of the issued equity.

Option 2 would result in the size of the loan facility provided by Council being unchanged at \$31.45m and ICHL investing a further \$25m in ICL shares taking ICHL's total investment to \$68.2m.

O'Donnell CBD Limited would retain its current shareholding \$27.7m and HWRF would have no further interest in ICL

## Invercargill Central Limited - Option 2

### Debt and Equity Structure

\$ million

	Current		Option 2		Debt	Equity
	Debt	Equity	Debt	Equity		
Invercargill City Council	31.45	-	-	-	31.45	-
Invercargill City Holdings Limited	-	43.20	-	25.00	-	68.20
O'Donnell CBD Limited	-	27.70	-	-	-	27.70
Geoff Thomson	-	3.94	-	-	-	3.94
Community Trust South	10.00	-	-	-	10.00	-
Provincial Development Unit	20.00	-	-	-	20.00	-
Crown Regional Holdings	-	19.50	-	-	-	19.50
HWR Finance	28.55	-	(28.55)	-	-	-
	90.00	94.34	(28.55)	25.00	61.45	119.34

At 31 August 2023 ICL has drawn down \$26.68m of the Council debt facility and \$25.37m of the HWRF debt facility.

## Community Views

The community has been consulted on the City Block project three times. At the first and subsequent consultations Council committed to consult the community should further funding be required.

At each consultation on balance the community has been supportive of Council's investment in city block and has seen the potential social and economic benefits to the community. They have understood the importance of making sure the project succeeds.

In 2019 the community were split into three groups – those in support, those opposed and those with comments. The general theme was supportive but no analysis was provided of the proportion of submissions.

68% supported allocation of further funding in 2020 – this was split across two options, with the higher proportion supporting the higher commitment.

75% supported the allocation of further funding in 2022.

The community was surveyed in 2023 and 80% said that the investment in the city centre (incorporating city block and city streets) made them more likely to say positive things about Invercargill.

The community have been visiting the central city area more frequently. Foot traffic since the opening of the mall has varied between 400 and almost 900 people a day over Christmas at the Cambridge Place entrance. This compares to between 150 and almost 300 visitors a day at the same location between 2007 and 2013 taken at four different days.

Consultation will take place between 14 September and 14 October 2023. The consultation will be promoted via Council's usual channels. This will be supported by a business breakfast for retailers, a stand and school holidays activity in the mall and a Facebook live Q&A event, as well as social media promotion.

## **Implications and Risks**

### **Strategic Consistency**

Ensuring the success of ICL is consistent with the strategic objectives of Council to create Our City with Heart – He Ngākau Aroha.

### **Financial Implications**

The financial implications are discussed in detail under each option above.

### **Legal Implications**

All parties recognised the potential for cost overruns at the commencement of the project. It was a requirement of other shareholders and funders that ICHL and O'Donnell CBD Limited guarantee the funds to complete the project and during the first year of operation. At that stage it was agreed to limit that exposure to 10% of the project cost or \$16.5m.

ICHL and O'Donnell CBD Limited are currently required under the Shareholders Agreement to provide those funds if requested. The Shareholders Agreement requires that ICHL fund its share by way of equity injection. Purchase of \$20m of equity by ICHL and O'Donnell CBD Limited is \$3.5m more than what is required under the shareholders agreement.

Both options for the financial restructure meet the legal requirements of the shareholder agreement.

The second option would result in a change of status for ICL as a CCTO under Part 5 of the Local Government Act 2002.

### **Climate Change**

There are no climate change implications.

### **Risk**

Council and ICHL are exposed to greater risk as a result of these transactions.

The unusual implication however, is that the overall risk to Council and ICHL is reduced from its current position. Currently if Council and ICHL do not take these steps it is likely that the development would be sold and the accounting losses, shown in the equity valuations would be realised. Although there is an exposure to potentially greater loss, taking steps to ensure that ICL is able to continue trading, all other things being equal, has the impact of reducing the likelihood that the current losses will be realised, in particular the equity investment would be lost if the property was sold currently.

There are a number of caveats to this that relate to the current and future state of retail in New Zealand over the coming years and the ability of ICL to complete the leasing of level 1 and the childcare centre.

It remains, as has been our advice in the past, that given the quality of the fitout and other factors the investment in ICL remains a solid long term investment. Current forecasts are that ICHL will begin to see returns by way of dividend in ten years. Current trading conditions for



the tenants indicate the continued potential uplift in return to ICL over the coming years dependent on future economic conditions.

## **Next Steps**

Following agreement of Council's preferred option, the final version of the consultation document will be completed and consultation will commence on 14 September 2023.

## **Attachments**

Appendix 1 - City Block West Consultation Document – A4855017