Date:	**Thursday, 19 November 2015**
Time:	**9.30am**
Meeting Room:	**Reception Lounge**
Venue:	**Auckland Town Hall 301-305 Queen Street Auckland**

Finance and Performance Committee

OPEN ATTACHMENTS

ATTACHMENTS UNDER SEPARATE COVER

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CAMERON PARTNERS

Auckland Council

Review of Alternative Sources of Financing

STRICTLY PRIVATE AND CONFIDENTIAL

30 OCTOBER 2015

GLOBAL ALLIANCE PARTNER OF ROTHSCHILD

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The Report may be based on or be by reference to:

- market conditions and economic rates and indicators, including assumptions regarding future market conditions and economic rates and indicators; and
- business forecasts, elements of which may have been provided by Auckland Council

With respect to valuation material, we have conducted our assessment using a range of underlying data and valuation methods. We have assumed without independent verification that:

- the financial projections sourced from Auckland Council have been reasonably prepared and reflect Auckland Council's current views of the most likely future financial results;
- the financial information has been prepared using accounting policies in line with industry standards, especially with regard to revenue recognition and the treatment of capitalised expenditure and other expenditure; and
- the publicly available financial data that has formed the basis of our comparable transaction and comparable company analysis is correct and has been properly prepared by the data providers we have used.

Business and economic conditions and what may be a reasonable assumption or forecast can and do often change without notice or warning. Cameron Partners has made, or adopted, assumptions and forecasts which it considers reasonable but those assumptions or forecasts may not be correct and, anyway, may be affected by changes in economic and other circumstances. Cameron Partners does not warrant that the assumptions are likely to be correct or that business forecasts will be achieved.

Cameron Partners will not update or correct this Report even if Cameron Partners becomes aware that it is out-of-date, affected by changes in circumstance, or contains errors.

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Glossary

Term	Definition
AC	Auckland Council
AC Property	Auckland Council property department
ACIL	Auckland Council Investments Limited
AIAL	Auckland International Airport Limited
AT	Auckland Transport
BAU	'business as usual'
CCO	Council Controlled Organisation
CHP	Community Housing Provider
Council	Governing body of Auckland Council
DFAP	Diversified Financial Asset Portfolio
Financing	The way in which money is raised to undertake the project
Funding	How the project will ultimately be paid for
HfOP	Housing for Older Persons
LGFA	Local Government Funding Agency
LTP	Long Term Plan
NZTA	New Zealand Transport Agency
NZX	New Zealand Stock Exchange
PDAM	Panuku Development Auckland Marinas
POAL	Ports of Auckland
POT	Ports of Tauranga
PPP	Public Private Partnership
ROA	Return on Assets
TMP	Treasury Management Policy

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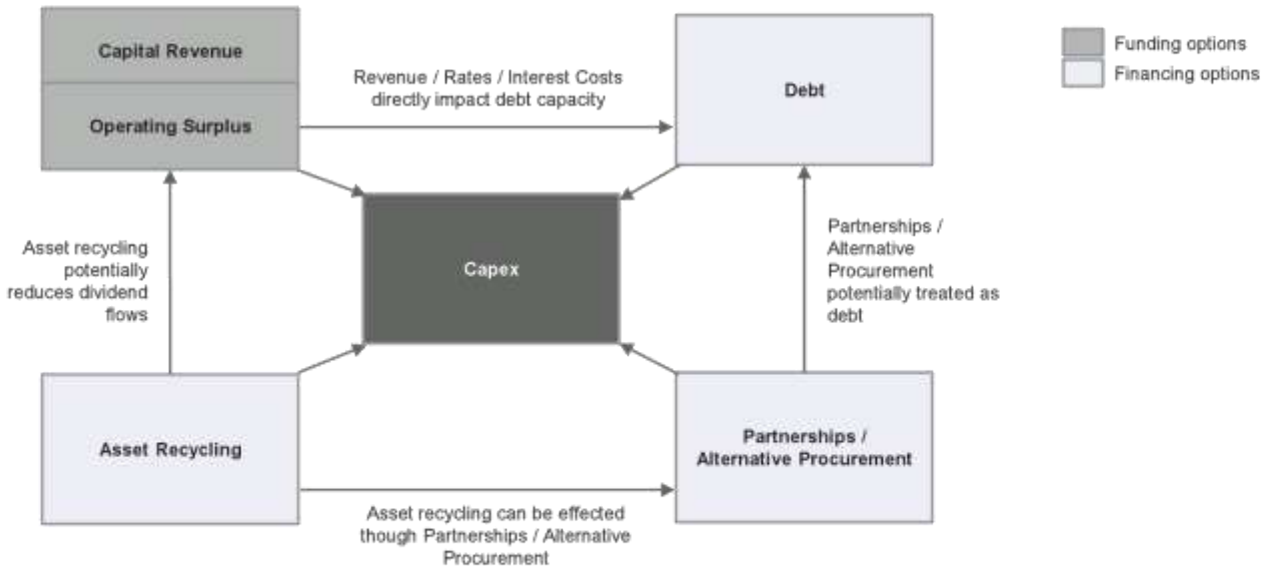
Executive Summary

Executive Summary

Background – four budgeting 'levers'

- Local Authority capital budgeting is an iterative process – the governing body of Auckland Council (Council) must make judgements about which capital projects it will undertake and how it will fund and finance the projects:
  - Funding is how the project will ultimately be paid for
  - Financing is the way in which the money is raised to undertake the project
- There are four broad inter-related levers available to Auckland Council (AC) to fund and finance its long term plan (LTP)



Source: Cameron Partners

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Background - key funding and financing principles

- By definition a 'balanced budget' LTP represents an optimum for the current Council requiring a number of explicit and implicit trade-offs:
  - Funding will be the maximum that it considers acceptable
  - The costs of providing AC services will be covered
  - Financing sources (debt, asset recycling, partnerships / alternative procurement) will have been considered
  - The capex plan will be what can be afforded within these constraints
- To undertake more capex within the funding constraint (i.e. AC's currently approved revenues and cost structure), AC has limited options:
  - If a capex project can self fund (either directly or indirectly through targeted rates) then it will be possible to raise financing that does not require additional AC funding. In those cases where a project cannot cover its cost of capital AC will need to fund any shortfall
  - Selling non-income generating assets into a higher use also does not necessarily create a funding requirement (as no income is foregone in the sale)
  - Increasing debt (which has a financing cost and principal sum requiring repayment) or selling assets that generate a return both create a funding requirement
- All financing options have drawbacks:
  - External third party finance has a cost – i.e. the providers of capital require a return on that capital whether the obligation to provide the return is fixed (as in debt), at risk (as in equity) or is structured via a partnership approach (e.g. in regard to timing of the delivery of returns)
  - Internal options that convert an asset into cash / another use, lose the benefits of that asset (e.g. public benefits; commercial returns) – effectively there is an opportunity cost of owning one asset over another
- There is no 'free lunch' – to receive the benefits of a project (public benefits and/or commercial returns) AC will need to choose between the costs of the financing option or losing the benefits of a recycled asset. Ultimately, Council will have to choose between two states of the world:
  - The status quo – i.e. no change to current financing arrangements or asset ownership but the project is not undertaken; or
  - The financing option is engaged (with the associated consequences) and the project goes ahead

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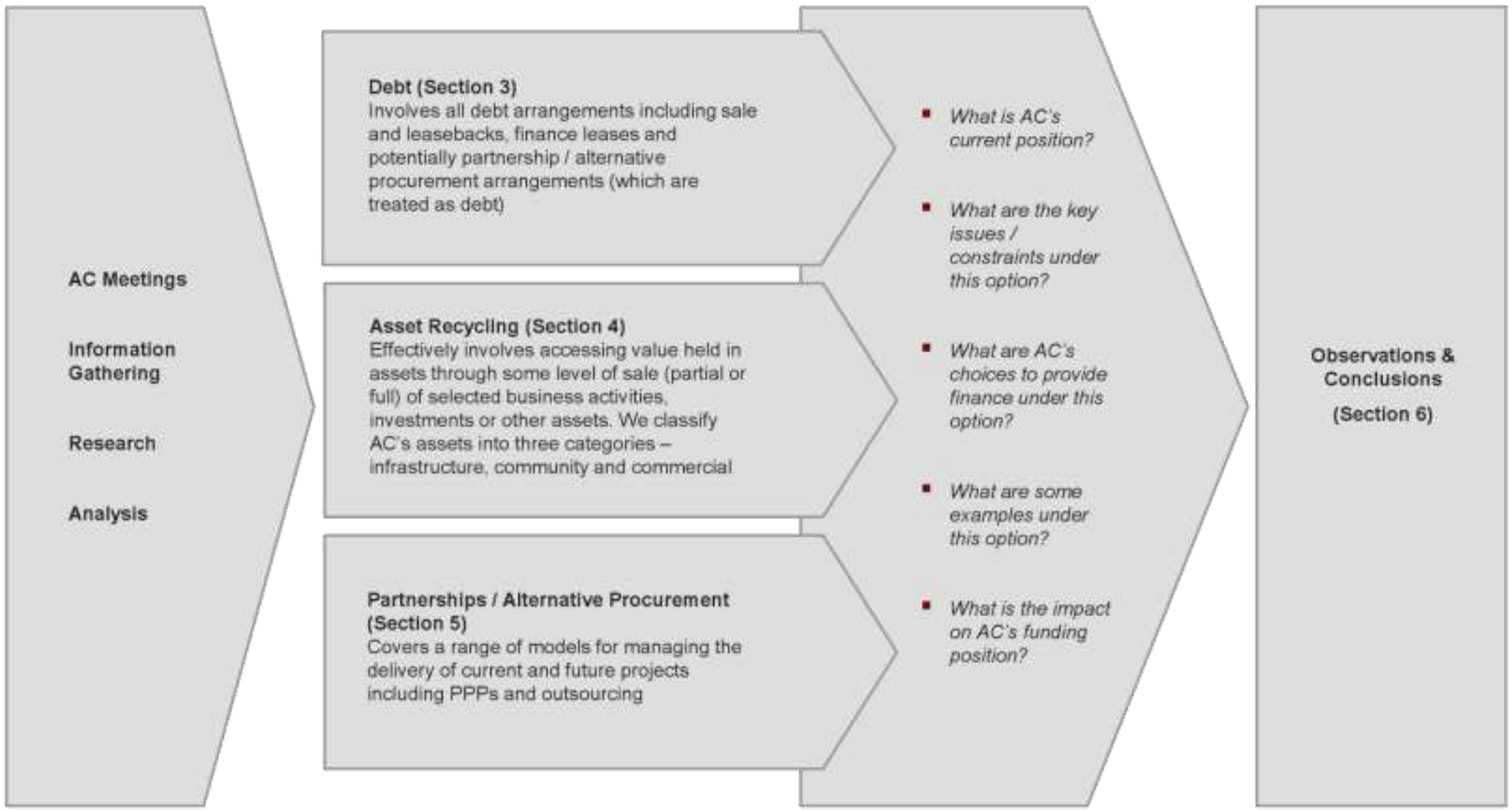
Approach to the review of alternative sources of financing

- Cameron Partners focus is on AC's financing options – debt, asset recycling and partnerships / alternative procurement



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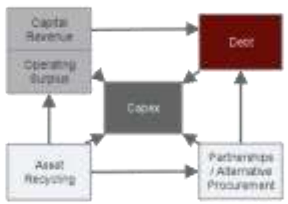
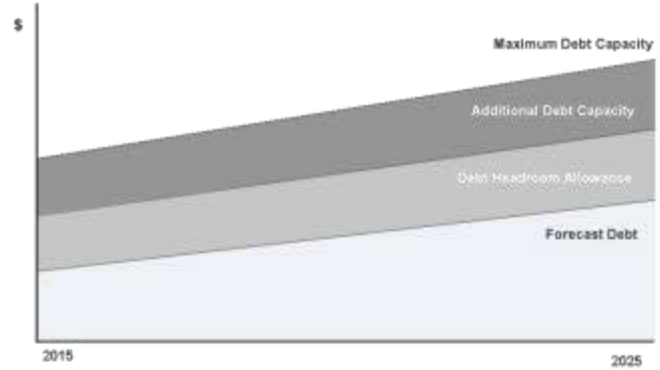


Debt – is there currently additional debt capacity?

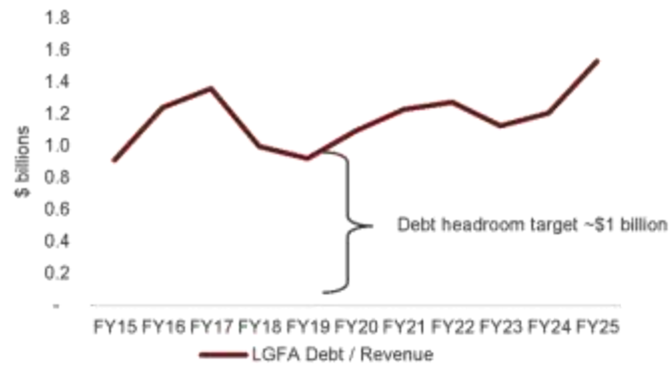
- Debt is the most flexible form of financing available to AC – it can be used to fund long-term core requirements assuming sufficient capacity and be used at short notice to meet unexpected financial events
- AC's actual additional debt capacity (if any) is the difference between AC's maximum debt capacity and its forecast debt levels plus AC's debt headroom allowance
- **Maximum Debt Capacity** - is ultimately constrained by a combination of the Local Government Funding Authority's (LGFA) lending policies; AC's internal prudential borrowing limits contained in its Treasury Management Policy (TMP) and AC's objective to maintain a 'A+' long-term S&P credit rating (or higher)
- **Forecast Debt** – is as per LTP (subject to variance)
- **Debt Headroom** – is based on an assessment of how much surplus debt capacity / debt headroom as part of AC's overall financial flexibility for unexpected financial events and potential decisions to make unfunded changes to its plans is considered appropriate.
- Based on our analysis AC maximum debt is primarily constrained by the LGFA Debt / Revenue ratio <250%
- This suggests surplus additional debt capacity of ~$1 billion exists although this takes no account of AC's wishes to retain debt headroom as a form of financial flexibility. Our discussions with AC management suggest $0.5 - $1.0 billion of debt headroom is being maintained
- We note that the calculation of the LGFA covenant is based on AC's interpretation of the LGFA calculations which excludes Watercare (and Ports of Auckland (POAL)) debt from the calculation

Debt Capacity



Source: Cameron Partners

AC / AC Group (as applicable) Additional Debt Capacity



Source: Cameron Partners

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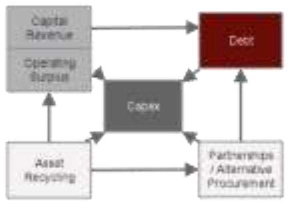

Debt - options to increase additional debt capacity

- The AC 2015 – 2025 LTP states *"Aucklanders…have no appetite for large increases in rates or council debt"*. Notwithstanding there are options to increase AC's additional debt capacity albeit that the decision to implement these will require an assessment of:
  - The consequences and judgements about the appropriateness of doing so
  - The challenges involved (e.g. approval from the LGFA would be required)

- There is a natural order that emerges for AC if it wishes to increase its additional debt capacity

1. **Reduce debt headroom** allowance - rely on other forms of financial flexibility (retained for example for potential variance from business as usual (BAU) forecasts; unexpected non-BAU events and for decisions to make unfunded changes to the existing plan) and reduce the level of debt headroom that AC needs to hold so that it can access more of any unused debt capacity

2. **Renegotiate the LGFA covenants** - LGFA lending criteria currently sets the 'hard' limit on AC debt capacity. The LGFA lending criteria is set in the LGFA Shareholders Agreement and any amendment to the policies for AC would require an ordinary resolution of LGFA shareholders (LGFA has 31 Local Authority Shareholders including a 20% stake held by the Crown). While there is no precedent for bespoke limits we consider that there are strong arguments to support different financial covenants for large high growth councils (such as AC) versus small low growth councils. Notwithstanding we also note that restating AC's position to bring it in line with the majority of councils, which include water as part of the core council, suggests that AC is at the upper end of LGFA debt constraints already

3. **Accept a credit rating downgrade** and the consequences of such a downgrade - as a credit rating declines typically the risk of default increases; pricing (debt margins) increases and the appetite from investors decreases. However, within reasonable bounds (e.g. a S&P rating of 'AA-') the impact is likely to be low (albeit there may be a negative reaction from existing bond investors)

4. **Amend AC's TMP / internal policies -** any amendments to the LGFA covenants and decision to accept a rating downgrade will necessarily require internal approvals and amendment of internal policies

- It should be noted that in the event that additional debt capacity is created and used, AC will:
  - Need to fund the increased debt
  - Bear the consequences of the increased debt including (within reasonable bounds) marginally higher pricing, higher financial risks and negative reaction from existing investors

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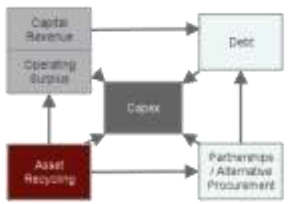

Asset Recycling - approach and observations

- Asset recycling effectively involves accessing the value held in assets through some level of sale (partial or full) of selected business activities, investments or other assets. The size and complexity of the AC Group balance sheet makes it impractical to analyse every asset, project and arrangement. Accordingly we classify AC's assets into three categories to assist with isolating the financing issues – infrastructure, community and commercial

Non Commercial

1. Infrastructure
- Large scale / asset intensive / networks
- Core networks to essential services
- Complex and long term investment / capital budgeting decisions
- No alternate use

2. Community
- Support the provision of community services
- Higher number, relatively low individual value
- Not typically run as businesses
- Potential higher value in alternative use

3. Commercial
- Commercial businesses
- Generate external revenues / return
- Activity would be provided without AC ownership

- Our intention is to provide Council with a set of broad options with considerations and examples for each. This approach will allow Council to review and (if appropriate) prioritise certain identified areas for deeper investigation. All analysis is necessarily high level. In particular, valuations should be regarded as broadly indicative only

Cameron Partners Asset Classification	$ millions[1]
Infrastructure Assets	
Auckland Transport (AT) (excl. Commercial Parking)	16,017
Watercare	8,446
Stormwater	4,149
Total Infrastructure Assets	28,612
Community Assets	
Regional Parks	4,904
Other Community Assets	2,683
Total Community Assets	7,588
Commercial Assets	
Auckland International Airport Limited (AIAL)	870
Ports of Auckland Limited (POAL)	778
Commercial Parking[2]	506
Diversified Financial Asset Portfolio (DFAP)	328
Housing for Older Persons (HfOP)	200
Panuku Development Auckland Marinas (PDAM)	80
Total Commercial Assets	2,761
Other Assets	3,206
Total	**42,167**

[1]The values reflect the FY15 AC balance sheet
[2]Includes land & buildings of all parking. Downtown, Victoria and Fanshawe carpark buildings account for $153 million

Source: Auckland Council

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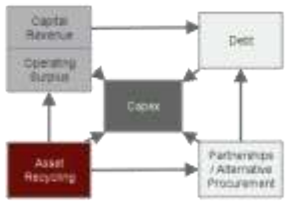

Infrastructure Assets

- Core infrastructure assets across AT, Watercare and Stormwater (held by AC directly) have a book value of $28.6 billion, or ~70% of AC assets and total 10 year forecast capex is $13.5 billion (~72% of total forecast AC capex)
- In the absence of changes to policies regarding external revenue generation from these assets, there is little scope for increased revenues to enhance AC funding - AT net contribution is -$328 million; Watercare is restricted by legislation from paying a dividend and Stormwater operations are fully funded by AC

Infrastructure Assets				
$ millions	AC	AT	Watercare	Total
AT		15,556		15,556
Watercare			8,438	8,438
Stomwater	4,149			4,149
Land held for future use		462	8	470
Total	4,143	16,017	8,446	28,612

Source: Auckland Council

- The scope to use the Infrastructure Assets to assist with financing includes:
  - **Surplus Land -** All three organisations have substantial land assets used in their operational activities. However, both Watercare and AT in particular also have significant land holdings purchased in anticipation of future requirements. The natural incentive for these organisations is to take a very conservative view of their future land requirements. There should be robust processes (including external oversight) that periodically review these land holdings to determine the likelihood of the project going ahead and their potential highest value use
  - **Asset Financing -** There may be assets that can be identified that AC could look to external parties to finance (e.g. sale and leaseback structures or similar for the electric rail fleet ~$400 million). However, Infrastructure Assets do not typically attract an external revenue source that supports their value:
    - Consequently, AC is the counterparty that must meet the financing cost and capital repayments. Accordingly any sale and leaseback structure of these assets is essentially just exchanging AC debt for an asset specific debt - no extra financing capacity is created
    - When some external revenues exist it may be possible to establish structures that ring fence these assets. However, to the extent that they still require / use up AC revenue then again this will effectively just replace AC debt with asset specific financing (albeit potentially with better flexibility)
  - **Partnership / Alternative Procurement**
    - Public Private Partnerships (PPP) - major infrastructure asset projects are well suited for Partnership Arrangements such as PPPs. However, as outlined in Section 5, the major benefits of PPPs relate to procurement and not financing capacity
    - Outsourcing of Asset Management - for a range of reasons, the infrastructure businesses do not operate in competitive markets and are not structured to run as profit-seeking or value-maximising organisations. In this situation, there is risk that asset management plans get weighted toward over-engineering in terms of capacity planning, technology, redundancy, maintenance and renewal. We have no evidence that this is the case. From what we observe, the processes that the AT and Watercare Boards and management go through in testing their asset and capex plans is very robust. Notwithstanding, as outlined in Section 5, there is evidence that supports savings (operational and capital) from outsource arrangements

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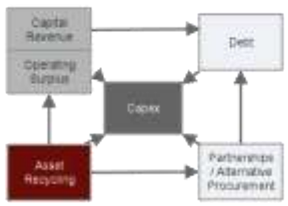

Community Assets

- Community assets are characterised by the following financial characteristics
  - They are generally land and buildings
  - They are being used to provide a council service to the community
  - The service is not sufficiently commercial to be provided by the private sector
  - Provision of the service is typically subsidised by AC

Community Assets	$ millions
Regional Parks	4,904
Community facilities	2,170
Other community assets (art, books, etc.)	452
Golf Courses	61
Total	7,588

Source: Auckland Council

- The financing opportunity exists in regard to these assets where:
  - There is a materially higher alternative use value for the land / buildings (e.g. housing)
  - Council's obligation to provide the service currently using the land / buildings could be met in other ways or with other assets

  In these situations there may be opportunities to either relocate the service (or in some cases cease providing the service) and release a net capital amount. In most circumstances, the underlying land and buildings are not earning any return therefore, while the decision to divest the land / buildings may have community impacts, it will not have any material funding impact as there is no material cash flow stream being foregone

- Indicative valuation work provided by AC's property department (AC Property) suggests the potential market value is significantly higher than current book value. However, we are not able to offer many specific examples of where opportunities lie. The reason for this is that although property records exist for all Community Assets, their valuations are often based on current use (i.e. as a park or community centre). There is no summary or analysis of the potential value in alternative use and legal issues associated with ending existing arrangements (especially where classified as a reserve)

- However, by way of example, AC Property has provided the following estimates:
  - AC's parks and reserves are currently valued at ~$4.5 billion, at ~$15 - $20 psm whereas the land under surrounding houses is valued at ~$1000 psm. A market valuation of AC parks and reserves if available for housing could be as high as $45 billion. Releasing as little as 5% of this could potentially equate to $2.25 billion. An alternative to reducing total land held for this purpose is to release land in the higher value urban areas and acquire land in lower value areas
  - AC is the owner of 13 golf courses, valued at ~$61 million in its FY15 financial statements. However, if the top four courses by market value (Remuera, Chamberlain Park, Pupuke and Takapuna) were made available for housing at the values of surrounding land (with 30% reserved for public spaces etc.), the estimated value obtainable is $1.4 billion. We do note however, that the courses are the subject of different lease arrangements which may prevent any monetisation opportunity in the near term

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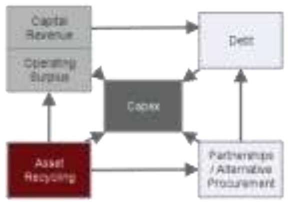
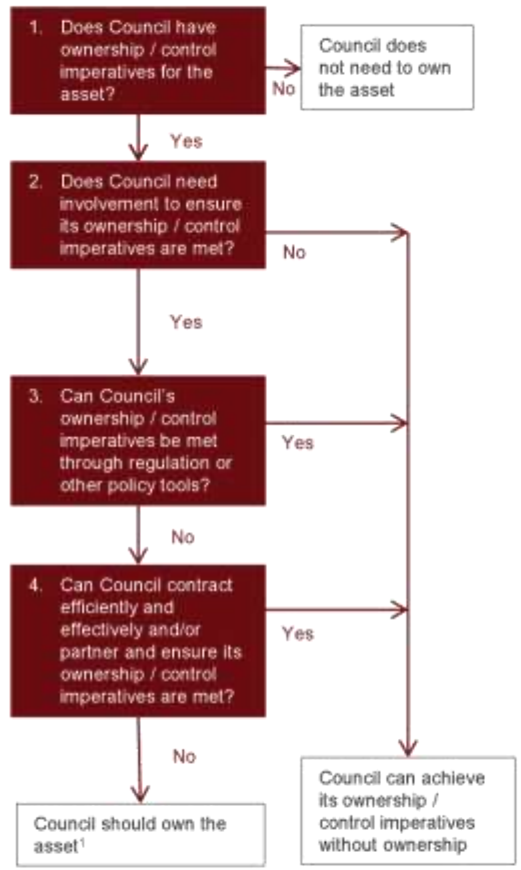


Commercial Assets – our framework

- AC's core business is to ensure delivery of certain key services and outcomes. We consider that it owns and controls certain assets to facilitate this and does not own assets for purely financial returns
- Accordingly the framework we apply for assessing the merits of recycling commercial activities and assets seeks to establish:
  - Whether there is an ownership / control imperative for the asset (as per the diagram to the right)
  - The likely impact on immediate financing capability and the longer term impact on funding if the asset were to be divested (i.e. the loss of future income)
- Considerations include:
  - Reasons for an ownership / control imperative, such as:
    - A conflict between the business plan that may be adopted in the absence of AC ownership and the wider public interest being served by Council
    - A market failure – the activity / asset would not be undertaken or provided without AC ownership
  - Whether the control imperative can be met through means other than ownership, such as:
    - The role of regulation (both the Council's regulatory role and that of other regulatory bodies such as the Commerce Commission)
    - Contracting between AC and an alternative owner to protect public interests
    - Achieving the required control objectives with lower levels of ownership than current
- If this analysis reveals there is no ownership / control imperative, then Council can actively consider divesting this asset / business as a financing option:
  - The ownership is simply a commercial investment earning a market return
  - There is almost certainly a higher value use for that scarce capital than simply earning a market-level commercial return
  - Council should consider this opportunity cost when making a decision to retain a commercial asset

Ownership Decision Process



[1] An exception could be where an investor is aligned with Council and is happy for its non-value maximising objectives to be pursued – e.g. Government; other local authorities; Iwi; philanthropic sources

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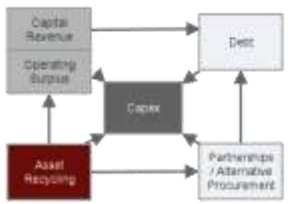

Commercial Assets – ownership / control imperative summary analysis

- Ultimately assessing AC's ownership / control imperative requires judgements by Council – potential ownership / control imperatives and mitigants to a sale could be as follows

Asset ($ millions)	Potential AC ownership / control imperative	Other means to meet AC ownership / control imperative
AIAL (22.4%) *Dividend $39* *BV - $870* *MV- $1,398*	Key regional asset - ensure development and management of infrastructure is fit for purpose, timely and meets customer needs	Commercial incentives will be aligned under private ownership
	Monopoly asset – ensure powers not abused	Aeronautical business subject to regulatory oversight
	Externalities – ensure public interests optimised	AC District Planning function provides constraints
	Influence - current shareholding gives AC no direct rights to appoint board members and no super decision rights to influence business plan	A 10% stake would be sufficient to block a full takeover
	New Zealand ownership – maintain New Zealand control	New Zealand Government has previously blocked an overseas bidder (CPPIB) from acquiring a controlling stake
POAL *Dividend $42* *BV - $779* *MV $1,078 - $1,164*	Key regional asset – ensure delivery of efficient port services and infrastructure for the region	Commercial incentives generally aligned but protections may be required to avoid potential conflicts with other New Zealand ports
	Environmental, H&S – ensure very high standards maintained Waterfront land / harbour management – ensure land use is optimised from AC's point of view	Port models (Landco / Opsco) enable key control rights to be maintained
	Cruise / Passenger facilities – ensure provision of very high standard facilities and service	Possible to contract direct with Port for services / facilities
Commercial Parking *Net Surplus $8.5* *BV - $153* *MV - $153*	Policy tool – potential use for congestion control; parking pricing control etc.	AC doesn't currently use its carparks as a policy tool No market failure in parking is apparent (competitive forces likely to ensure sufficient CBD parking)
DFAP *Est. $25 (7% yield)* *BV - $328* *MV - $328*	Liquidity – ensure AC has sufficient financial flexibility	Other forms of financial flexibility are available (unusual investment relative to other New Zealand Local Authorities)
HfOP *Net Income - $6.4* *BV - $200* *MV - $225*	Key social asset – ensure provision of accommodation for those in need	Central government provision AC contracts directly with private sector to deliver desired HfOP outcomes
PDAM *EBITDA $4.9* *BV - $80* *MV - $80*	Auckland identity – ensure sufficient public access to marina facilities exists	No market failure is apparent (a number of marinas in wider Auckland are privately owned) Public objectives could be met through contractual / regulatory means

BV = Book Value MV = Market Value

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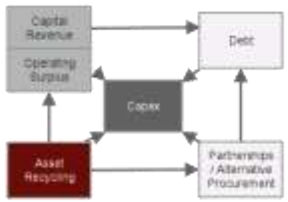
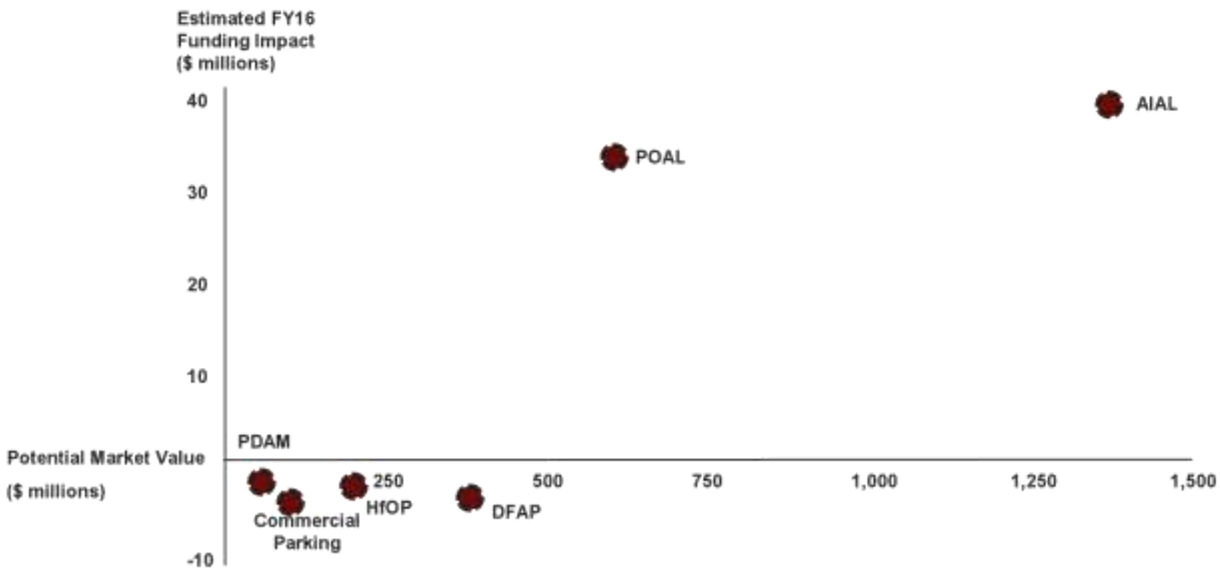


Commercial Assets - funding / financing summary analysis

- The diagram below highlights the current approach that AC applies to assessing the short-term net funding impact if the sale proceeds of the assets are applied to repay debt. The short-term net funding impact is:
  - Positive if the "yield" of the assets is below the LTP borrowing rate of 6%
  - Negative if the "yield" of the assets is higher than the LTP borrowing rate of 6%
- We note this analysis is relatively superficial. It is based on the income received by AC in FY15 only – it does not reflect the full return that the assets are expected to yield (some of which will be impounded in the capital value / share price). It also takes no account of the relative risks associated with the investments
- The analysis assumes that the sale proceeds are used to repay debt, and are based on scenarios (option 1) outlined in section 4



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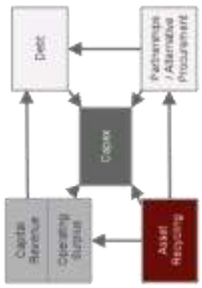

Asset Recycling - observations

- As we have reviewed AC's assets our discussions with AC management have highlighted a number of practices on which we make the following observations – there is:
- **No systematic opportunity cost analysis** applied to assets despite AC's capital constraints. The decision to retain ownership of an asset should consider the alternative use of the capital involved. For example, in a capital constrained world, a decision to own Asset X is actually a decision to own Asset X in preference to spending the capital on Project Y. An analogy is to start from a premise that Council has the cash and does not hold either Asset X or Project Y. On which opportunity would Council choose to spend the money on?
- **Limited rigorous testing of ownership / control imperative** - we consider a decision process as set out on page 6 should be followed when assessing Council's rationale for ownership of assets (particularly commercial assets)
- **No systematic cost of capital analysis** applied to investment / ownership decisions and when there is, it typically uses AC's borrowing rate as the hurdle rate:
  - This (unjustifiably) favours retention of higher yielding assets (as to sell to repay debt results in a cash shortfall) but takes no account of the associated risk
  - In corporate finance terms is incorrect - AC's assets are not funded 100% by debt. Of AC's $42 billion of assets, only $7 billion is debt funded and the remainder of the balance sheet is ratepayers equity. We believe ratepayers should be receiving a better return on their equity than AC's borrowing rate, i.e. investment in assets that provide a return that includes a delivery of services and outcomes that enhance the liveability of Auckland
- **A focus on capital solutions rather than solutions that increase expenses** (e.g. ownership vs leasing) due to close scrutiny of expenses and the lack of application of a 'cost of capital'
- **Strong incentive to not sell assets at Ward level** because proceeds from the sale of community assets at Ward level are typically returned to the general AC coffers
- All other things equal these factors create a bias towards asset ownership, 'inefficient' use of capital and difficulties identifying and implementing asset recycling financing options

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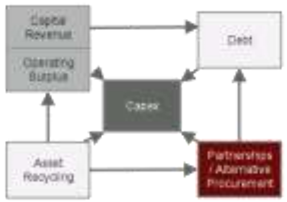
Observations and Conclusions



Partnerships / Alternative Procurement

PPPs

- All projects are capable of being procured through traditional means. However, there is evidence to suggest that project outcomes (especially for large infrastructure assets) and risks can be enhanced by procuring via PPPs. The choice of procurement model is driven by the following factors: whole-of-life value for money (relative to the public sector comparator); service quality; risk transfer and budgeting certainty / flexibility

- PPPs are not a funding solution. A project:
  - Without external cash flows will require public sector funding
  - With external cash flows may be capable of attracting funding from other sources

- Because, all things equal funding sources don't change, PPPs don't create financing capacity. However, PPPs do potentially offer financing flexibility:
  - AC can effectively 'lock in' payment streams that provide budget certainty (over the term of the contract)
  - Very long term financing can effectively be accessed
  - Cash flows can be manipulated to best suit AC requirements (e.g. weighted to the end of the contract term)

Outsourcing

- Compared to similar sized expenditure the extent to which AC's internal operations (e.g. IT, fleet, printing etc.) are outsourced seems low

- The methods of outsourcing are case-specific. However, general market experience suggests there is potential to monetise assets associated with these functions and have cost-savings offset any negative funding implications

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Executive Summary

Summary and observations on financing options

	Funding Impact	Financing Available	
Debt			• AC currently has very limited additional debt capacity • There are options to increase additional debt capacity, in order - accept lower debt headroom; renegotiate LGFA covenants; accept a lower credit rating; amend the TMP Borrowing Policy • AC will need to bear the consequences of any increased debt including fully funding it and (within reasonable bounds) marginally higher pricing, higher financial risks and negative reaction from existing investors

Infrastructure Assets			• Infrastructure Assets typically have no alternate use and, for a range of reasons, limited capacity to generate a commercial return
			• Key funding / financing issues include:
			  ◦ Develop processes to identify and rigorously test the need for surplus land
			  ◦ Actively consider these assets for PPP arrangements given potential procurement benefits
			  ◦ Develop and test options for outsourcing asset management decisions and risks with the objective of reducing the 10 year capex path of $13.5 billion by introducing a commercial imperative and developing benefit-sharing models

Community Assets			• Community Assets are mostly non income generating so a sale has no funding consequences
			• Potentially very large proceeds available suggesting processes should be established:
			  ◦ Develop a central register of Community Assets that compares the value and use of Community Assets to their value in alternative use
			  ◦ Incorporate into Council processes periodic reviews of delivery of community services to see if aggregate cost (including cost of capital deployed) can be reduced
			  ◦ Identify individual situations where the value in alternative use is significant and determine whether the current arrangements or alternative arrangements would be a better balance of Councils obligations to the current users of the facility and to wider Auckland
			  ◦ Develop appropriate incentive arrangements with local boards whereby local boards share in any savings achieved by changes to service delivery and the release of capital where the total cost of delivery (including capital cost) is reduced

Commercial Assets			• Commercial Assets in particular require a specific assessment of the ownership / control imperative and alternatives • If sold to repay debt, Commercial Assets generating a yield in excess of the AC debt rate will create a short-term funding requirement
PPPs			• PPPs are not a funding solution. Because, all things equal funding sources don't change under a PPP - PPPs don't create financing capacity. However, they can provide financing flexibility (term, payment profile, etc.) • In addition PPPs can provide significant procurement benefits (whole-of-life value for money (relative to the public sector comparator); service quality; risk transfer and budgeting certainty / flexibility etc.)
Outsourcing			• Compared to similar sized organisations the extent to which AC's internal operations (e.g. IT, fleet, printing etc.) are outsourced seems low. The methods of outsourcing are case-specific. However, general market experience suggests there is potential to monetise assets associated with these functions and have cost-saving offset any negative funding implications

Low
High

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Attachment A **Item 15**

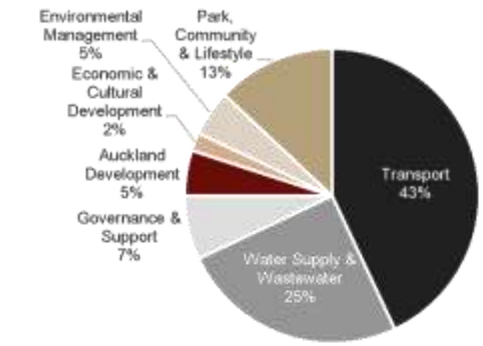
1. Introduction

1. Introduction, Scope & Layout

Introduction

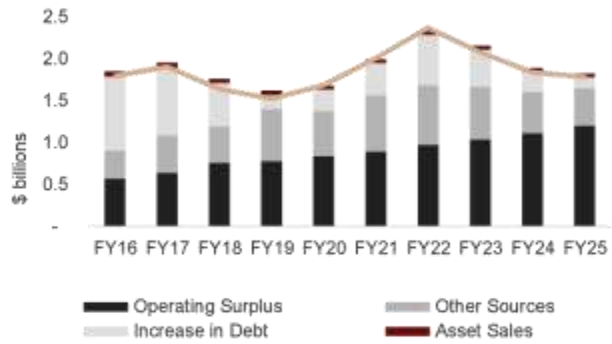
- Over the next 30 years the population in Auckland is forecast to increase by ~50% or ~750,000 people. Effectively it will add the population of Hamilton every 5-6 years. To meet this growth AC must make significant infrastructure investment on a timely basis
- Every three years New Zealand Local Authorities are required to adopt a LTP based on a balanced budget approach to their projected capital expenditure and funding requirements for 10 years. AC has recently finalised its 2015-2025 LTP. Among other things the LTP sets out:
  - A detailed capex plan (totalling $18.7 billion over the ten year forecast period)
  - A plan for how this capex will be funded and financed
- Notwithstanding the significant capex plan funding constraints have excluded a number of projects from the LTP. By value the majority of these are infrastructure related, including Penlink ($0.6 billion) and Light Rail ($1 billion+)
- Accordingly Council wishes to investigate its ability to change the capex plan and potentially accommodate various new projects or deliver existing projects to an earlier time frame through a review of alternative financing sources

AC Capex Uses 2015 – 2025 LTP



Source: Auckland Council

AC Funding Sources 2015 – 2025 LTP



Source: Auckland Council

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Attachment A

Item 15

1. Introduction, Scope & Layout

Scope & layout of report

Scope

- Cameron Partners has been engaged by Council to undertake a review of its alternative sources of financing. The scope of Cameron Partners' engagement includes:
  - Identification and assessment of AC's financing alternatives - debt-like arrangements, equity-like arrangements, and changes to procurement and business models
  - Undertaking analysis to understand the implications of what a change to any, or all, of the above alternatives would result in for AC's funding requirements
  - Engagement with AC management and Council Controlled Organisation (CCO) representatives regarding matters of financing
  - Engagement with Council to assist its understanding of funding issues
  - Preparation and presentation of a comprehensive report on AC's alternative sources of financing, including observations and conclusions

Layout

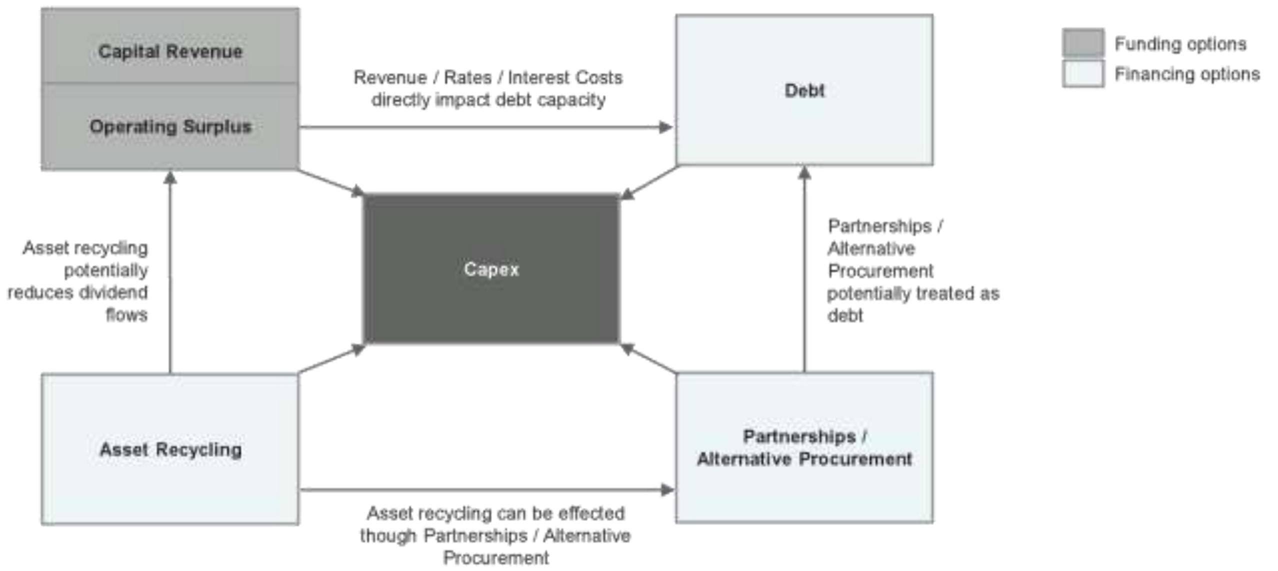
- This report contains Cameron Partners review of AC's alternative sources of financing
- The report is set out as follows:
  - Section 1 Introduction
  - Section 2 Background & Approach provides some overarching commentary on choosing financing options
  - Section 3 Debt
  - Section 4 Asset Recycling
  - Section 5 Partnerships / Alternative Procurement
  - Section 6 Observations & Conclusions

2. Background & Approach

2. Background & Approach

Four budgeting 'levers'

- Local Authority capital budgeting is an iterative process – Council must make judgements about which capital projects it will undertake and how it will fund and finance the projects:
  - Funding is how the project will ultimately be paid for
  - Financing is the way in which the money is raised to undertake the project
- There are four broad inter-related levers available to AC to fund and finance its LTP
- Cameron Partners focus is on the financing options



Source: Cameron Partners

2. Background & Approach

Key funding and financing principles

- By definition a 'balanced budget' LTP represents an optimum for the current Council requiring a number of explicit and implicit trade-offs:
  - Funding will be the maximum that it considers acceptable
  - The costs of providing AC services will be covered
  - Financing sources (debt, asset recycling, partnerships / alternative procurement) will have been considered
  - The capex plan will be what can be afforded within these constraints
- To undertake more capex within the funding constraint (i.e. AC's currently approved revenues and cost structure), AC has limited options:
  - If a capex project can self fund (either directly or indirectly through targeted rates) then it will be possible to raise financing that does not require additional AC funding. In those cases where a project cannot cover its cost of capital AC will need to fund any shortfall
  - Selling non-income generating assets into a higher use also does not necessarily create a funding requirement (as no return must be replaced)
  - Increasing debt (which has a financing cost and principal sum requiring repayment) or selling assets that generate a return both create a funding requirement
- All financing options have drawbacks:
  - External third party finance has a cost – i.e. the providers of capital require a return on that capital whether the obligation to provide the return is fixed (as in debt), at risk (as in equity) or is structured via a partnership approach (e.g. in regard to timing of the delivery of returns)
  - Internal options that convert an asset into cash / another use, lose the benefits of that asset (e.g. public benefits; commercial returns) – effectively there is an opportunity cost of owning one asset over another
- There is no 'free lunch' – to receive the benefits of a project (public benefits and/or commercial returns) AC will need to choose between the costs of the financing option or losing the benefits of a recycled asset. Ultimately, Council will have to choose between two states of the world:
  - The status quo – i.e. no change to current financing arrangements or asset ownership but the project is not undertaken; or
  - The financing option is engaged (with the associated consequences) and the project goes ahead

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2. Background & Approach

Approach to the review of alternative sources of financing

AC Meetings

Information Gathering

Research

Analysis

Debt (Section 3)
Involves all debt arrangements including sale and leasebacks, finance leases and potentially partnership / alternative procurement arrangements (which are treated as debt)

Asset Recycling (Section 4)
Effectively involves accessing value held in assets through some level of sale (partial or full) of selected business activities, investments or other assets. We classify AC's assets into three categories – infrastructure, community and commercial

Partnerships / Alternative Procurement (Section 5)
Covers a range of models for managing the delivery of current and future projects including PPPs and outsourcing

- *What is AC's current position?*
- *What are the key issues / constraints under this option?*
- *What are AC's choices to provide finance under this option?*
- *What are some examples under this option?*
- *What is the impact on AC's funding position?*

Observations & Conclusions

(Section 6)

Source: Cameron Partners

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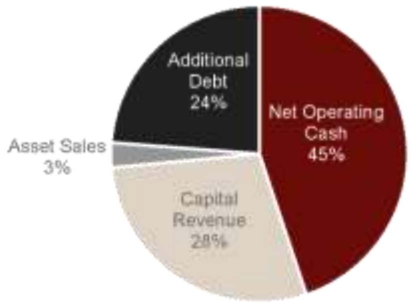
3. Debt

3. Debt

AC debt

- Debt financing is forecast to provide a significant component of AC's cash requirements over the LTP forecast period
- Capital expenditure requirements of ~$18.7 billion over ten years are forecast to be met through net operating cash ~$8.3 billion; capital revenue $5.3 billion; asset sales $0.5 billion and additional debt $4.4 billion with total debt rising to ~$11.6 billion in 2025
- AC debt typically comprises financing provided by banks, financial institutions and investors in AC bonds and commercial paper. However, it also potentially includes less standard arrangements, such as the sale and leaseback of assets whereby AC retains use of the asset and must make long-term lease payments. Such arrangements are effectively debt and treated as such for accounting purposes and calculation of borrowing limits

LTP 10 Year Capex Financing Sources



Source: Auckland Council

- AC's debt is:
  - Governed by its TMP which sets out AC's policies on how it will manage its borrowings and other liabilities, including interest rate exposure, liquidity, credit exposure and debt repayment. Among other things the TMP sets out:
    - AC's prudential borrowing limits
    - Liability management objectives including to "maintain a credit rating of at least 'A+' from Standard & Poor's"
  - Borrowed from domestic and offshore sources in local and foreign currency – including the LGFA, the Crown, wholesale and retail investors
  - Secured by rates under a debenture trust deed
  - Currently rated long-term 'AA' by Standard & Poor's (S&P) and 'Aa2' by Moody's
  - Ultimately constrained by a combination of its lenders' policies (specifically the LGFA's lending policies); AC's internal prudential borrowing limits and AC's objective to maintain an 'A+' long-term S&P credit rating

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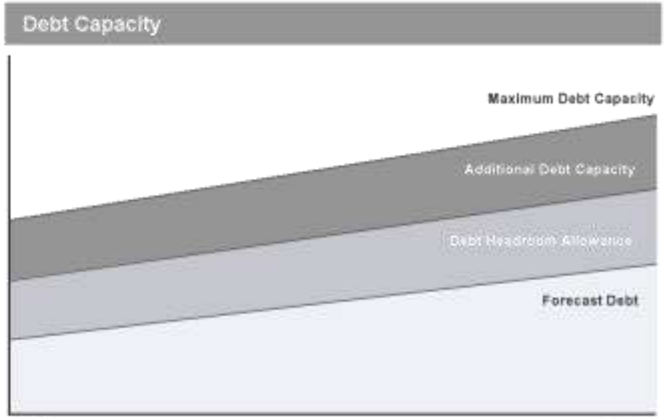
3. Debt

Calculation of additional debt capacity

- Debt is the most flexible form of financing available to AC – it can:
  - Be used to fund long-term core requirements and to achieve inter-generational objectives
  - Assuming sufficient capacity, be used at short notice to meet unexpected financial events - including general variance from forecasts, emergency funding as a result of external shocks and to take advantage of 'valuable' investment opportunities
- AC's actual additional debt capacity (if any) is the difference between AC's maximum debt capacity and its forecast debt levels plus AC's debt headroom allowance
- **Maximum Debt Capacity** - AC's maximum debt capacity is ultimately constrained by a combination of its lenders' policies (specifically the LGFA's lending policies as other lenders do not explicitly impose but instead implicitly benefit from them); AC's internal prudential borrowing limits contained in its TMP and AC's objective to maintain a 'A+' long-term S&P credit rating (or higher)



Source: Cameron Partners

- **Forecast Debt** – As per LTP subject to variance (due to unexpected events and plan changes)
- **Debt Headroom** - Given the flexibility of debt, it is appropriate for AC to maintain some surplus debt capacity / debt headroom as part of AC's overall financial flexibility for unexpected financial events and potential decisions to make unfunded changes to its plans. The appropriate level of 'headroom' requires an assessment of:
  - Unexpected variance from AC's BAU forecasts, which based on our understanding from AC is likely to be small (e.g. rates revenue, other charges and operating costs are quite predictable) and in many cases (e.g. New Zealand Transport Agency (NZTA) contributions; development contributions and capex) can be 'managed' to some extent
  - Unexpected non-BAU events (e.g. natural disasters; unforeseen investment opportunities; crystallised contingent liabilities)
  - Other forms of financial flexibility that may be available to AC at short notice including cash, liquid assets (such as the DFAP if genuinely for sale) and insurance

Our discussions with AC management suggest $0.5 - $1.0 billion of debt headroom is being maintained

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Item 15

3. Debt

Maximum debt capacity

- The limits imposed by the LGFA, AC and S&P (outlined in the table below and in the following slides) all vary, making direct comparison difficult – for example:
  - The financial covenants, while on the face of it similar, in all cases are defined differently
  - The LGFA financial covenants are applied to AC only (i.e. the 'parent' entity in accounting terms), S&P analysis is based on the AC Group (i.e. the consolidated group in accounting terms) and AC's prudential limits are applied to a 'hybrid' position under which Watercare and POAL is excluded from the calculation of debt for the AC Group. The application of financial covenants across the group has the effect of limiting the scope for AC to receive any overall debt capacity benefits from raising debt at the council level vs raising debt in CCOs (and making cash distributions to AC)
- Historically AC has operated a decentralised funding model under which its various CCOs have borrowed directly without explicit support from AC. While these entities have benefited from AC's ownership 'halo' their borrowing terms and conditions have been inferior to AC. More recently in order to improve the overall AC Group's borrowing efficiency AC has changed its policy to borrow on behalf of, and then on lend to these CCOs. While this has no impact on the AC Consolidated Group debt position – it does 'inflate' the AC Parent debt position (with potential consequences for AC's compliance with the LGFA lending criteria)

LGFA Shareholders' Agreement	AC TMP	S&P Methodology
Council only, not consolidated group	**Consolidated group excluding Watercare & POAL**	**Consolidated group**
Net debt / total revenue <250% Net interest / total revenue <20% Net interest / annual rates income <30% Liquidity >110%	Net debt / total revenue < 275% Net interest / total revenue < 15% Net interest / annual rates income (debt secured under debenture) < 25% Liquidity (cash and liquid investments plus headroom under committed funding facilities to equal at least 6 months forecast net cash outflow including maturing debt on a rolling basis)	S&P's methodology assesses seven factors: Economy, Financial Management, Budgetary Flexibility, Budgetary Performance, Liquidity, Debt Burden, Contingent Liabilities Two the debt related ratios are calculated and contribute to the overall assessment: • Tax supported debt / consolidated operating revenues • Interest as % of operating revenues S&P commented in its latest rating report *"Downward rating pressure might arise if Auckland's debt increases to more than 270% of operating revenues…"*

Source: LGFA Shareholders' Agreement, Auckland Council, S&P's Methodology for Rating Non-US Local and Regional Governments

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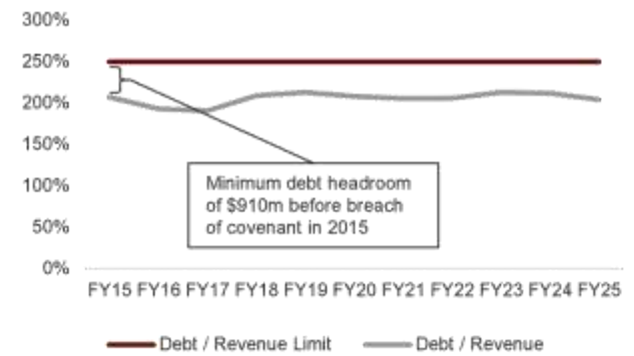
3. Debt

Maximum debt - LGFA financial covenants

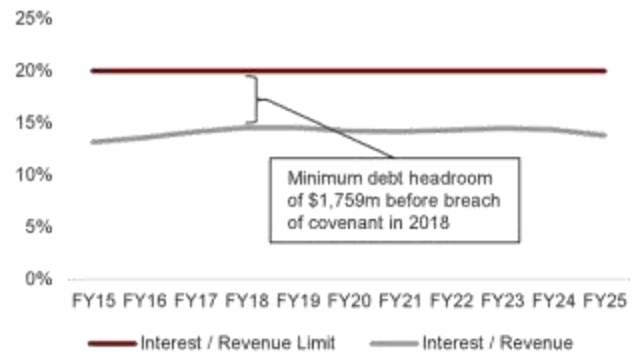
- AC's borrowing arrangements with the LGFA are subject to the following financial covenants which are measured on the AC parent position only. The constraint over the forecast period is the net debt / total revenue < 250% ratio
- AC is limited to its borrowings comprising <40% of the LGFA's total local government assets
- AC can apply for bespoke financial covenants that exceed the covenants shown with the approval of an ordinary resolution of LGFA shareholders
- In the event that AC is unrated or its credit rating drops below 'A', it may be required to comply with stricter LGFA covenants

Net Debt / Total Revenue – LGFA Limit 250%



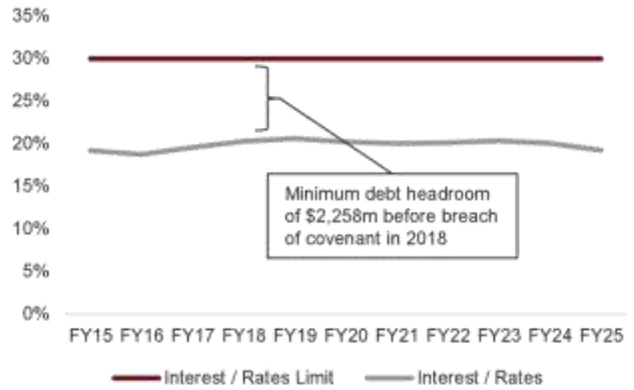
Source: LGFA Shareholders' Agreement, Auckland Council

Net Interest / Total Revenue – LGFA Limit 20%



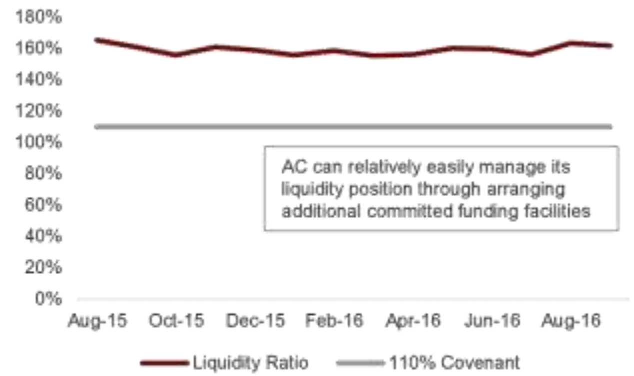
Source: LGFA Shareholders' Agreement, Auckland Council

Net Interest / Rates Income – LGFA Limit 30%



Source: LGFA Shareholders' Agreement, Auckland Council

Liquidity – LGFA Minimum of 110% of External Borrowing



Source: LGFA Shareholders' Agreement, Auckland Council

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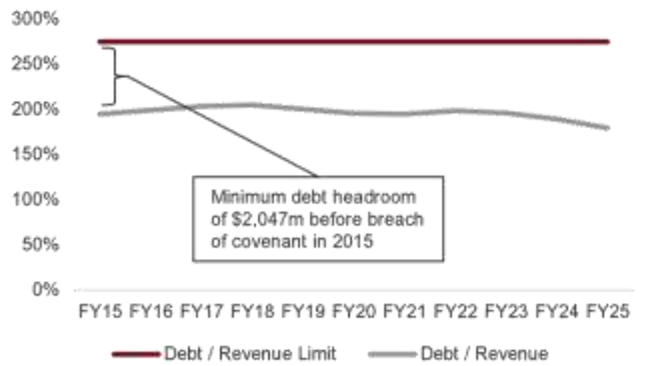
3. Debt

Maximum debt - AC financial covenants

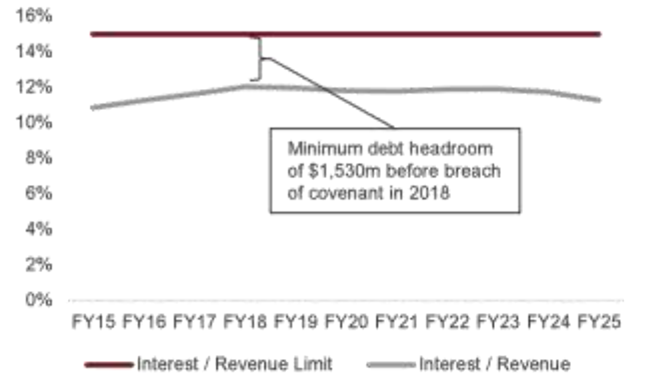
- AC's borrowing limits are contained in its TMP and include the following financial covenants which are measured on the AC Group position excluding Watercare & POAL
- The constraint provided by the AC prudential limits over the forecast period is the net interest / rates income < 25% ratio

Net Debt / Total Revenue – AC Limit 275%



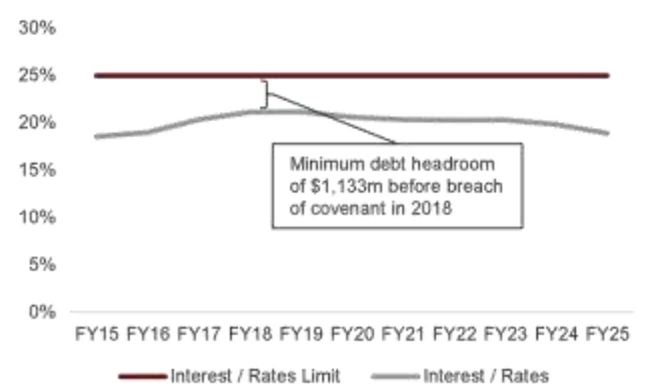
Source: Auckland Council

Net Interest / Total Revenue – AC Limit 15%



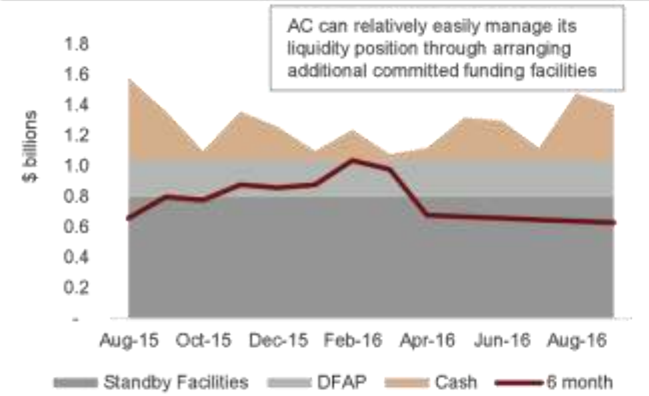
Source: Auckland Council

Net Interest / Rates Income – AC Limit 25%



Source: Auckland Council

Liquidity – AC Minimum 6 Month Borrowing Requirement



Source: Auckland Council

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3. Debt

Maximum debt - S&P

- S&P has a standardised methodology it uses to assign Credit Ratings to Local and Regional Government Authorities globally (S&P's 'Methodology for Rating International Local and Regional Governments' dated 20 September 2010 and updated 24 November 2014). This methodology assesses a number of factors, including the:
  - National institutional framework (the same for all entities at the same level of Government within a country i.e. state level or municipal level)
  - Profile of the individual entity including an assessment of:
    - Economy
    - Financial Management
    - Budgetary Flexibility / Budgetary Performance
    - Liquidity / Debt Burden
    - Contingent Liabilities
- S&P's methodology:
  - Places significant weight on New Zealand's Institutional Framework, which it considers to be "one of the best in the world". This results in all New Zealand Local Authorities currently rated being assessed as having high credit quality
  - Limits the impact of changes in any one factor. As a result, within reasonable bounds, a significant change in debt levels will only have a limited impact on the overall Credit Rating
- Given S&P's methodology, under reasonable scenarios we consider it unlikely that AC's credit rating would be downgraded below 'AA':
  - As outlined, financial metrics are only one consideration by S&P, given its strong view of the New Zealand institutional framework and use of more qualitative measures in the individual entity assessment
  - All other things equal, AC LTP forecasts would not lead to a rating downgrade
  - S&P commentary suggests that based on recent information AC's credit rating is likely to remain at 'AA' – however, *"Downward rating pressure might arise if Auckland's debt increases to more than 270% of operating revenues as the council borrows to invest in infrastructure or if its operating position weakens because of lower-than-expected revenue. This would reflect further deterioration in Auckland's budgetary performance with sustained after-capital account deficits of about 23% of total revenues"*
- The debt / operating revenues < 270% ratio implies an additional debt capacity constraint of $1.6 billion in 2016

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Attachment A

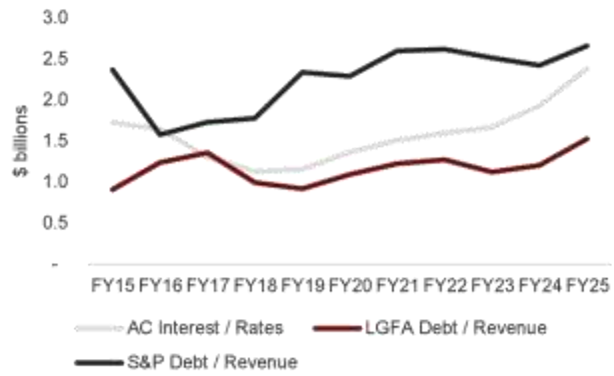
Item 15

3. Debt

Actual AC additional debt capacity

- Based on our analysis AC maximum debt is primarily constrained by the LGFA Debt / Revenue ratio <250%
- This suggests surplus additional debt capacity of ~$1 billion exists although this takes no account of AC's wishes to retain debt headroom as a form of financial flexibility
- We note that the calculation of the LGFA covenant is based on AC's interpretation of the LGFA calculations (which excludes Watercare and POAL debt from the calculation, even when AC expects to borrow and on-lend capital to Watercare and POAL)
- This appears to be inconsistent with the way the ratio would be calculated for other councils where water services and water charges are retained within the core council. It highlights a 'grey' area in the LGFA's measurement of council's debt levels. All things equal if AC included Watercare and POAL in its debt calculations then it would have significantly less debt capacity at times over the LTP
- We note that AC's own TMP Net Interest / Rates <15% is the constraint on maximum debt levels in 2017. This ratio is sensitive to movements in interest rates and technically a movement in interest rates of slightly over 1% would see virtually all additional debt capacity used up. In practice AC has a hedging policy which has 'fixed' the majority of its interest rate exposure over the next 3-4 years so that the risk of interest rate movements is significantly reduced. Notwithstanding this is a consideration in later years where lower levels of interest rate hedging are in place

AC / AC Group (as applicable) Additional Debt Capacity



Source: Cameron Partners, Auckland Council

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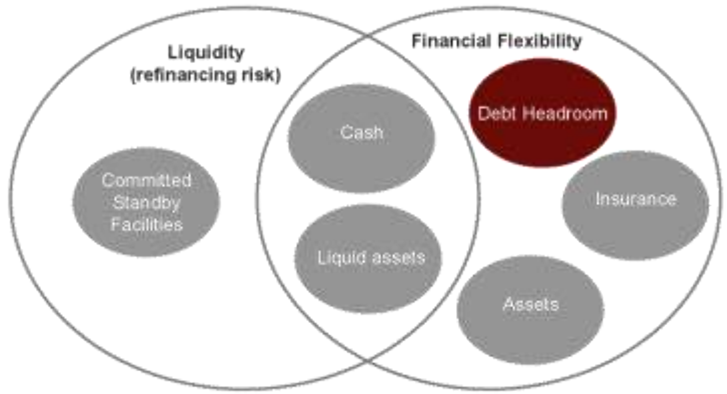
3. Debt

Options to increase additional debt capacity

- The AC 2015 – 2025 LTP states *"Aucklanders…have no appetite for large increases in rates or council debt"*. Notwithstanding there are options to increase AC's additional debt capacity albeit that the decision to implement these will require an assessment of:
  - The consequences and judgements about the appropriateness of doing so
  - The challenges involved (e.g. approval from the LGFA would be required)
- There is a natural order that emerges for AC if it wishes to increase its additional debt capacity:
  1. Rely on other forms of financial flexibility and reduce the level of debt headroom that AC needs to hold so that it can access more of any unused debt capacity
  2. Renegotiate the LGFA covenants
  3. Amend AC own prudential limits contained in its TMP
  4. Accept a credit rating downgrade and the consequences of such a downgrade

Other Forms of Financial Flexibility

- As outlined AC wishes to retain financial flexibility for a number of reasons – including potential variance from BAU forecasts; unexpected non-BAU events and for decisions to make unfunded changes to the existing plan
- Debt headroom is one of the options that AC has to maintain financial flexibility. Debt is particularly useful to meet short-term requirements (other sources of material funding and financing – increases in rates / user charges and other financing alternatives (e.g. asset 'optimisation') are of limited use due to the lead times required for approval and transaction costs and potential value implications of a 'speedy' sale
- We note that 'headroom' differs from 'liquidity requirements' which refers to refinancing risk only. Both are met from a combination of sources including committed debt facilities



Source: Cameron Partners

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Attachment A

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3. Debt

Options to increase additional debt capacity (cont.)

LGFA

- LGFA lending criteria currently sets the 'hard' limit on AC debt capacity (Net Debt / Total Revenue < 250%)
- The LGFA lending criteria is set in the LGFA Shareholders Agreement and any amendment to the policies for AC would require ordinary resolution of LGFA shareholders. LGFA has 31 Local Authority Shareholders including a 20% stake held by the Crown
- While there is no precedent for bespoke limits we consider that there are strong arguments to support different financial covenants for large high growth councils (such as AC) versus small low growth councils. Notwithstanding we also note that restating AC position to bring it in line with the majority of councils, which include water as part of the core council, suggests that AC is at the upper end of LGFA debt constraints already
- Alternatively AC could refinance and repay all the LGFA debt and borrow from other sources although we note this would be a significant and unusual step

S&P

- As AC's debt rises above 270% of operating revenues there is a significantly increased likelihood of rating downgrade below the current 'AA' rating
- As a credit rating declines typically the risk of default increases; pricing (debt margins) increases and the appetite from investors decreases (albeit marginally within reasonable bounds)
- To put the impact of a rating downgrade in context we note the following:
  - At 'AA' AC is only one rating notch lower than the New Zealand Government and LGFA (New Zealand's highest rated entities)
  - A long-term issuer with a credit rating of 'AA' is described by S&P as having very strong capacity to meet its financial commitments. It differs from the highest-rated obligors (rated AAA) only to a small degree
  - There are 20 rated local authorities in New Zealand (see Appendix 1) - 10 Rated 'AA', 5 Rated 'AA-'; 5 Rated 'A+'
  - Pricing will increase: e.g. the LGFA increases its margin by 0.05% for 'AA-', 0.10% for 'A' rated and below and 0.20% for unrated. Market pricing will increase more significantly as a rating decreases
  - When selling its rated bonds AC could be considered to have made an implicit 'promise' to investors to maintain the current credit rating (when a rating decreases and pricing increases this has the effect of reducing the issued bonds value). A deliberate move by AC to increase debt to levels that result in a rating downgrade may receive some negative reaction from investors

Amend AC's TMP / internal policies

- Any amendments to the LGFA covenants and decision to accept a rating downgrade will necessarily require internal approvals and amendment of internal policies

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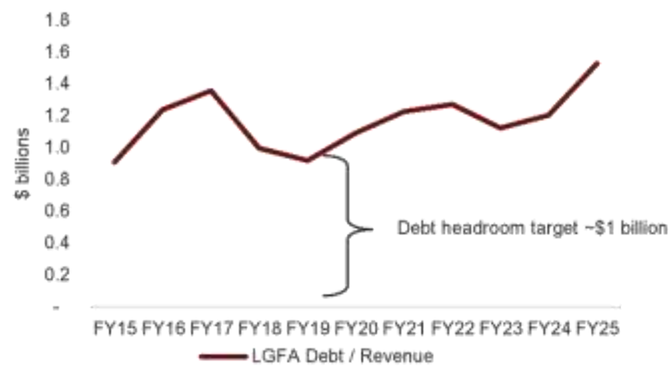
3. Debt

Conclusions

- Under existing assumptions and constraints there appears to be virtually zero additional debt capacity
- The LGFA net debt / revenue covenant indicates minimum debt capacity of ~$1 billion which approximates the level of debt headroom targeted by AC Treasury
- Using a more conservative application of the LGFA net debt / revenue covenant would indicate minimum debt capacity of even lower levels
- There are options to increase additional debt capacity:
  - Accept lower debt headroom
  - Renegotiate LGFA covenants
  - Accept a lower credit rating
  - Amend the TMP Borrowing Policy

AC / AC Group (as applicable) Additional Debt Capacity



Source: Cameron Partners

- It should be noted that in the event that additional debt capacity is created and used, AC will:
  - Need to fund the increased debt
  - Bear the consequences of the increased debt including (within reasonable bounds) marginally higher pricing, higher financial risks and negative reaction from existing investors

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Item 15

4. Asset Recycling

4. Asset Recycling

Approach to asset recycling

- Asset recycling effectively involves accessing value held in assets through some level of sale (partial or full) of selected business activities, investments or other assets
- The size and complexity of the AC Group balance sheet makes it impractical for us to analyse every asset, project and arrangement. Accordingly we classify AC's assets into three categories to assist with isolating the financing issues – infrastructure, community and commercial

Non Commercial

1. Infrastructure
- Large scale / asset intensive / networks
- Core essential services
- Complex and long term investment / capital budgeting decisions
- No alternative use

2. Community
- Support the provision of community services
- Higher number, relatively low individual value
- Not typically run as businesses
- Potentially higher value in alternative use

3. Commercial
- Commercial businesses
- Generate external revenues / return
- Activity would be provided without AC ownership

- Our intention is to provide Council with a set of broad options with considerations and examples of each. This approach will allow Council to review and (if appropriate) prioritise certain identified areas for deeper investigation. All analysis is necessarily high level. In particular, valuations should be regarded as broadly indicative only
- We note that our engagement is in regard to assessing alternative financing options. This is a different concept from "optimising AC's balance sheet":
  - We consider the assessment of financing options is a relative test. It involves an assessment of the best (or least worst) financing option in relation to a project and then an assessment of whether the costs of the preferred financing option are outweighed by the benefits of the project being financed. Failing this, the status quo prevails
  - Optimising the balance sheet, by contrast, is an absolute test. It seeks to answer the question "what should AC own". It does not require Council to be seeking to finance something and does not assume the status quo will or should otherwise be maintained. The decision to exit certain assets or services is not related to financing a new project
  - As noted, our engagement is in regard to financing options. Therefore, our focus is on laying out options and considerations for Council to determine which financing options it would like to prioritise in the event that further financing is sought. We do not make absolute commentary on whether AC should or should not own certain assets

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4. Asset Recycling

AC assets

- AC records a total of $42 billion in assets in its financial statements. These assets are categorised into four major groups:
  - Infrastructure - $25.8 billion
  - Restricted - $5.0 billion
  - Operational – $7.1 billion
  - Investments – $1.8 billion
- **Infrastructure** comprises the fundamental networks necessary for a city to function, such as roads, water, wastewater and stormwater systems
- **Restricted** consists of regional parks, urban parks and sport facilities. Restricted land refers to land held under the Reserves Act
- **Operational** encompasses commercial office buildings required for AC staff, community facilities, and public transport structures, such as bus shelters and train stations
- **Investments** include the legacy shares in AIAL, investment property and other financial assets, including the DFAP

AC Asset Classification	$ millions[1]
Infrastructure	
Roads	7,960
Water and wastewater	6,871
Machinery	944
Stormwater	4,149
Land & Other	5,892
Total Infrastructure	25,816
Restricted	
Parks, reserves and buildings	4,160
Improvements	805
Total Restricted	4,965
Operational	
Land and buildings	5,126
Marina structures, wharves and rolling stock	879
Art, cultural and heritage	418
Other operational	493
Total Operational	6,916
Investments	
Investment Property	560
Investment in Associates & Joint Ventures	890
Other financial assets	461
Total Investments	1,911
Other (Intangibles, WIP, Derivatives, etc.)	2,559
Total	**42,167**

[1]The values reflect the FY15 AC balance sheet
Source: Auckland Council

CAMERON PARTNERS

4. Asset Recycling

Cameron Partners asset classification

- To assist our analysis we have reclassified assets into slightly different categories which help isolate key financing issues
- Core infrastructure assets include: stormwater, water, waste water and transport assets (including roads and public transport facilities) and land held for these purposes. These account for nearly 70% of AC's assets ($28.6 billion)
- Commercial assets include: AIAL shares, POAL, the DFAP, commercial parking, commercial marinas, and housing - with a book value of $2.8 billion
- Community assets include: parks, sports facilities, community facilities, stadium, libraries, community centres, the Zoo, the Art Gallery, event centres and the town hall – these have a book value of $7.6 billion
- There is a group of residual assets. Within this grouping, we have identified assets that could be considered for outsourcing. These include: IT, vehicle fleet, and printing activities and assets, as well as commercial offices

Cameron Partners Asset Classification	$ millions[1]
Infrastructure Assets	
AT (excl. Commercial Parking)	16,017
Watercare	8,446
Stormwater	4,149
Total Infrastructure Assets	28,612
Community Assets	
Regional Parks	4,904
Other Community Assets	2,683
Total Community Assets	7,588
Commercial Assets	
AIAL	870
POAL	778
Commercial Parking[2]	506
DFAP	328
HfOP	200
PDAM	80
Total Commercial Assets	2,761
Other Assets	3,206
Total	**42,167**

[1]The values reflect the FY15 AC balance sheet
[2]Includes land & buildings of all parking. Downtown, Victoria and Fanshawe carpark buildings account for $153 million

Source: Auckland Council

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4. Asset Recycling

4.1 Infrastructure Assets

4.1 Infrastructure Assets

Infrastructure Assets comprise 70% of AC assets

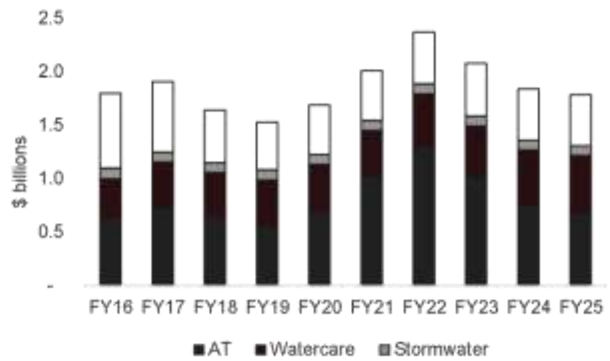
- Core infrastructure assets across AT, Watercare and Stormwater (Stormwater is held by AC directly) have a book value of $28.6 billion, or approximately 70% of total AC assets
- AT encompasses roads (incl. land underneath roads), wharves and public transport assets (incl. bus shelters, train stations and ferry buildings). We treat commercial parking as a commercial asset, hence the total value of $15.6 billion of AT infrastructure assets excludes the book value of commercial parking of $506 million
- We have excluded the value of AT and Watercare assets with potential to outsource ($114 million – IT and fleet). We discuss these in the section on Outsourcing
- We have separated out land identified by AT and Watercare as being not currently used but reserved for potential future use. We discuss these later in this section
- The chart on the right depicts the total forecast capex spend for AC, and highlights the share of forecast infrastructure spending. AC is forecasting to spend $13.5 billion on AT, Watercare and Stormwater infrastructure assets over the next 10 years. This expenditure accounts for c. 72% of total forecast capex. Even small % reductions in capex can equate to large $ savings – e.g. if AC was able to decrease this expenditure by 10%, this would free up $1.4 billion in capex flexibility over the ten year period

Infrastructure Assets

$ millions	AC	AT	Watercare	Total
AT		15,556		15,556
Watercare			8,438	8,438
Stomwater	4,149			4,149
Land held for future use		462	8	470
Total	4,143	16,017	8,446	28,612

Source: Auckland Council

Forecast Infrastructure Capex



Source: Auckland Council

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Item 15

4.1 Infrastructure Assets

Potential contribution to financing through revenue / cash flow mgmt

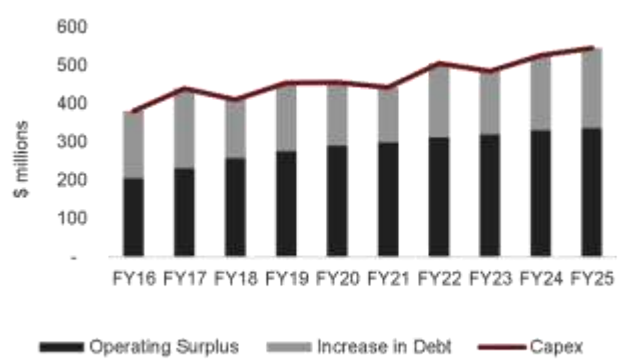
Income Statement / Cash flow Position

- In the absence of changes to policies regarding the capturing of external revenues from these assets, there is little scope for increased revenues to enhance AC funding:
  - Stormwater operations are fully funded by AC, other than vested assets and development contributions
  - AT net contribution (revenues other than AC / NZTA less expenses) is -$328 million
  - Watercare:
    - By legislation, is not able to pay a dividend. Accordingly it is run with the intention of not generating a long term cash surplus that could be returned to AC (with all cash reinvested in the business)
    - Is itself a capital constrained organisation with a capex envelope dictated by its ability to increase prices over the long term (see figure at right) – i.e. all operating surplus is spoken for
    - Not earning an appropriate return on assets (ROA) also raises issues regarding the allocation of scarce water resources through incorrect pricing and fairness between ratepayers and water users. We note that to earn an appropriate ROA (an increased surplus of at least $400 million), water prices would need to approximately double
- There may be scope for greater operational efficiency across AT, Watercare and Stormwater although that analysis is beyond the scope of this review. However, we note the following:
  - All three organisations already make extensive use of outsourcing in construction, maintenance and operations
  - Benchmarking data comparing the efficiency of these organisations to peer organisations will be readily available

AT Summary Income Statement	
FY15 ($ millions)	
Funding from AC and NZTA	767
Non-exchange transactions	290
Total Revenue	1,057
Expenses	619
EBITDA	439
Less: Funding from AC and NZTA	767
EBITDA (adjusted)	(328)

Source: Auckland Council

Watercare Plan 2016 - 2025



Source: Auckland Council

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4.1 Infrastructure Assets

Potential contribution to financing through balance sheet mgmt

- The ability to use the Infrastructure Asset elements of Stormwater, Watercare and AT to assist with financing include: Surplus Land; Asset financing; and Partnership arrangements (PPP and Outsourcing of asset management responsibilities)

Surplus Land

- All three organisations have substantial land assets used in their operational activities. However, both Watercare ($8 million*) and AT ($462 million) in particular also have significant land holdings purchased in anticipation of future requirements
- The natural incentive for these organisations is to take a very conservative view of their future land requirements. There should be robust processes (including external oversight) that periodically review these land holdings to determine the likelihood of the project going ahead and the potential highest value use of that land

Asset Financing

- Council may be able to identify assets that can be financed by external parties, e.g. sale and leaseback structure or similar (e.g. the electric rail fleet ~$400 million)
- However, infrastructure assets do not typically attract an external revenue source that supports their value:
  - Consequently, AC is the counterparty that must meet the financing cost and capital repayments. Accordingly any sale and leaseback structure of these assets is essentially just exchanging AC Group debt for an asset specific debt - no extra financing capacity is created
  - When some external revenues exist it may be possible to establish structures that ring fence these assets. However, to the extent that they still require / use up AC revenue then again this will effectively just replace AC finance with asset specific financing (although they may offer better flexibility)

Partnership Arrangements

- Major infrastructure asset projects are well suited for Partnership Arrangements such as PPPs. However, as outlined in Section 5, the major benefits of PPPs relate to procurement and not financing capacity

** This figure appears to be an anomaly as we are aware for example, that Watercare owns 2,200 ha of land currently in forestry use at Riverhead (reserved for a potential future dam) and still owns the land around the old Rosedale settling ponds adjacent to the Northern Motorway*

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4.1 Infrastructure Assets

Potential contribution to financing through balance sheet mgmt (cont.)

Outsourcing of Asset Management

- For a range of reasons, the infrastructure businesses do not operate in competitive markets and are not structured to run as profit-seeking or value-maximising organisations. In this situation, there is risk that asset management plans get weighted toward over-engineering in terms of capacity planning, technology, redundancy, maintenance and renewal. We have no evidence that this is the case. From what we observe, the processes that the AT and Watercare Boards and management go through in testing their asset and capex plans is very robust. Notwithstanding, as outlined in Section 5, there is evidence that supports savings (operational and capital) from outsource arrangements
- An example is the legacy arrangement Watercare has inherited in regard to the local water services of the Papakura district, where a third party (Veolia) has acquired the rights to operate this network and manage the asset. Veolia has the obligation to meet local growth requirements and maintain/renew the asset so as to maintain its quality and return the asset in equivalent condition at the end of the contract. Veolia has billing responsibility and retains the revenue from customers and pays Watercare a wholesale charge for water and wastewater:
  - The pricing structure has a ceiling at the price Watercare charges elsewhere in Auckland
  - The service agreement includes an obligation to maintain the asset quality through renewal capex as well as extension of the network as required
  - The agreement has an initial term of 30 years with one renewal of 20 years with regular performance monitoring
- There are shortcomings to the arrangement. For example, Watercare is unhappy with the transparency it has in regards to assessing asset quality and being able to compare KPIs with its own local network operations
- Nonetheless, we believe it would be worth further investigation to determine the ability to establish arrangements across civil infrastructure assets (AT, Watercare and Stormwater), to assess the merits of such and design the optimal contracting arrangements that would have the following characteristics:
  - Local groupings of assets are created
  - Arrangements are entered into with third parties (by way of a competitive process) where they take responsibility for local asset groups (similar to the Veolia obligations) and are required to maintain the asset quality and meet local growth
  - Arrangements are agreed with the party regarding the prices they have access to, or the revenue they receive ex AC/CCO
  - Either the expected benefits of the outsourcing are captured up front or arrangements are entered into where a default asset management plan is agreed and the parties share in any savings (both operational and capex) against that plan
  - AC (or the relevant CCO) manages the contracts and benchmarks performance and asset quality across the different local asset groups
- The objective is to use a commercial driver to encourage savings in the asset management plan without comprising the obligation to meet growth requirements or long term asset quality. We are unable to suggest what level of savings (if any) might be achieved from these arrangements (or whether they can be operationally implemented), but given the extend of forward looking capex, percentage savings do not need to be large to provide a high level of absolute savings

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4.1 Infrastructure Assets

Impact on financing and observations

- Infrastructure Assets can impact financing through:
  - Revenue / cash flow management although this is constrained by current policies
  - Balance sheet management potentially through:
    - Surplus land sales
    - Asset financing / PPPs although this would essentially be replacing AC debt with asset specific debt and not create additional financing capacity (albeit a potentially flexible source of financing)
    - Outsourcing can potentially lead to more efficient asset management plans (and operations) and given the scale of Infrastructure Asset investment requirements even small % savings could equate to large $ amounts

- In regard to Infrastructure Assets we observe the following:
  - Stronger processes (including external oversight) that periodically review land holdings not currently used in operations could highlight:
    - The likelihood of the project for which the land is reserved going ahead (and if so, over what timeframe and whether there is an interim higher value that could be captured)
    - Clear analysis of the potential highest value use of that land (which may well be different from the valuation basis used in the accounts)
  - Major projects in regard to core Infrastructure Assets are prime candidates for partnership arrangements such as PPPs that offer flexible financing arrangements and procurement benefits (see section 5 for further discussion on PPPs) and justify Council investigating partnership options in regard to these more thoroughly
  - The scale and nature of the markets that the Infrastructure Asset businesses operate in suggests there may be benefits from outsourcing. Consequently, further investigation would be justified to determine the ability to establish arrangements with the private sector across civil infrastructure assets (AT, Watercare and Stormwater) with the objective to introduce a commercial driver to asset planning encouraging savings in the asset management plan without compromising the obligation to meet growth requirements or long term asset quality

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Attachment A

Item 15

4. Asset Recycling

4.2 Community Assets

4.2 Community Assets

Introduction

- In this section we consider the use of Community Assets to provide financing
- The assets that fall under this grouping are shown in the tables on the right
  - The first table summarises the community assets
  - The second table provides a breakdown of the community facilities

Community Assets	
$ millions	
Large Regional Parks (land)	3,764
Community facilities	1,985
Other Regional Parks (land & buildings)	1,140
Other community assets (art, books, etc.)	452
Sport Stadium / Event Centre	185
Golf Courses	61
Total	7,588

Source: Auckland Council

Breakdown of Community Facilities	
$ millions	
Library	255
Club Rooms	144
Community Centres	262
Zoo	40
Town Hall	210
RFA Assets (Civic, Aotea, other)	96
Art Gallery	417
Commercial (Cafes at Libraries, etc.)	561
Total Community Facilities	1,985

Source: Auckland Council

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4.2 Community Assets

The financing opportunity

- Community Assets are characterised by the following financial characteristics
  - They are generally land and buildings
  - They are being used to provide a council service to the community
  - The service is not sufficiently commercial to be provided by the private sector
  - Provision of the service is often subsidised by Council. To the extent that contributions are received from community groups or users, these are usually applied to the operating expenses of providing the service, not to providing any return on the assets employed
- The financing opportunity exists in regard to these assets where:
  - There is a materially higher alternative use value for the land / buildings than is currently being recognised in their current use
  - Council's obligation to provide the service currently using the land / buildings could be met other than through the particular land and buildings being used; or the extent of the mismatch between current use and alternative use value is so great, the relative merits of continuing to provide the service should be tested
- The most likely higher value use is housing development
- Where these situations exist, there may be opportunities to either relocate the service to an alternative location (or in some cases cease providing the service) and release the underlying land / buildings to that higher value use. While the decision to relocate or cancel a service will never be easy, the advantages of this financing alternative are:
  - Implementation would facilitate the release of land for high density housing and / or retail / commercial development
  - In most circumstances, the underlying land and buildings are not earning any return (or more precisely, the particular assets we are interested in will be at best earning a return that is insignificant compared to the value of the land in alternative use). Therefore, while the decision to divest the land / buildings may have community impacts, it will not have any material funding impact as there is no material cash flow stream that is being foregone by selling the land
  - Indicative valuation work provided by AC Property suggests the potential value is very significant

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4.2 Community Assets

Examples of the scale of financing opportunities

- We are not able to offer many specific examples of where opportunities lie. The reason for this is that although property records exist for all Community Assets, their valuations are often based on value in use (i.e. as a park or community centre). There is no analysis of the potential value in alternative use. There is also no easy way to summarise the existing use arrangements, legal issues associated with ending these and AC's ability to monetise any Community Asset (especially where classified as a reserve)
- However, by way of example, AC Property has provided the following estimates:
  - The balance sheet value of AC's parks and reserves is in the order of $4.5 billion. A map of Auckland showing the number and range of parks and reserves is shown overleaf. Different colours denote different end uses
  - Inner-city parks are commonly valued at around $15 - $20 psm, whereas the land under surrounding houses would be valued at around $1000 psm
  - A market valuation of AC parks and reserves if available for housing could be as much as $45 billion rather than the current $4.5 billion carrying value
- Releasing as little as 5% of this could potentially release $2.25 billion to AC. An alternative to reducing total land held for this purpose is to release land in the higher value urban areas and acquire land in lower value areas
- Similarly, AC Property has provided the following information:
  - AC is the owner of 13 golf courses. They are listed on page 53. AC Property estimates the value of these assets in AC's balance sheet is in the order of $61 million
  - However, if the top four courses by market value (Remuera, Chamberlain Park, Pupuke and Takapuna) were made available for housing at the values of surrounding land (with 30% reserved for public spaces etc.), the estimated value obtainable is $1.4 billion. We do note however, that the courses are the subject of different lease arrangements which may prevent any monetisation opportunity in the near term
  - These valuations should encourage Council to review its obligations to providing inner city golf courses (especially those that have limited community access) or at lease consider whether its current portfolio is optimised given changes to the city since they were built

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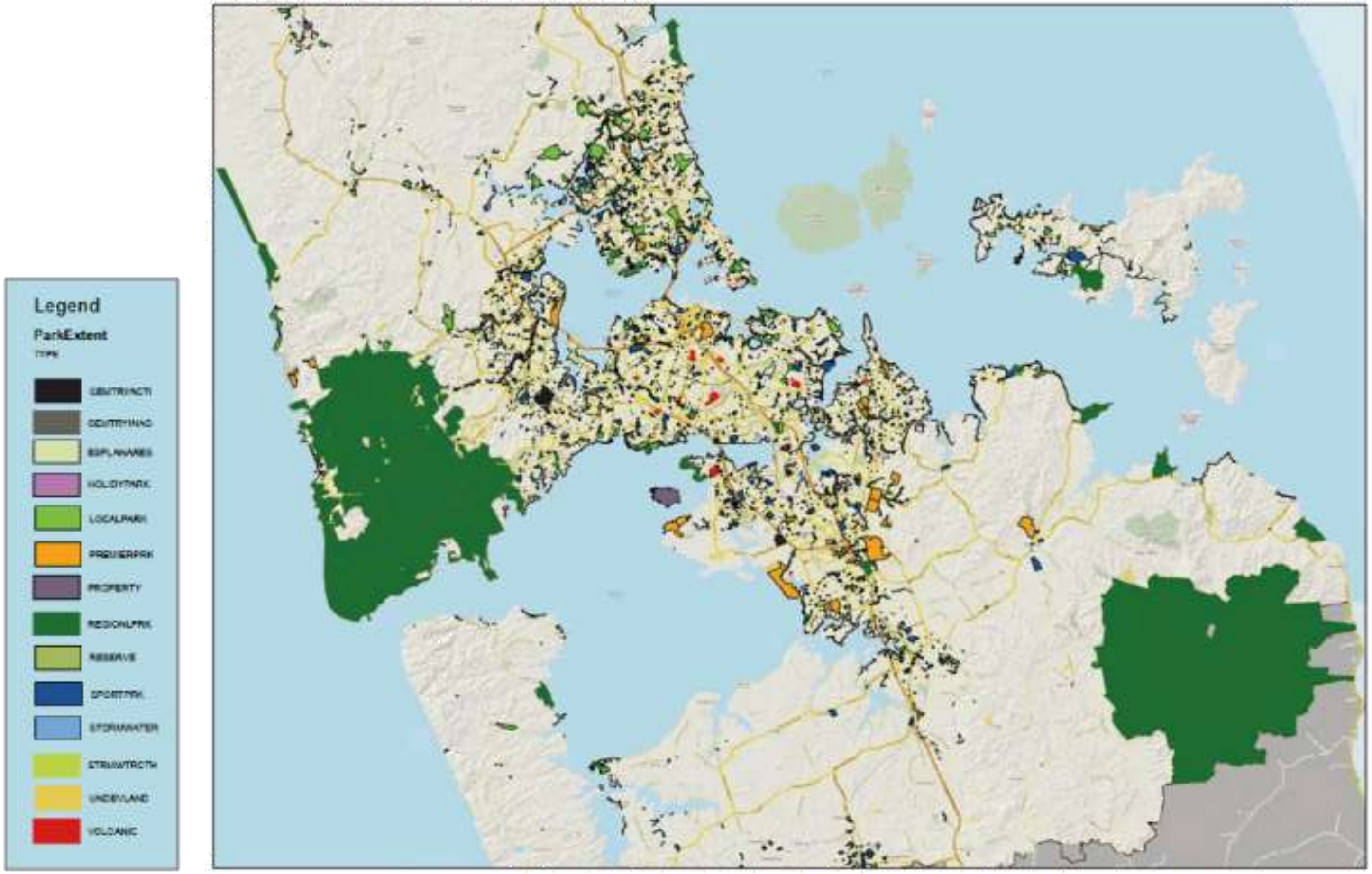
4.2 Community Assets

Regional parks



Source: Auckland Council

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4.2 Community Assets

Golf Courses - estimated values in alternative use and current lease arrangements

Club ($ millions)	Rates systems Land Value	Alternative Use Value	Current Lease Period Expires	Number of further renewals	Latest final renewals date
Remuera	18.5	517.1	2070		
Chamberlain Park	Unavailable	315.6	Operated by Council staff	N/A	N/A
Pupuke	10.8	307.2	31 December 2022	Yes (subject to an odd renewal clause)	1 December 2038
Takapuna	17.1	229.7	Public course managed via parks operation		
Waitemata	Unavailable	212.2			2016 (correspondence)
Muriwai	1.7	173.1	31 December 2028	Perpetual Renewal subject to Reserves Act Public use considerations	
Omaha Beach	5.5	146.6	30 November 2021	No	n/a
Clarks Beach	2.8	98.7	1 April 2017	None	n/a
Waiuku	2.8	36.1			
Waiheke	1.5	34.6	5 October 2017	1	5 October 2022
Awhitu	0.2	34.0	Unknown	Unknown	Unknown
Waitakere	0	14.5	Unknown	Unknown	Unknown
Great Barrier Island	0.3	13.5	31 August 2017	1	31 August 2022
Total	61.2	2,132.9			

Source: Auckland Council

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4.2 Community Assets

Current processes do not lead to optimal asset decisions

- A key observation we make is that there appears to be a lack of rigorous process in regard to decisions related to Community Assets
- There is a high level of oversight and control over the cash costs of providing community services. However the capital cost of providing the land and buildings that underlie a service does not get considered. Once on AC's balance sheet, the capital associated with land and buildings is treated as free
- Further, the values of Community Assets on AC's balance sheet are often defined by their current use (which in commercial terms is generally low value). There is no overt consideration of whether there is an alternative higher use that may be available to Council and therefore no appreciation of the opportunity cost of using the land / buildings for the community service in question
- This leads to the following outcomes:
  - Land assets are regarded as free and perpetual by users and by local boards
  - There are no widespread and formal processes in place to constantly assess whether a particular service could be provided in an alternative manner that freed up the land / buildings such that when the net position after considering the cost of the alternative provision of the service and the sale of the land and buildings are considered, Council is better off
    - As an example, say a community hall was sitting on land that in an alternative use was worth $5 million and the cost of providing the services in the hall to AC was $200,000 pa. Even simply using the borrowing rate of AC (say 6%), the cost of retaining that land / building is a further $300,000 pa (i.e. the debt cost retained by continuing to own the land / buildings) or $500,000 pa in total. If Council could find an alternative method of delivering a facility for the activities that cost less than $500,000 pa it would be better off to do that (in the short-term at least) and sell the land
- If anything, the institutional arrangements create the opposite incentive in two ways:
  - The budgetary focus on cash operating costs rather than the total cost including the cost of capital employed encourages an asset intense delivery platform
  - If a local board gives up a community asset, the sale proceeds go to AC's central coffers. Local boards have no incentives to search for alternative forms of service delivery (such as leasing or sharing) that may reduce the all up cost (including capital cost), as it does not share in the savings and loses the flexibility of asset ownership

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4.2 Community Assets

Observations

- This report is not advocating a wholesale sale of city parks, reserves and community facilities. However, the decision to retain the existing portfolio and regard it as optimal should be made with complete information including what the value being foregone is. Related questions that should be explicitly addressed are:
  - Are there alternatives to providing the service / facility that in total cost terms (both operating and capital combined) are lower than the current asset-heavy delivery
  - In situations where there is materially large value in alternative use, is it equitable to all ratepayers to be dedicating this amount of value to providing the facility to the end-users concerned or should the capital be applied to infrastructure with wider community benefits

We recommend that Council further investigates the following:

- Developing a central register of Community Assets that captures the following:
  - The key features of the land / buildings
  - The current AC book value and the basis for this
  - Details of the current end uses and users and the level of usage
  - The potential value of the land / buildings in their highest value alternative use
  - The effective cost to AC (financing cost) of retaining the land / buildings together with the cash costs of service provision
  - The issues that would need to be addressed to release and monetise all or part of the asset
- Incorporating into AC processes, reviews of delivery of community services to see if total cost (including capital) can be reduced
- Identifying individual situations where the value in alternative use is significant and:
  - Developing alternatives to the status quo of full retention of the asset
  - Bringing the analysis to Council for Council to determine whether the current arrangements or alternative arrangements would be a better balance of Council's obligations to the current users of the facility and to wider Auckland
- Developing appropriate incentive arrangements with local boards under which they share in any savings achieved by changes to service delivery and the release of capital where the total cost of delivery (including capital cost) is reduced

CAMERON PARTNERS

4. Asset Recycling
4.3 Commercial Assets

4.3 Commercial Assets

AC's key Commercial Assets

Asset	Description
AIAL	• New Zealand's largest airport with 14 million travellers each year • Listed on the New Zealand stock exchange (NZX) with a market cap of $6.2 billion (as at 30 October 2015) • AC owns a 22.4% legacy stake – implying a market valuation of $1.4 billion. It is valued at $870 million on the AC balance sheet • Council has no direct rights to appoint Board members and no super decision rights
POAL	• New Zealand's largest port, handling around 34% of New Zealand's container movements • Council is currently reviewing the role of the port, its importance, its location and its impact on Auckland • Its assets are recorded on the AC balance sheet at $790 million
Commercial Parking	• AT owns a number of multi-storey carparks and other commercial off-street parking facilities across Auckland • The value of the land and buildings is recorded at $506 million on the AC balance sheet, of which $153 million relates to Downtown, Victoria and Fanshawe carparks
DFAP	• A portfolio of investments in global shares and bonds with a market value of $328 million (as at 30 June 2015) • It is managed to maintain a consistent market value, by passing through any yield income to AC and to the extent the portfolio increases above $328 million, liquidating the surplus
HfOP	• AC owns and operates a portfolio of 1,412 rental units – making AC Auckland's largest owner and operator of affordable housing • AC currently pays an effective subsidy of $130 per week (the shortfall between market rent and rent received) • It is valued on the AC balance sheet at $200 million
PDAM	• AC owns the management rights to three marinas: Westhaven, Silo and Viaduct Harbour (incl. Hobson West) • The asset is recorded on the AC balance sheet at $80 million, reflecting the future earnings stream

- We note that we have considered but excluded:
  - Panuku Development Auckland land – Panuku Development Auckland already has a model in place for monetising the value of this land
  - Cityparks Services - current value is not likely to be material and it is used as a key performance indicator for outsourced arrangements
  - Events Centre - value of events business is not likely to be material compared to value of land and buildings. More appropriately assessed within the Community Asset framework we established in section 4.2
  - Commercial offices used by AC are included under Outsourcing in section 5.2

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4.3 Commercial Asset Considerations

Asset ownership under a capital constraint

- AC is capital constrained and there is therefore a need to make choices between alternative uses of scarce capital. However, we observe three key issues regarding Council decision-making regarding ownership of Commercial Assets. These are:
  - Asset retention decisions are being made without explicitly considering the alternative use of the capital involved (i.e. the opportunity cost)
  - AC's borrowing rate is used to analyse / make ownership decisions
  - The 'strategic' need for control / ownership of Commercial Assets should be more rigorously tested
- We discuss these three issues in more detail below

Opportunity Cost

- The decision to retain ownership of an asset should consider the alternative use of the capital involved. For example, when capital constrained, a decision to own Asset X is actually a decision to own Asset X **in preference to** spending the capital on Project Y
- An analogy is to start from a premise that AC has the cash and does not hold either Asset X or Project Y. On which opportunity would AC choose to spend the money on?
- Essentially, when capital constrained, the decision to own an asset is also a decision **not** to do something else. Unless the best alternative use of the capital currently being employed is considered, ownership and investment decisions are being made implicitly. The explicit decision is not to sell Asset X. The implicit decision is not to do Project Y
- We believe AC should adopt an opportunity cost framework, for the following reasons - it will:
  - Ensure ownership and investment decisions are made explicitly (and can therefore be justified against other choices) rather than being made implicitly
  - Enable AC to prioritise assets and potential capital expenditure which will lead to:
    - A better allocation of scarce capital across AC
    - A more optimal balance sheet (AC owning what it should own)

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4.3 Commercial Asset Considerations

Asset ownership under a capital constraint

Borrowing rate as a hurdle rate

- The borrowing rate of AC gets used to analyse / make ownership decisions. For example, the financial analysis to own a dividend-yielding Commercial Asset is based on analysis that sale would forego the dividend stream but only save the borrowing cost on the value received. This approach reflects the funding constraint on AC (i.e. any net loss of future cash surplus needs to be made up somehow)

- In corporate finance terms, this analytical construct is incorrect for the following reasons:
  - The asset is not funded 100% by debt. Of AC's $42 billion of assets, only $7 billion is debt funded. The rest of the balance sheet is ratepayers equity. We believe ratepayers should be receiving a better return on their equity than AC's borrowing rate, i.e. investment in assets that provide a return that includes a delivery of services and outcomes that enhance the liveability of Auckland
  - Secondly, in any event it is not the cost of borrowing that determines the return that should be earnt on an asset, it is riskiness of the asset being invested in. It is incorrect to use the borrowing rate as the cost of capital involved in the ownership of commercial assets

- However, more importantly, in a capital constrained world (i.e. one where there are more value-enhancing projects than there is capital to fund them), AC should not be satisfied with owning assets simply for the sake that they earn a market-level commercial return. By owning assets solely for this reason, AC is foregoing investing in assets / projects that (we presume) Council believes are higher value for Auckland. In a capital constrained world, AC's effective cost of capital (or required return) is higher than a market level return

- In our view, in the absence of a strong rationale for 'strategic' control, there is unlikely to be an economic case for continued ownership of assets for commercial reasons only. There must be a stronger rationale for AC ownership than obtaining a standard commercial return. Where that is the only material reason for ownership, then it is almost certain there is a higher value use for that scarce capital. AC should consider using the market's capital to fund these commercial assets and use AC capital for funding higher value projects the market will not fund

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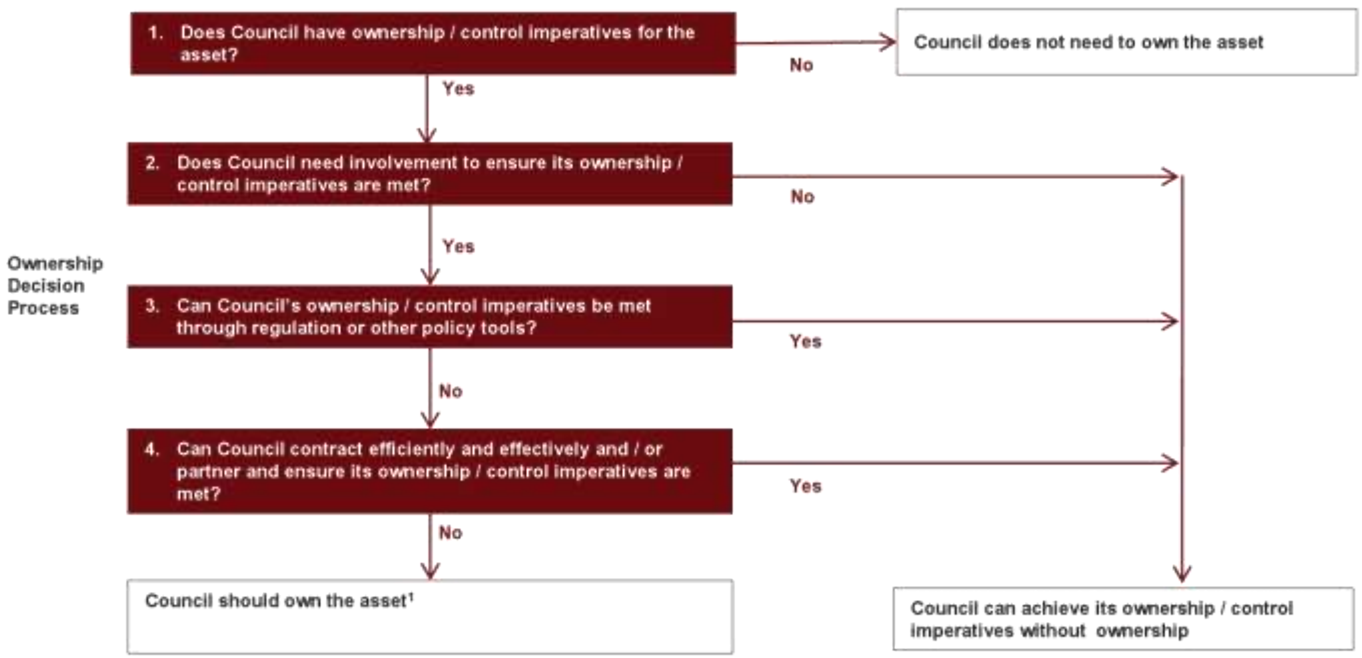
4.3 Commercial Asset Considerations

Testing the strategic imperative for ownership / control

- AC's core business is to ensure delivery of certain key services and outcomes. We consider that it owns and controls certain assets to facilitate this and does not own assets for purely financial returns
- When considering whether AC should own Commercial Assets, a rigorous process of testing the strategic imperative for ownership/control is required
- The diagram below sets out our framework for determining whether AC has a strategic imperative for control and whether it should own an asset or can achieve its objectives without ownership. The individual steps of the decision process are discussed over the following pages



Source: Cameron Partners

[1] An exception could be where an investor is aligned with Council and is happy for its non-value maximising objectives to be pursued – e.g. Govt; other local authorities; iwi; philanthropic sources

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4.3 Commercial Asset Considerations

Testing the strategic imperative for ownership / control (cont.)

Does Council have ownership / control imperatives for the asset?

- Council should be able to clearly define its specific ownership / control imperatives for each asset and assess their materiality
- In general ownership / control imperatives will relate to:
  - Service – i.e. quality, availability and / or price
  - Regional economic development

Does Council need involvement to ensure its ownership / control imperatives are met?

- We consider that there are three broad situations where it is reasonable for Council to have a ownership / control imperative that would drive ownership of commercial assets:
  1. Council's ownership / control imperatives for the business / asset have a cost (and are non value maximising), therefore another owner would not pursue these imperatives unless compelled to or compensated for doing so
  2. Council is concerned that another owner could implement a business plan that is value maximising for the owner but would have negative consequences for the regional economy or wider stakeholders
  3. Council is concerned that there is market failure – i.e.:
     - Competitive failure (the business is a natural monopoly); and / or
     - Regulatory failure (the business is not otherwise appropriately regulated)
- If these situations do not exist then Council can achieve its ownership / control imperatives without ownership of the asset

Can Council's ownership / control imperatives be met through regulation or other policy tools?

- In some cases (e.g. those where a natural monopoly exists, or an unconstrained business may adopt plans with poor public outcomes), Council may be able to minimise risks through its other regulatory functions (e.g. land–use decisions; consenting). In other cases these risks may be mitigated through government regulation or the threat of regulation (e.g. from the Commerce Commission)

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4.3 Commercial Asset Considerations

Testing the strategic imperative for ownership / control (cont.)

Can Council contract efficiently and effectively and / or partner to ensure its ownership / control imperatives are met?

- Where Council's non-value maximising objectives can be quantified and contracted for, then it may be possible for Council to:
  - Simply acquire the outcomes it is seeking and therefore not need to own / control the asset
  - Sell (all or part of) the asset at a discount (to reflect the cost of the non-value maximising objectives) and contractually bind the business / asset (with the prior knowledge of the new owner) to deliver the outcomes
- Mechanisms available to ensure Council ownership / control imperatives are achieved include:
  - A Shareholders Agreement (in the situation where Council were to partially sell-down)
  - Changes to the constitution
  - Arm's length contractual arrangements

Can Council contract efficiently and effectively and / or partner to ensure its ownership / control imperatives are met?

- Equity partnering with other investors may be possible while still ensuring Council's ownership / control imperatives are met. There are investors who specialise in being long term partners of (local) government that may introduce capabilities and capital that augment existing business plans and add value
- The nature of any strategic partner will be an important consideration:
  - General public and listed markets impose constraints that typically drive towards value maximisation and protect minority shareholder rights (e.g. the Government's mixed ownership model)
  - There may be strategic investors that are very aligned with Council's ownership / control imperatives that may require no concessions including the Crown; other local authorities; iwi; and philanthropic sources
  - Long-term strategic investment partners exist that are structured to specifically work with Local Authorities (and similar public sector entities) and with special focus on infrastructure assets and that may be able to add value to AC assets

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4.3 Commercial Asset Considerations

Testing the strategic imperative for ownership / control (cont.)

- Different ownership levels should also be tested to determine sale flexibility. Certain ownership / control imperatives may be achievable without full ownership

- There are a number of considerations regarding the impact of different levels of ownership, including those contained in the Companies Act, Takeovers Code, Overseas investment Act and Securities Markets Act. If not specifically addressed in contractual arrangements that bind shareholders, the impact of different levels of ownership on Council's control rights and tax position include:
  - >10%: Blocking stake – applicable to takeover code companies only (listed companies or companies with 50 or more shareholders and parcels of shares)
  - >25%: Block special resolutions – these are required to adopt or change a constitution; approve a major transaction; approve an amalgamation of the company; or put the company into liquidation
  - >50%: Control of the board, strategy, business plan etc. albeit subject to various regulatory constraints – e.g. directors must act in the best interests of the company
  - >66%: threshold to qualify for common ownership, allowing the company to transfer tax losses with other group companies
  - >75%: Special resolution – see above. Also, a sale below this level may require OIO approval if to a foreign buyer (25% stake and / or the value exceeds $25 million, or a 25% stake of any value if sensitive land is involved)
  - >90%: Code companies only – the threshold beyond which remaining shares can be compulsorily acquired
  - 100%: Complete control over business plan including pursuit of non-value maximising objectives free from any regulatory constraints (e.g. having to contract between group entities, minority share-holder buyout rights / claims of oppression or unfair conduct)

Source: Cameron Partners

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4.3 Commercial Asset Considerations

Framework for reviewing Commercial Assets

- Based on our comments from previous slides the framework we apply for assessing the merits of recycling commercial activities and assets is as follows:

1. Consider ownership / control imperative created by:
   - Council's existing control / influence
   - Whether the activity would not be provided otherwise, i.e. there is a market failure
   - The mismatch between private sector outcomes and preferred AC outcomes which is unresolvable by regulation or contract

   If this analysis reveals there is no strategic control imperative for Council ownership, then Council can actively consider divesting this asset / business as a financing option. This reflects our earlier observation that in the absence of a strategic control imperative:
   - The ownership is simply a commercial investment earning a market return
   - There is almost certainly to be a higher value use for that scarce capital than simply earning a market-level commercial return
   - Council should consider this opportunity cost when making a decision to retain a commercial asset
2. Establish financing potential through estimating the market value of the asset and the factors that may influence the ability to obtain this value
3. Consider future short-term impact on funding - by considering the immediate net financial impact of using the proceeds from any sale to repay debt (due to the loss of future income)
4. Compare ownership to opportunity cost, not to borrowing cost
5. Establish a least-worst ordering for recycling

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4.3 Commercial Assets

4.3.1 AIAL

4.3.1 AIAL

Background and valuation

Background

- AC owns 22.4% of AIAL, with a current market valuation of $1.4 billion (30 October 2015). AIAL is a publicly listed company, with its shares trading on the NZX. As at 30 October 2015, it has a market capitalisation of $6.2 billion. The investment is held by Auckland Council Investments Limited (ACIL)
- The investment was originally entered into as a joint venture agreement between Government and the three local councils (Auckland City Council, Manukau City Council and North Shore City Council)
- AIAL floated its shares on the NZX in 1998. Government sold its stake at the time. North Shore City Council divested its stake in 1999; Manukau City Council retained its stake; and Auckland City Council reduced its stake from 25.8% to 12.8% in 2002
- AC received an annual dividend income of $39 million in FY15. On the market value of its investment this is a yield of 4%

Market Value

- AIAL is recorded in the balance sheet of AC, as an investment at $870 million
- AIAL's share price as at 30 October was $5.26, implying a market capitalisation of $6.2 billion. The market value of AC's stake in AIAL is valued at $1.4 billion
- On the basis that this holding was sold by way of an institutional sell down, the sale may attract a discount of up to 5% - we suggest a realisable value of $1,342 million

Current Control and Influence

- AIAL is publicly listed and AC's 22% shareholding gives it no direct rights to appoint Board members and no super decision rights to control the Board or the activities or business plan of the company through its ownership
- However, with a 22% shareholding (and no other cornerstone shareholder), AC has a material ability to influence board representation over the longer term should it wish to

4.3.1 AIAL

Strategic ownership / control imperative

Strategic Ownership / Control Imperative

- AIAL is an asset of critical importance to the Auckland region. There are potentially two ownership / control imperatives that we discuss over the following paragraphs. These are:
  - The use of the shareholding to control or influence AIAL's business plan
  - The need to prevent direct control of AIAL passing to a third party (e.g. by way of takeover)

Business Plan Control

- We observe the following in regard to Council's need to control the business plan of AIAL:
  - There is little scope for conflict between private sector ownership and public objectives in regard to the airport's business plan
    - To the extent that AIAL policies influence passenger numbers, it is possible that Council may prefer a different trade-off between airport pricing and passenger numbers than is observed. But as far as we are aware, this is not a source of tension between Council and AIAL
  - Regulatory functions, rather than the ownership position of Council, are relied upon to manage public outcomes. This includes in regard to:
    - Land use
    - Pricing control of monopoly elements
    - Noise and other community impact issues
  - Council does not act in a way (as owner) that suggests any conflict exists. If there was, then the current level of ownership would be insufficient to protect its position in any event
  - Even if it could, Council directing AIAL to act in certain ways (that would be in conflict with a value maximising approach) would be inconsistent with the publicly listed nature of AIAL
- Despite AIAL being a critical asset for the Auckland region, AC's shareholding does not appear to be linked to any need to influence or control the business plan of AIAL

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4.3.1 AIAL

Strategic ownership / control imperative (cont.)

Ownership Protection

- AC's shareholding acts as an effective blocking stake against a full takeover of AIAL. However, in this regard we note:
  - As noted on the previous slide, there is no apparent conflict between private sector ownership and public outcomes that cannot be managed by existing regulatory functions
  - AC shareholding does not prevent control (51%) of AIAL passing to a private sector owner. If protecting control / influence of the AIAL business plan was important, this shareholding does not deliver that
  - A stake of 10% would be sufficient to block a full takeover
  - The Crown's response to previous takeover attempts suggests that Council could rely on the application of the Overseas Investment Act to prevent a full takeover of AIAL. However, further work would be required to determine the reliability of this
- In summary, we believe the following:
  - There is a strong case that no strategic control imperative exists for Council in regard to AIAL
  - The 22% shareholding does not deliver and is not being used as if it did deliver meaningful control and influence over the AIAL business plan
  - The Overseas Investment Office processes may be able to be relied upon to block a takeover of AIAL. In any event a shareholding of 10% (rather than 22%) would be sufficient for these purposes
- It is highly likely that in practical terms the AIAL holding is simply an investment (and this certainly applies to the holding in excess of 10%). Ownership of this stake should be tested against better uses of the capital – i.e. if AC did not own the airport shares and consequently had $1.3 billion in extra funding capacity, would it use this cash to buy airport shares or would it invest in Auckland infrastructure?

4.3.1 AIAL

Divestment funding impacts – all shares sold

Assumptions:

- *We assume a value for the whole AIAL shareholding of $1,342 million (assuming transaction costs of 4%)*
- *We have estimated the dividend flow based on equity analyst reports and the growth assumptions inherent in AC's LTP*
- *We use the expected interest rate of 6% from the LTP*

- The table below sets out the indicative impact on AC funding from divesting all of the AIAL shareholding
- Two scenarios are shown:

  Scenario 1: Debt Reduction – sale proceeds are used to reduce debt

  Scenario 2: Non-income generating asset investment – sale proceeds are used to fund capex of a non-income generating asset

AIAL – All Shares ($ millions)	Sale	FY16	FY17	FY18	FY19	FY20	FY21	FY22	FY23	FY24	FY25
Scenario 1: Debt Reduction											
Sale Proceeds	1,342	-	-	-	-	-	-	-	-	-	-
Debt Reduced	(1,342)	-	-	-	-	-	-	-	-	-	-
Interest cost savings	-	80	80	80	80	80	80	80	80	80	80
Estimated dividends foregone	-	(40)	(45)	(47)	(51)	(54)	(56)	(58)	(60)	(63)	(65)
Net funding impact	-	40	36	34	30	27	24	22	20	18	16
Scenario 2: Asset Investment (Non-Income Generating)											
Sale Proceeds	1,342	-	-	-	-	-	-	-	-	-	-
Asset Investment	(1,342)	-	-	-	-	-	-	-	-	-	-
Estimated dividends foregone	-	(40)	(45)	(47)	(51)	(54)	(56)	(58)	(60)	(63)	(65)
Net funding impact	-	(40)	(45)	(47)	(51)	(54)	(56)	(58)	(60)	(63)	(65)

Source: Capital IQ, Auckland Council, JP Morgan, Deutsche Bank

- If the sale proceeds are used to repay debt, the full sale of AIAL shares results in an improvement to future cash flows (because the cash dividend yield is currently below AC's borrowing rate). We note this analysis does not factor in the full AIAL return (which is partially reflected in share price movements) and risk
- If the funds are reinvested in non-income generating assets, a funding gap equal to the AIAL dividends foregone is created

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4.3.1 AIAL

Divestment funding impacts – 12.4% stake sold

Assumptions:

- *We assume a value for the 12.4% AIAL shareholding of $743 million (assuming transaction costs of 4%)*
- *We have estimated the dividend flow based on equity analyst reports and the growth assumptions inherent in AC's LTP*
- *We use the expected interest rate of 6% from the LTP*

- The table below sets out the indicative impact on AC funding from divesting part of the AIAL shareholding. A sale of 12.4% enables AC to retain a 10% blocking stake
- Two scenarios are shown:

  Scenario 1: Debt Reduction – sale proceeds are used to reduce debt

  Scenario 2: Non-income generating asset investment – sale proceeds are used to fund capex of a non-income generating asset

AIAL – 12.4% stake ($ millions)	Sale	FY16	FY17	FY18	FY19	FY20	FY21	FY22	FY23	FY24	FY25
Scenario 1: Debt Reduction											
Sale Proceeds	743	-	-	-	-	-	-	-	-	-	-
Debt Reduced	(743)	-	-	-	-	-	-	-	-	-	-
Interest cost savings	-	45	45	45	45	45	45	45	45	45	45
Estimated dividends foregone	-	(22)	(25)	(26)	(28)	(30)	(31)	(32)	(33)	(35)	(36)
Net funding impact	-	22	20	19	16	15	14	12	11	10	9
Scenario 2: Asset Investment (Non-Income Generating)											
Sale Proceeds	743	-	-	-	-	-	-	-	-	-	-
Asset Investment	(743)	-	-	-	-	-	-	-	-	-	-
Estimated dividends foregone	-	(22)	(25)	(26)	(28)	(30)	(31)	(32)	(33)	(35)	(36)
Net funding impact	-	(22)	(25)	(26)	(28)	(30)	(31)	(32)	(33)	(35)	(36)

Source: Capital IQ, Auckland Council, JP Morgan, Deutsche Bank

- If the sale proceeds are used to repay debt, the full sale of AIAL shares results in an improvement to future cash flows (because the cash dividend yield is currently below AC's borrowing rate). We note this analysis does not factor in the full AIAL return (which is partially reflected in share price movements) and risk.
- If the funds are reinvested in non-income generating assets, a funding gap equal to the AIAL dividends foregone is created

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4.3 Commercial Assets

4.3.2 POAL

4.3.2 POAL

Background and valuation

- AC owns 100% of POAL, the largest container port in New Zealand. The port handles around 34% of New Zealand's container movements. The investment is held by ACIL
- Recent operating performance for POAL is set out on the right
- POAL believes that extending its existing wharves further into the Waitemata harbour is required to manage the growth expectations for the next thirty years. The role of the port, its importance, its location, its impact on Auckland (both economically and in terms of infrastructure requirements) and its use of land is currently the subject of review by Council. The outcomes of this review may have a material impact on the business plan and value of POAL

Indicative Market Valuation

- Appendix 2 sets out the detail of our approach to developing an estimate of POAL value
- Our analysis suggests an overall indicative market equity value for POAL of $1,078 - $1,164 million. This is marginally higher than the equity value referred to in the ACIL 2014 Statement of Intent of $1,079 million
- As noted above, in FY15, AC received a total declared dividend of $41.7 million from POAL. On our estimate of market, this is a dividend yield of 3.6% – 3.9%

POAL Operating Performance

	FY14A	FY15A
Container volumes (TFEU)	968,741	
Total cargo volumes (tonnes)	5,679,325	
Revenue ($m)	221.2	218.3
EBITDA ($m)	106.3	85.5
AC declared dividend ($m)	66.6	41.7

Source: POAL

AC Balance Sheet – POAL Extract

$ millions	FY15A
Land and wharves	462.9
Operating assets	197.7
Investments	117.0
Total	778.6

Source: POAL

NB: As a 100% owned subsidiary, POAL is recorded in the accounts of AC, not as an investment (with a single value for the whole firm), but according to the underlying assets of POAL

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4.3.2 POAL

Ownership / control imperative - introduction

- It is impractical to consider a sale of POAL (or part-sale) until the Council review process currently underway is complete. The uncertainty regarding business plan and valuation would likely see a material discount to value
- Notwithstanding the review (and assuming the outcome still has POAL in its current form and footprint), we have identified two areas of potential conflict between the interests of a private sector owner and that of AC. These are:
  - Incremental land use and intrusion into the harbour
  - Participation in any upper North Island port consolidation
- We discuss these in turn in the following slides. In limiting our control issues to the above, we are acknowledging that competition with Port of Tauranga (POT) is an effective constraint on POAL's pricing and an effective driver of efficiency and this can be expected to remain the dominant driver of these factors (rather than AC ownership). We also believe that there is no inherent need or benefit for the Council to be involved in other operational issues at POAL (for example industrial relations). If anything ownership by AC sees Council drawn into such issues unnecessarily

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4.3.2 POAL

Ownership / control imperative – land use

- As recent events have shown, there is clearly the potential for conflict between public preferences for waterfront land usage and wharf extensions and the preferences of a profit-seeking port
- Ideally, Council and the public should be able to rely on its (and others) regulatory functions to achieve desired waterfront outcomes, and as the proposed extensions have now been shown to be a notifiable consent, it may be that these processes could still be relied upon to achieve a considered balance between the competing views. It would certainly seem a more efficient outcome if Council could rely on AC's regulatory functions and Resource Management Act processes, rather than having to use scarce capital to own companies to otherwise achieve these outcomes. The effectiveness of existing processes to manage waterfront outcomes requires more investigation than we are capable of under this engagement
- Nonetheless, assuming that Council seeks stronger control rights in regard to land and waterfront usage than are achievable through regulatory oversight, we believe this could be achieved by dividing POAL into two companies:
  - Landco that owns the land and underlying wharf structures of POAL
  - Opsco that owns the improvements and operational assets of POAL
- There would be an explicit contract between Landco and Opsco that would govern land use. This contract could cover:
  - The footprint available to Opsco
  - Elements of that footprint that Landco may have rights (under limited circumstances and with sufficient notice) to reacquire the lessee interest in (e.g. some of the wharves nearer the city)
  - Any immediate agreements to extend the footprint or wharves and conditions attached to those extensions
  - Processes under which Opsco can seek extensions to its footprint and the decisions rights to be retained by the Council in this regard
- The term of the lease agreement would need to be of sufficient length to give Opsco confidence regarding investment decisions (e.g. 49+ years), or could have shorter length but with evergreen characteristics (e.g. 30 years but rolled over annually)
- The contract would see lease payments flow from Opsco to Landco. Structured correctly, these payments could replace the dividend flow that AC currently receives from POAL to effectively create no funding gap should Opsco be sold

4.3.2 POAL

Ownership / control imperative – ports consolidation

- We believe it is reasonable for Council to be concerned about the potential impact on POAL and the Auckland region in the event there is any consolidation of POT and POAL. This reflects two main concerns:
  - As we noted earlier, POT provides an effective competitive control on POAL, restraining prices and encouraging efficiency. A merger between the two may see this competitive influence diminished to the detriment of Auckland importers and exporters
  - There is a risk that under joint control, cargo volumes may be directed (by price signals) to one port over the other (compared to what happens under competition) as the combined port owner seeks to move volumes through the port that presents the lowest cost of handling marginal volumes. This may result in cargo volumes being directed to POT over POAL. There is likely to be some correlation between this outcome and regional economic activity over the long term. Council will want to ensure any detrimental impacts are avoided
- While it is reasonable to be concerned about the impact of port consolidation, it does not necessarily lead to a conclusion that ownership of POAL (or Opsco) is required to mitigate the risk. We believe it is likely that existing competition regulation in New Zealand would find any merger between POAL and POT to be anti-competitive and there would be strong resistance from upper North Island port users. Further work would be required to ascertain the extent to which this would be the case
- Other options which could be considered to manage this risk include:
  - Retention of a share of Opsco that could block such a merger (circa 25%) unless Council was satisfied
  - Capturing some form of decision right either in the contract between Landco and Opsco or in the constitution of Opsco
- In summary, we believe the risk of an unconstrained merger between POT and POAL (that is not supported by Council and a wide range of port users) is unlikely. However, in the event that further analysis of this suggested otherwise, there are levers other than full ownership of either POAL or Opsco that are available to Council to manage this risk

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4.3.2 POAL

Summary

Lease cost

A lease yield of 7.8% would deliver a gross revenue stream equal to the current dividend and leave Opsco with an EBITDA of $44.1 million

Whether this is a lease payment that supports the valuation of land we have used would require further analysis

Further work would be required to develop the appropriate lease arrangement, lease payments and capital structure of Landco and Opsco

- Subject to (and dependent on) resolving the current review issues that will determine POAL's future business plan and value, we believe that Council's ongoing strategic control imperatives can be delivered by:
  - Separating POAL into Landco and Opsco and creating a contract between the two that gives Landco explicit rights in regard to incremental land and waterfront decisions
  - Ensuring adequate protections exist (most likely through the Commerce Act, but potentially through direct rights over Opsco) such that a competition-reducing business combination of POT and POAL could not occur (without widespread agreement across affected stakeholders)
- Our indicative views are that the lease between Opsco and Landco could be structured so that there is negligible impact on forecast cash released to AC from the port – i.e. the lease payments would replace current dividend flows. However, further detailed work would be required to establish this
- The table overleaf sets out the indicative impact on AC funding from:
  - Separating POAL into Landco and Opsco
  - Establishing a lease between Landco and Opsco
  - Divesting Opsco
- We make the following assumptions:
  - A value for Opsco of $588 million (mid point of our equity valuation less the current book value of the land, wharves and pavements)
  - An initial lease payment matched to the current dividend and thereafter reviewed every 5 years (as per Wynyard Wharf arrangements)
  - Assume underlying land value increases at 3% p.a.
  - Dividend as per LTP (assume 65% stream is from POAL)
  - An interest rate of 6%, as per LTP
  - The analysis excludes any tax benefits

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4.3.2 POAL

Divestment funding impacts

- Two scenarios are shown:

  Scenario 1: Debt Reduction – sale proceeds are used to reduce debt

  Scenario 2: Non-income generating asset investment – sale proceeds are used to fund capex of a non-income generating asset

POAL ($ millions)	Sale	FY16	FY17	FY18	FY19	FY20	FY21	FY22	FY23	FY24	FY25
Scenario 1: Debt Reduction											
Sale Proceeds	588	-	-	-	-	-	-	-	-	-	-
Debt Reduced	(588)	-	-	-	-	-	-	-	-	-	-
Interest cost savings	-	35	35	35	35	35	35	35	35	35	35
Estimated lease payments received	-	42	42	42	42	42	53	53	53	53	53
Estimated dividends foregone	-	(43)	(46)	(50)	(54)	(57)	(60)	(62)	(64)	(67)	(69)
Net funding impact	-	34	31	27	23	20	29	27	24	22	19
Scenario 2: Asset Investment (Non-income Generating)											
Sale Proceeds	588	-	-	-	-	-	-	-	-	-	-
Asset Investment	(588)	-	-	-	-	-	-	-	-	-	-
Estimated lease payments received	-	42	42	42	42	42	53	53	53	53	53
Estimated dividends foregone	-	(43)	(46)	(50)	(54)	(57)	(60)	(62)	(64)	(67)	(69)
Net funding impact	-	(1)	(4)	(8)	(12)	(16)	(6)	(9)	(11)	(13)	(16)

Source: Auckland Council, Cameron Partners

- If the Opsco sale proceeds are used to reduce debt, the net funding impact is positive (because the cash dividend yield is currently below AC's borrowing rate)
- If the Opsco sale proceeds are invested in a non-income generating asset, the net funding impact is marginally negative due to the assumed lease payments from Opsco to Landco (which is still owned by AC) offsetting the estimated foregone dividend from POAL

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Attachment A

Item 15

4.3 Commercial Assets

4.3.3 Commercial Parking

4.3.3 Commercial Parking

Background

- AT manages a number of multi-storey carpark and other commercial off-street parking facilities across Auckland. The table below divides these into major CBD parking buildings and other
- Summary financials for FY14 are presented below

NZ$000	Civic	Downtown	Victoria	Fanshawe	Major CBD	All other[1]	Total
Revenue	5,074	7,861	3,672	1,191	17,800	20,291	**38,091**
Net Surplus	2,220	4,931	1,156	227	8,500	*na*	
Book Value	68,202	84,263	46,116	21,978	221,000	285,000	**506,000**

Source: Auckland Council

[1] estimated from Auckland Transport Annual Report

Key considerations

- The Civic parking sits below the Civic centre
- The remaining major CBD parking buildings are standalone dedicated for parking
- All CBD parks are freehold
- Other carparks include a large number where no parking fee is charged

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4.3.3 Commercial Parking

Indicative market valuation

Valuation assumptions:

- *WACC 7% (ex PwC study);*
- *Growth rate 2%;*
- *Tax rate 28%; and*
- ***Commercial yield 8%** (Source: Colliers International)*

Indicative Market Value

- We assess two alternative options for the CBD parking activities as follows:
  1. **No Development Rights** - where AC retains the freehold interest but sells the building and leasehold interest (in the case of the Civic the sale would be a management right). The new owner is obliged to maintain the buildings for the purposes of parking and AC retains any development rights. On this basis the value is estimated by establishing the present value of the parking activities. This provides a value estimate of around $120 million. As a check we also capitalise the current surplus at an observed commercial building yield of 8%. This delivers a value estimate of around $106 million. So we have used an estimate of $110 million
  2. **With Development Rights** - as above, but AC also sells the development rights with an obligation to provide at least the existing extent of parking (other than for the Civic where only a management right is sold). The book values of the previous page are professional valuations based on observations of similar land and buildings and we assume are in line with the scenario we use here. This provides a value of $153 million – higher than Option 1 given that the new owners acquire the development rights to the building
- In the remainder of this section we use the value range of $110 million to $153 million as a working estimate. The lower end may be conservative as we note that AC appears to have a de-facto policy of not being a price leader for CBD parking. There is potential for price increases
- We note the non-CBD carparks have combined land value of $285 million yet are generating $20 million in parking revenue. It is clear that a large number of these parks have materially higher value in an alternative use. Council should conduct a review of these carparks to determine:
  - Whether parking charges should be introduced
  - Whether the gap between the alternative use value and the community value of the land being available for parking is so significant that an alternative approach to providing parking should be investigated and the land released for sale / development

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4.3.3 Commercial Parking

Ownership / control imperative

- Potential ownership / control imperatives exist in relation to CBD parking for the reasons set out below. After each reason we set out potential mitigants

- In the absence of AC ownership, CBD parking may not be provided in sufficient volumes
  - Council may be relaxed to let market find its own level where pricing and supply of CBD parking reflects a commercial view of the costs of providing it given the alternative value of the land / buildings
  - The structure of underlying lease arrangements could require that the current level of parking is retained
  - Council could sell different locations to different end-users to maintain / increase competition

- Prices may increase after sale
  - There appears to be a number of competing offerings for CBD parking. Council may be able to rely on competitive forces
  - Council could sell different locations to different end-users to maintain/increase competition
  - Council could restrict price increases
  - Council may not be concerned that prices for CBD parking increase. AC ownership may in fact be restraining a preferred price path. The key issue may be insuring that AC obtains the value of this prospect in any sale

- Council can use parking prices (and variation in prices) as a lever to discourage inner-city travel by car or to at least discourage it at certain times of the day
  - This implies that AC pricing alone can impact traffic volumes. This assumption may be incorrect in a competitive market for parking
  - This does not appear to be a current use of ownership. The focus of AT is on optimising occupancy / price trade-offs as per any owner (albeit without price leadership), not managing CBD traffic flows. Parking appears to be currently run as a surplus-maximising venture
  - If not an owner of CBD parking, Council could potentially develop alternative regulatory levers to impact costs of CBD parking

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4.3.3 Commercial Parking

Divestment funding impacts – no development rights

Assumptions

We assume a value for commercial parking portfolio with no development rights of $110 million

We apply a 2% growth rate to the FY14 net surplus

- Two scenarios are shown:

  Scenario 1: Debt Reduction – sale proceeds are used to reduce debt

  Scenario 2: Non-income generating asset investment – sale proceeds are used to fund capex of a non-income generating asset

Commercial Parking – no development rights ($ millions)	Sale	FY16	FY17	FY18	FY19	FY20	FY21	FY22	FY23	FY24	FY25
Scenario 1: Debt Reduction											
Sale Proceeds	110	-	-	-	-	-	-	-	-	-	-
Debt Reduced	(110)	-	-	-	-	-	-	-	-	-	-
Interest cost savings	-	7	7	7	7	7	7	7	7	7	7
Estimated net surplus foregone	-	(9)	(9)	(9)	(9)	(9)	(9)	(10)	(10)	(10)	(10)
Net funding impact	-	(2)	(2)	(2)	(2)	(3)	(3)	(3)	(3)	(3)	(4)
Scenario 2: Asset Investment (Non-Income Generating)											
Sale Proceeds	110	-	-	-	-	-	-	-	-	-	-
Asset Investment	(110)	-	-	-	-	-	-	-	-	-	-
Estimated net surplus foregone	-	(9)	(9)	(9)	(9)	(9)	(9)	(10)	(10)	(10)	(10)
Net funding impact	-	(9)	(9)	(9)	(9)	(9)	(9)	(10)	(10)	(10)	(10)

Source: Auckland Council, Cameron Partners

- If the sale proceeds are used to repay debt, the sale results in a near-zero change to future cash flows (because the cash dividend yield approximates AC's borrowing rate)
- If the funds are reinvested in a non-income generating asset, a funding gap equal to the net surplus foregone is created

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CAMERON PARTNERS

4.3.3 Commercial Parking

Divestment funding impacts – with development rights

Assumptions

We assume a value for commercial parking portfolio with development rights of $153 million

We apply a 2% growth rate to the FY14 net surplus

- Two scenarios are shown:

  Scenario 1: Debt Reduction – sale proceeds are used to reduce debt

  Scenario 2: Non-income generating asset investment – sale proceeds are used to fund capex of a non-income generating asset

Commercial Parking – with development rights ($ millions)	Sale	FY16	FY17	FY18	FY19	FY20	FY21	FY22	FY23	FY24	FY25
Scenario 1: Debt Reduction											
Sale Proceeds	153	-	-	-	-	-	-	-	-	-	-
Debt Reduced	(153)	-	-	-	-	-	-	-	-	-	-
Interest cost savings	-	9	9	9	9	9	9	9	9	9	9
Estimated net surplus foregone	-	(9)	(9)	(9)	(9)	(9)	(9)	(10)	(10)	(10)	(10)
Net funding impact	-	-	-	-	-	-	-	-	(1)	(1)	(1)
Scenario 2: Asset Investment (Non-Income Generating)											
Sale Proceeds	153	-	-	-	-	-	-	-	-	-	-
Asset Investment	(153)	-	-	-	-	-	-	-	-	-	-
Estimated net surplus foregone	-	(9)	(9)	(9)	(9)	(9)	(9)	(10)	(10)	(10)	(10)
Net funding impact	-	(9)	(9)	(9)	(9)	(9)	(9)	(10)	(10)	(10)	(10)

Source: Auckland Council, Cameron Partners

- If the sale proceeds are used to repay debt, the sale results in a near-zero change to future cash flows (because the cash dividend yield approximates AC's borrowing rate)
- If the funds are reinvested in a non-income generating asset, a funding gap equal to the net surplus foregone is created

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4.3 Commercial Assets
4.3.4 DFAP

4.3.4 DFAP

Background and valuation

- The DFAP is a portfolio of investments in global shares and bonds. The DFAP has the following two goals:
  - Provide a portfolio of assets held in reserve to meet any unforeseen liquidity or funding events
  - Maintain the real capital value of the portfolio after making distributions
- Responsibility for the DFAP has recently transferred from ACIL to AC Treasury (the AC Treasuy management arrangement mirrors the earlier ACIL arrangement, and any difference in return is due to market performance only)

Indicative Market Valuation

- The portfolio is continually marked-to-market and comprises liquid stocks and bonds
- It is managed to maintain a constant market value of $328 million. This is achieved by passing through any yield income to AC and to the extent the portfolio ex yield increases above $328 million, liquidating the excess
- Accordingly a value of $328 million is a reliable estimate of realisable value
- AC targets a long-term return of 7% p.a. on the portfolio. Given recent equity capital market performance, recent years have seen stronger returns than this

Strategic Imperative for ownership / control

- The DFAP is a pure investment comprising minor positions in a wide range of public securities – no control rights of the underlying companies exist for Council. Accordingly, there is no ownership / control imperative
- However, the DFAP is maintained as part of the liquidity support for AC's treasury function – i.e. AC maintains ready access to liquid assets in the event a market event prevents AC from refinancing facilities as they come due
- The overall level of liquidity support held by AC Treasury (and the optimal form of it) would need to be considered if the DFAP was to be liquidated. We note that AC has an $800 million standby facility for the same purpose that could presumably be extended
- We note it is unusual for an organisation with the purposes of AC to hold such an asset

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4.3.4 DFAP

Divestment funding impacts

- The table below sets out the indicative impact on AC funding from divesting the DFAP. We assume a value for the whole DFAP of $328 million. We make the following assumptions:
  - Return 7% p.a. paid out in full each year (as per LTP)
  - Interest rates of 6% (as per LTP)
- Two scenarios are shown:

  Scenario 1: Debt Reduction – sale proceeds are used to reduce debt

  Scenario 2: Non-income generating asset investment – sale proceeds are used to fund capex of a non-income generating asset

DFAP ($ millions)	Sale	FY16	FY17	FY18	FY19	FY20	FY21	FY22	FY23	FY24	FY25
Scenario 1: Debt Reduction											
Sale Proceeds	328	-	-	-	-	-	-	-	-	-	-
Debt Reduced	(328)	-	-	-	-	-	-	-	-	-	-
Interest cost savings	-	20	20	20	20	20	20	20	20	20	20
Estimated yield foregone	-	(23)	(23)	(23)	(23)	(23)	(23)	(23)	(23)	(23)	(23)
Net funding impact	-	(3)	(3)	(3)	(3)	(3)	(3)	(3)	(3)	(3)	(3)
Scenario 2: Asset Investment (Non-Income Generating)											
Sale Proceeds	328	-	-	-	-	-	-	-	-	-	-
Asset Investment	(328)	-	-	-	-	-	-	-	-	-	-
Estimated yield foregone	-	(23)	(23)	(23)	(23)	(23)	(23)	(23)	(23)	(23)	(23)
Net funding impact	-	(23)	(23)	(23)	(23)	(23)	(23)	(23)	(23)	(23)	(23)

Source: Auckland Council

- If the sale proceeds are used to repay debt, the sale results in a near-zero change to future cash flows (because the cash dividend yield approximates AC's borrowing rate)
- If the funds are reinvested in a non-income generating asset, a funding gap equal to the net surplus foregone is created

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4.3 Commercial Assets
4.3.5 HfOP

4.3.5 HfOP

Background and valuation

- AC owns and operates a portfolio of 1,412 HfOP rental units. AC is Auckland's largest owner and provider of affordable housing. To be eligible for HfOP units applicants eligibility criteria are as follows:
  - Aged above 60
  - Genuine housing need
  - Capable of independent living
- Annual income from HfOP is currently around $8.8 million. This is equal to an average rental per house per week of $120. The capital and operating costs are estimated at 1% – 1.4% of the value of the properties, ~$2.4 million per annum. Therefore we estimate an approximate net surplus of $6.4 million per annum
- The average market rental for similar properties is estimated by AC Property at $250 per week. This implies AC is currently providing an average subsidy of around $130 per week (or $9.5 million a year in foregone rents)
- Council is currently in conversation with Government to access its Income Related Rentals Scheme, which would enable AC to charge market rates, with the Government effectively taking over the subsidy

Indicative Market Value

- HfOP is recorded in the AC financial statements as part of land and buildings and is valued at around $200 million based on the rateable values of the properties. AC Property has valued the 20 year net present value of future rent income streams at market rent (i.e. $250/week and growing) is $250 million. We use a midpoint estimate for the market value of the properties of $225 million
- However, this valuation assumes that the owner of the housing stock is receiving a market rental. The following should be noted:
  - The implication is that, under current arrangements, if Council was to sell its HfOP stock it would have to pay the subsidy to the new owner. So this would crystallise the subsidy that is currently rent foregone into an explicit payment of $9.5 million per annum
  - If the proposed arrangements with the Crown come to fruition, then we assume Council could divest its HfOP stock and not have to meet the subsidy payment as this would be met by the Crown

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4.3.5 HfOP

Ownership / control imperative

- Ownership by AC currently allows Council to control all aspects of HfOP delivery. In the absence of ownership, desired outcomes would have to be achieved through contract. Factors that would have to be covered include the allowable uses of the housing stock, tenant policies, pricing obligations and asset management obligations
- While it remains the subsidy provider, Council should be able to enforce the desired outcomes across these factors. However, the ultimate sanction is to withdraw the subsidy. To make this an effective lever, the use of the housing stock would have to be limited to HfOP (or other targeted groups preferred by Council)
- We assume that any sale of HfOP would be to a party (or parties) that was committed and obliged to continue the use of the stock for the purposes of HfOP and would be suitably qualified to manage these arrangements and qualify for the subsidy. This would most likely be an alternative Community Housing Provider (CHP). In this respect, the model is very similar to that being rolled out by Treasury in regard to selling Housing New Zealand Stock to CHP's. Council should be able to 'piggy back' on the contractual intellectual property being created for this activity
- Further work would have to be undertaken to determine the ability to manage Council outcomes through contract. Key elements to consider would include:
  - Should the Crown become the subsidy provider, AC would save on that payment but the Council's control over outcomes would become more tenuous as the major counterparty of the CHP would be the Crown
  - CHPs would likely need to be backed by external financing to be able to acquire the properties. The impact of this stakeholder on acceptable contracting arrangements would need to be considered
- Council could also consider its ability to ensure HfOP is retained in Auckland through means other than ownership or specific contract. For example to the extent AC land is made available for housing, Council could choose to designate portions of that land as available only to providers of HfOP who qualify for Crown subsidies for the purposes of HfOP. This may allow Council to divest its existing stock over time – although we note this is a net outcome of near zero – the gains on the sale of HfOP are offset by the value foregone by limiting the value of land sold

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4.3.5 HfOP

Divestment funding impacts – with Council subsidy

Assumptions

We assume a value for the whole of HfOP of $225 million based on a midpoint between the capital value and the future income streams

We make the following additional assumptions:

- *Income of $120 per week / per unit*
- *Expenditure of 1.2% of capital value per annum*
- *Subsidy of $130 per week*

- The table below sets out the indicative impact on AC funding from divesting the HfOP portfolio where the subsidy is paid by AC
- Two scenarios are shown:

  Scenario 1: Debt Reduction – sale proceeds are used to reduce debt

  Scenario 2: Non-income generating asset investment – sale proceeds are used to fund capex of a non-income generating asset

HfOP – Council subsidy ($ millions)	Sale	FY16	FY17	FY18	FY19	FY20	FY21	FY22	FY23	FY24	FY25
Scenario 1: Debt Reduction											
Sale Proceeds	225	-	-	-	-	-	-	-	-	-	-
Debt Reduced	(225)	-	-	-	-	-	-	-	-	-	-
Interest cost savings	-	14	14	14	14	14	14	14	14	14	14
Estimated revenue foregone	-	(9)	(9)	(9)	(9)	(9)	(9)	(9)	(9)	(9)	(9)
Estimated opex saved	-	2	2	2	2	2	2	2	2	2	2
Estimated subsidy	-	(10)	(10)	(10)	(10)	(10)	(10)	(10)	(10)	(10)	(10)
Net funding impact	-	(2)	(2)	(2)	(2)	(2)	(2)	(2)	(2)	(2)	(2)
Scenario 2: Asset Investment (Non-income Generating)											
Sale Proceeds	225	-	-	-	-	-	-	-	-	-	-
Asset Investment	(225)	-	-	-	-	-	-	-	-	-	-
Estimated revenue foregone	-	(9)	(9)	(9)	(9)	(9)	(9)	(9)	(9)	(9)	(9)
Estimated opex saved	-	2	2	2	2	2	2	2	2	2	2
Estimated subsidy	-	(10)	(10)	(10)	(10)	(10)	(10)	(10)	(10)	(10)	(10)
Net funding impact	-	(16)	(16)	(16)	(16)	(16)	(16)	(16)	(16)	(16)	(16)

Source: Auckland Council

- If the sale proceeds are used to repay debt, the sale results in a near-zero change to future cash flows (because the cash dividend yield approximates AC's borrowing rate)
- If the funds are reinvested in a non-income generating asset, a funding gap equal to the net surplus foregone is created

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4.3.5 HfOP

Divestment funding impacts – with Crown subsidy

Assumptions

We assume a value for the whole of HfOP of $225 million based on a midpoint between the capital value and the future income streams

We make the following additional assumptions:

- *Income of $120 per week / per unit*
- *Expenditure of 1.2% of capital value per annum*

- The table below sets out the indicative impact on AC funding from divesting the HfOP portfolio where the subsidy is paid by the Crown
- Two scenarios are shown:

  Scenario 1: Debt Reduction – sale proceeds are used to reduce debt

  Scenario 2: Non-income generating asset investment – sale proceeds are used to fund capex of a non-income generating asset

HfOP – Crown subsidy ($ millions)	Sale	FY16	FY17	FY18	FY19	FY20	FY21	FY22	FY23	FY24	FY25
Scenario 1: Debt Reduction											
Sale Proceeds	225	-	-	-	-	-	-	-	-	-	-
Debt Reduced	(225)	-	-	-	-	-	-	-	-	-	-
Interest cost savings	-	14	14	14	14	14	14	14	14	14	14
Estimated revenue foregone	-	(9)	(9)	(9)	(9)	(9)	(9)	(9)	(9)	(9)	(9)
Estimated opex saved	-	2	2	2	2	2	2	2	2	2	2
Net funding impact	-	7	7	7	7	7	7	7	7	7	7
Scenario 2: Asset Investment (Non-Income Generating)											
Sale Proceeds	225	-	-	-	-	-	-	-	-	-	-
Asset Investment	(225)	-	-	-	-	-	-	-	-	-	-
Estimated revenue foregone	-	(9)	(9)	(9)	(9)	(9)	(9)	(9)	(9)	(9)	(9)
Estimated opex saved	-	2	2	2	2	2	2	2	2	2	2
Net funding impact	-	(6)	(6)	(6)	(6)	(6)	(6)	(6)	(6)	(6)	(6)

Source: Auckland Council

- If the sale proceeds are used to repay debt, the sale results in a positive change to future cash flows, as the debt costs saved are larger than the surplus foregone
- If the funds are reinvested in a non-income generating asset, a small funding gap is created equal to the forecasted net surplus foregone
- Not surprisingly, the result with the Crown as subsidy provider is materially better than with AC as subsidy provider

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Attachment A

Item 15

4.3 Commercial Assets

4.3.6 PDAM

4.3.6 PDAM

Background and valuation

- AC owns the management right to three marinas: Westhaven, Silo and Viaduct Harbour (including Hobson West). The investment is held by Panuku Development Auckland. In 2015 PDAM earned EBITDA of $4.9 million

- The Westhaven Marina is made up of the following assets / rights:
  - The underlying water space is owned by the Crown. PDAM has a right of occupation until 2048. The right is expected to be renewed
  - The land around the marina. The freehold interest is held by PDAM
  - Commercial properties are held by third parties and are on ground leases
  - The berths are held in a participatory trust which has issued berth licences
    - PDAM owns 52% of the berth units which it rents out. The rest are owned privately, but will revert to PDAM over the period 2026 – 2029
  - PDAM also receives a management fee from all berth owners
  - PDAM is extending the number of berths and will rent these out as they are built

- The commercial elements that could be wrapped for divestment comprise
  - PDAM's existing berths and the value of the remaining berths transferring back to it from 2026-29
  - The surplus from the management fee less expenses
  - The benefit of the development options

- PDAM owns 100% of the berths at Silo and Viaduct Harbour. It has a range of agreements in place:
  - Short term rental berths for super yachts
  - Perpetual rights of occupation for Sanford at the fishing marina

Indicative Market Value

- PDAM is valued at $80 million on AC's balance sheet. The valuation was completed in June 2015, and reflects the future earning stream of the identified divestible assets and rights

	Valuation
Westhaven Operational Asset	$54 million
Silo Marina	$9 million
Hobson West	$6 million
Viaduct Harbour	$11 million
Total	$80 million

Source: Jones Lang LaSalle

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4.3.6 PDAM

Ownership / control imperative

- Although the marina berths are highly visual waterfront asset, there appears to be little clear strategic ownership / control imperative that we can assess
  - There are a number of other marinas in the Auckland region in which Council has no ownership interest or feels the need to
  - The development and consenting processes appear to be a sufficient level of control over marinas in those case and presumably should be in the case of Westhaven
  - Pricing is set by market competition and occupancy / pricing trade-offs. There is no pricing control being exhibited by Council
  - The business activity is naturally limited to the development, leasing or renting, and management of berth units. The assets cannot be used for another purpose. There is no risk of the marinas being removed from the market or developed into some alternative use
  - Waterfront development remains with Panuku Development Auckland. No land-based development rights would be included in the sale package

4.3.6 PDAM

Divestment funding impacts

Assumptions

We have made the following assumptions:

- *The value of the operational rights is $80 million*
- *The interest rate is 6% (as per LTP)*
- *The net income foregone (before Capex) as per Jones Lang LaSalle valuation report (June 2015)*

- The table below sets out the indicative impact on AC funding from divesting the operational rights to PDAM
- Two scenarios are shown:

  Scenario 1: Debt Reduction – sale proceeds are used to reduce debt

  Scenario 2: Non-income generating asset investment – sale proceeds are used to fund capex of a non-income generating asset

PDAM ($millions)	Sale	FY16	FY17	FY18	FY19	FY20	FY21	FY22	FY23	FY24	FY25
Scenario 1: Debt Reduction											
Sale Proceeds	80	-	-	-	-	-	-	-	-	-	-
Debt Reduced	(80)	-	-	-	-	-	-	-	-	-	-
Interest cost savings	-	5	5	5	5	5	5	5	5	5	5
Estimated net income foregone	-	(6)	(6)	(6)	(6)	(7)	(8)	(8)	(8)	(8)	(8)
Net funding impact	-	(1)	(1)	(1)	(1)	(1)	(1)	(1)	(1)	(1)	(1)
Scenario 2: Asset Investment (Non-Income Generating)											
Sale Proceeds	80	-	-	-	-	-	-	-	-	-	-
Asset Investment	(80)	-	-	-	-	-	-	-	-	-	-
Estimated net income foregone	-	(6)	(6)	(6)	(6)	(7)	(8)	(8)	(8)	(8)	(8)
Net funding impact	-	(6)	(6)	(6)	(6)	(7)	(8)	(8)	(8)	(8)	(8)

Source: Auckland Council, Jones Lang LaSalle

- If the sale proceeds are used to repay debt, the sale results in a near-zero change to future cash flows, as the debt costs saved are approximately equal to the surplus foregone
- If the funds are reinvested in a non-income generating asset, a small funding gap is created equal to the forecasted net surplus foregone

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4.3 Commercial Assets

4.3.7 Summary & observations

4.3.7 Summary and observations

Net Funding Impact and observations

Assumes sale of the following

- *All AIAL shares*
- *POAL Opsco*
- *Commercial Parking with the development option*
- *DFAP*
- *HfOP with Council Subsidy*
- *PDAM*

- The table below summarises the aggregate financing potential and funding implications from the Commercial Assets reviewed

Summary impact ($millions)	Sale	FY16	FY17	FY18	FY19	FY20	FY21	FY22	FY23	FY24	FY25
Scenario 1: Debt Reduction											
Sale Proceeds	2,715	-	-	-	-	-	-	-	-	-	-
Debt Reduced	(2,715)	-	-	-	-	-	-	-	-	-	-
Interest cost savings	-	163	163	163	163	163	163	163	163	163	163
Other P&L impacts	-	(93)	(103)	(108)	(117)	(125)	(118)	(123)	(128)	(133)	(138)
Net funding impact	-	70	60	55	46	38	45	40	35	30	25
Scenario 2: Asset Investment (Non-Income Generating)											
Sale Proceeds	2,715	-	-	-	-	-	-	-	-	-	-
Asset Investment	(2,715)	-	-	-	-	-	-	-	-	-	-
Other P&L impacts	-	(93)	(103)	(108)	(117)	(125)	(118)	(123)	(128)	(133)	(138)
Net funding impact	-	(93)	(103)	(108)	(117)	(125)	(118)	(123)	(128)	(133)	(138)

- If all the identified assets were divested, Council could raise up to $2.7 billion. If the sale proceeds were used to repay debt, the sale results in a positive impact on future cash flows as the debt costs saved are greater than contributions foregone.
- If the funds are reinvested in a non-income generating asset, a funding gap is created equal to the forecasted surplus foregone
- It is recommended that more detailed work is undertaken in regard to the key factors that will affect Council decision-making:
  - Testing the strategic rationale for ownership. This may be best done through a series of workshops where all Council's concerns can be adequately teased out and addressed
  - Expected proceeds and structuring
  - Impact on future funding

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5. Partnerships / Alternative Procurement

5.1 PPPs

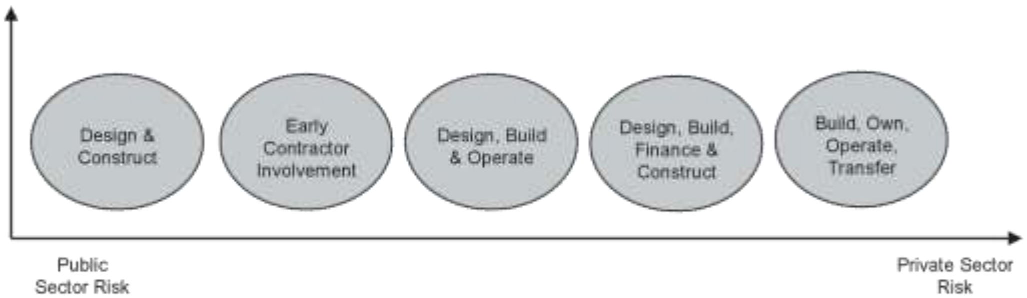
5.1 PPPs

Types of PPPs

- There are various procurement models ranging from "traditional" procurement to "Public Private Partnerships" available to AC
- These procurement models are given various names and acronyms (Design & Construct (D&C), Early Contractor Involvement (ECI), Design Build Operate (DBO), Design Build Finance Operate (DBFO), Build Own Operate Transfer (BOOT) etc.) but are essentially differentiated by the level of integration, and control and risk assumed by the public and private sector in relation to key project components, as outlined below

Project component	Traditional	PPP
Functional scope / output specifications	Public	Public
Design	Public	Public / Private
Construction	Private	Private
Construction schedule	Private	Private
Financing	Public	Public / Private
Facility Management	Public	Public / Private
Operations	Public	Public / Private
Ownership	Public	Public / Private
Lifecycle	Public	Public / Private
Facility availability, performance and asset value	Public	Public / Private

Source: Cameron Partners



Source: Cameron Partners

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5.1 PPPs

Drivers for PPPs vs traditional procurement

- All projects are capable of being procured through traditional means. However, project outcomes and risks can be optimised by procuring via PPP. The optimal outcome from a PPP procured project is where public sector value for money is improved relative to the traditional procurement method (often measured through establishment of a public sector 'comparator'). In some cases, this will be in the form of improved project outcomes for the same amount of capital invested. In other cases, whole of life project costs will be reduced under a PPP model while still delivering project outcomes similar to those achieved in the traditional procurement comparator

- The choice of procurement model is driven by the following factors:
  - Whole-of-life value for money (relative to the public sector comparator)
  - Service quality
  - Risk transfer – including project delivery timing and costs and other operational and lifecycle risks
  - Budgeting certainty across the project's lifecycle

- Key PPP procurement selection criteria are presented below

Criteria	Key PPP procurement criteria
Project scale	Generally large but can also be small scale if other criteria met
Project complexity	High
Other characteristics	The project and related services can be defined and are capable of being costed on a whole-of-life basis
Opportunities to innovate	High
Project efficiencies	High, such that any additional transaction costs associated with PPP procurement can be offset by the likely benefits
Operational capabilities required	High
Risk profile	Risks can be assessed and priced by the private sector
Other issues to consider	Project amenable to political interference in the absence of private sector control and decision rights

Source: Cameron Partners

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5.1 PPPs

Funding vs financing

- As outlined there is a difference between funding and financing. Funding is how a project is ultimately paid for (e.g. road tolls; rates). Financing is how the capital is raised upfront to deliver the project (e.g. private project debt; AC debt)
- All things equal the procurement model chosen will not materially change the source and quantum of funding required for a project – i.e. the project's underlying economics cannot be changed (although this may be impacted by AC's willingness and ability to use (and Central Government's willingness to approve) different funding mechanisms, for example specific road tolls). A project:
  - Without commercial cash flows will require public sector funding
  - With commercial cash flows may be capable of attracting funding from other sources (e.g. user pays; private sector)

  It is the underlying funding support that determines the financing options for a project
- Projects will sit on a continuum from those which are fully commercial through projects with some commercial revenues (albeit insufficient to provide an appropriate return to the private sector on their own) to projects without any commercial revenues
- Examples include:
  - Light rail – transport infrastructure costs too significant for private sector to make an appropriate return so funded from AC general sources; operational component able to be funded through user charges so operations and rolling stock funded from project revenues
  - Road project – without road tolls funded from AC general sources; with road tolls funded from project sources and / or AC general sources (depending on the extent that road tolls cover project costs)
  - Water / waste water – (as per Veolia in Papakura) operational and capital responsibility passed to operator under franchise agreement with pricing subject to Auckland-wide benchmarking against Watercare – no funding impact and limited financing impact

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5.1 PPPs

Impact on AC financing and observations

- In New Zealand the accounting treatment of PPP projects (due to the nature of the control exerted by AC and the beneficial rights to any residual interest) is typically to be treated as an asset on the balance sheet with any private sector contribution treated as a financing liability (and amortised over the term of the agreement). Consequently regardless of whether AC is directly involved in the operations, "ownership", raising of any project financing etc - it will likely need to account for it as if it had owned and debt financed the asset – with any potential consequences on its overall debt financing position. It should be noted that the accounting treatment may vary significantly from the actual cash flows. It may also be possible to structure a PPP to avoid this treatment but this would need to be clarified on a case-by-case basis

- Due to the limited nature of New Zealand's capital markets, the financing options available for PPPs potentially offer features that may be attractive to AC (subject to an assessment of counterparty risk):
  - AC can effectively 'lock in' payment streams that provide budget certainty (over the term of the contract)
  - Very long term financing can effectively be accessed
  - Cash flows can be manipulated to best suit AC requirements (e.g. weighted to the end of the contract term)

- Funding costs will be marginally higher than AC's equivalent borrowing rate. However, this reflects two inter-related factors:
  - The true funding of the project (whether by AC or partner) does have an equity component and the project should provide a return on this
  - The project transfers risks that the PPP counterparty will recognise and want compensated for. These risks exist and are borne by AC in a traditional procurement process, but they are not recognised in the borrowing cost of AC
- On a risk adjusted basis, there will be a minor difference between PPP financing costs and those of AC. However, this margin is generally offset by the primary rationale for PPPs which relates to superior project outcomes (value for money, superior services etc.) and not their role as a financing mechanism

- We suggest that Council more fully investigates the use of PPP structures for infrastructure assets – including in situations where there is no material demand risk transfer and therefore limited external commercial funding:
  - The procurement and risk transfer outcomes can be superior
  - Currently very low costs of capital are being applied to PPP offerings that are supported by local government payments
  - The combined effect of these two points can offset the higher cost of funds (compared to AC's borrowing cost and consequently deliver better value for money outcomes
  - The financing cost and repayment profile can be individualised to Council preferences

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5. Partnerships / Alternative Procurement

5.2 Outsourcing

5.2 Outsourcing

Introduction

- In this section, we comment on the opportunity for further outsourcing of AC functions and the consequent divestment of the assets associated with those functions. We also separately examine the sale of AC's offices
- Outsourcing is already a well established behaviour at AC. It is the common approach to maintenance operations across AT, Watercare, Stormwater and Parks. AT outsources the provision of public transport operations to third parties. However, AC itself has a limited approach to outsourcing. Functions that AC retains that we observe are outsourced at many organisations include the following:
  - Property (incl. ownership of offices)
  - IT
  - Fleet
  - Printing
  - Certain HR functions such as Payroll
  - Customer management
- A 2012 global PwC survey found these kinds of functions outsourced to some extent at between 30% and 50% of businesses. A key reason for the lack of outsourcing is the difficulty in overcoming organisational resistance to it
- The major potential benefits of outsourcing include:
  - Cost savings – a 2006 study by TPI, a leading global outsourcing advisory firm, suggested savings from outsourcing were on average around 15% (albeit with a wide range of outcomes)
  - Access to better capabilities and improved performance
  - Free up capital
  - Increase workforce flexibility
- The risks of outsourcing primarily relate to poor contracting that fails in one or more of the following aspects:
  - Does not properly scope the services required
  - Lacks the flexibility to handle the evolution of the organisation
  - Lack of appropriate cost control and cost incentives

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5.2 Outsourcing

AC opportunities

- The table on the right sets out the current assets identified with outsourcing potential across AC, the number of staff and the estimated cost of these staff
- The opportunity clearly exists to exit these functions and assets as part of an outsourcing process. Within an outsourcing arrangement it is certainly possible to require the service provider to acquire the incumbent assets and therefore get an immediate release of capital. Whether this is the optimal form of arrangement with the service provider would need to be further tested
- While the provider will look for a return on the assets it assumes under these arrangements, the cost of meeting this return could be offset by the underlying efficiency and productivity savings the outsourcing programme generates, resulting in a minimal future funding impact while freeing up the immediate capital of potentially around $250 million
- A great deal more detailed work would have to be done on each function to determine the ability to outsource, the expected merits of doing so (incl. cost savings), the optimal contracting structure the extent to which capital would be released

Outsourcing Assets

	IT	Fleet	Printing	Total
Asset Value ($ million)	235	30	n/a	**250**
Number of staff	570	n/a	15	**585**
Annual Salary Expenditure ($ millions)	30.4	n/a	0.8	**31.2**
Salary per staff ($)	53,281	n/a	53,933	**53,297**

Source: Auckland Council

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5.2 Outsourcing

Commercial Offices - background, value and rationale for ownership

- AC owns a range of commercial offices. A list of the major buildings and their book value is set out in the box below

Building	Suburb	BV Building ($m)	BV Land ($m)	Total Value ($m)
Albert Street	Auckland Central	107.0	18.2	125.2
Henderson Civic Centre	Henderson	29.0	3.8	32.8
Bledisloe House	Auckland Central	17.5	14.8	32.3
Graham Street	Auckland Central	12.3	15.5	27.8
Pacific Tasman Building	Orewa	13.6	2.7	16.3
Manukau Civic Centre	Manukau	8.3	5.3	13.6
Henderson Valley Road	Henderson	7.7	3.5	11.2
Kotuku House	Manukau	6.4	1.3	7.8
Pukekohe Service Centre	Pukekohe	1.0	3.9	4.8
Griffiths Building	Auckland Central	0.8	2.5	3.3
Papakura Service Centre	Papakura	1.1	1.6	2.7
The Strand	Takapuna	0.9	0.8	1.7
Mt Roskill Borough Building	Three Kings	0.7		0.7
Total		206.3	73.7	280.0

Source: Auckland Council

- The extent of ownership of office buildings in part reflects the origins of AC where the five constituent councils that came together each had a selection of owned premises

- There is no ownership / control imperative for ownership of commercial premises. AC's requirements of office buildings are not unique (as the use of Albert St – being a standard commercial office building demonstrates) and AC's requirements can be met through standard leasing arrangements in the way that most commercial businesses choose to do so

- We believe the principal analysis that supports an ownership decision is a comparison of AC's borrowing rate (used as the cost of ownership) with the commercial yield that would have to be paid if the premises were leased (as the cost of leasing). This approach reflects that at any point in time, AC's plan is fully funded and a decision that creates a future funding gap should be avoided. We discuss the shortcomings of this approach on the following slide

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5.2 Outsourcing

Commercial Offices - testing the rationale for ownership

- In corporate finance terms, using the borrowing rate as a proxy for the cost of ownership this analytical construct is incorrect for the following reasons:
  - The asset is not actually funded 100% by debt. Of the council's $42 billion of assets, only $7 billion is debt funded. The rest of the balance sheet is ratepayers equity. We believe ratepayers should be receiving a better return on their equity than AC's borrowing rate
  - It is not the cost of borrowing that determines the return that should be earnt on an asset, it is riskiness of the asset being invested in. It is incorrect to use the borrowing rate as the cost of capital involved in the ownership of commercial assets
  - If Council applies this benchmark to the ownership of risky assets (for example offices and commercial assets), it will be able to justify owning anything as AC's borrowing rate will always be lower than the commercial return sought on risky assets
- The correct analytical construct is to assume that AC the building owner is a separate person from AC the lessee. The building owner requires a commercial return on its asset (as this is the return it should get and would get if it leased the building on the wider market). AC as lessee is notionally paying this amount (as it is the rent foregone by not leasing the building to another party). Under this approach, ownership is at best a zero sum game – AC is in effect paying a commercial rental as this is the opportunity foregone by not leasing the building to a third party
- However, there are strong reasons to believe that ownership is sub-optimal. These include:
  - Commercial property ownership and management is unlikely to be a core competency of AC compared to commercial property owners
  - In the capital constrained world of AC (i.e. one where there are more value-enhancing projects than there is capital to fund them), Council should not be satisfied with owning assets simply for the sake that they earn a market-level commercial return. By owning assets solely for this reason, Council is foregoing investing in assets / projects that (we presume) Council believes are higher value for Auckland. In a capital constrained world, AC's effective cost of capital (or required return) is higher than a market level return
  - Under a capital constraint, the decision to retain ownership of an asset should consider the alternative use of the capital involved. For example, in a capital constrained world, a decision to own Asset X is actually a decision to own Asset X in preference to spending the capital on Project Y

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Attachment A

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5.2 Outsourcing

Commercial Offices - divestment funding impacts and observations

Assumptions

- *Interest costs of ownership is 6% (as per LTP)*
- *Lease costs of 8% p.a.*
- *Operational expenses are ignored as they are assumed to be the same under either a lease or ownership structure*
- *We have assumed that AC's indirect costs of property ownership (admin etc.) is equal to 10% of the revenue that would be obtained if the properties were rented at a commercial yield. This is a ratio in line with other property owning companies*

- Notwithstanding our commentary that the simple impact on future funding is the incorrect analytical construct for testing the ownership of commercial buildings (or any commercial asset), we set out the estimated impact of moving from an ownership model to a leasing model in the table below. Two scenarios are shown

  Scenario 1: Debt Reduction – sale proceeds are used to reduce debt

  Scenario 2: Non-income generating asset investment – sale proceeds are used to fund capex of a non-income generating asset

Commercial Offices ($millions)	Sale	FY16	FY17	FY18	FY19	FY20	FY21	FY22	FY23	FY24	FY25
Scenario 1: Debt Reduction											
Sale Proceeds	280	-	-	-	-	-	-	-	-	-	-
Debt Reduced	(280)	-	-	-	-	-	-	-	-	-	-
Interest cost savings	-	17	17	17	17	17	17	17	17	17	17
Estimated lease costs	-	(22)	(22)	(22)	(22)	(22)	(22)	(22)	(22)	(22)	(22)
Estimated property department savings	-	2	2	2	2	2	2	2	2	2	2
Net funding impact	-	(3)	(3)	(3)	(3)	(3)	(3)	(3)	(3)	(3)	(3)
Scenario 2: Asset Investment (Non-income Generating)											
Sale Proceeds	280	-	-	-	-	-	-	-	-	-	-
Asset Investment	(280)	-	-	-	-	-	-	-	-	-	-
Estimated lease costs	-	(22)	(22)	(22)	(22)	(22)	(22)	(22)	(22)	(22)	(22)
Estimated property department savings	-	2	2	2	2	2	2	2	2	2	2
Net funding impact	-	(20)	(20)	(20)	(20)	(20)	(20)	(20)	(20)	(20)	(20)

Source: Auckland Council, Colliers International, Cameron Partners

- If the sale proceeds are used to repay debt, the sales result in a marginally negative change to future cash flows as the debt and other costs saved are slightly less than the new lease costs incurred. If the funds are reinvested in non-income generating assets, a funding gap is created equal to the forecasted lease costs is created
- Notwithstanding the funding implications, we recommend that Council reviews its ownership of Commercial properties using a commercial return as the appropriate benchmark test, not AC's borrowing rate

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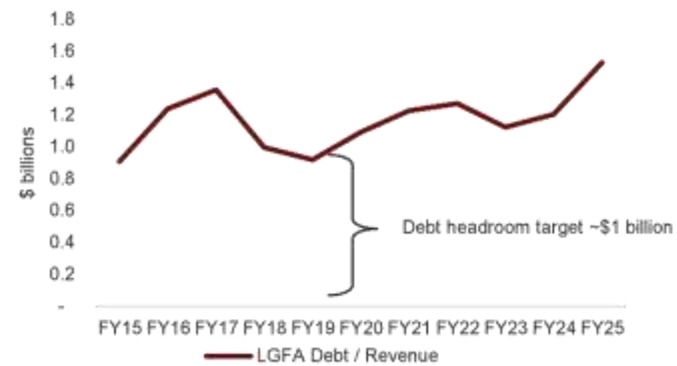
6. Observations & Conclusions

6. Observations and Conclusions

Debt

- AC debt is constrained by a combination of its lenders' policies, AC internal borrowing policies and AC credit rating objectives
- The constraints apply:
  - To a range of different products – including bank debt, bonds, commercial paper and also including sale and leaseback / financing leases and certain Partnerships / Alternative Procurement arrangements (e.g. PPPs)
  - Across both AC Parent and AC Consolidated Group consequently there is no benefit from debt at CCO level vs AC Parent level
- Debt is the most flexible form of financing available to AC – it can be used for long-term core requirements and to meet short-term requirements

AC / AC Group (as applicable) Additional Debt Capacity



Source: Cameron Partners

- Additional debt capacity to finance capex projects is a function of AC's maximum debt levels, forecast debt and the amount of debt headroom AC wishes to maintain. Under the current arrangements there appears to be little additional debt capacity available particularly when an allowance for debt headroom is made
- There are options to increase additional debt capacity (in order):
  - Accept lower debt headroom - e.g. AC may be happy to rely on liquid assets to meet short-term requirements
  - Renegotiate LGFA covenants – this will require and ordinary resolution of LGFA shareholders and may not be straightforward
  - Accept a lower credit rating - consequences of a rating downgrade may be considered acceptable
  - Amend the TMP Borrowing Policy
- It should be noted that in the event that additional debt capacity is created and used, AC will:
  - Need to fund the increased debt
  - Bear the consequences of the increased debt including marginally higher pricing, higher financial risk and negative reaction from existing investors

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6. Observations and Conclusions

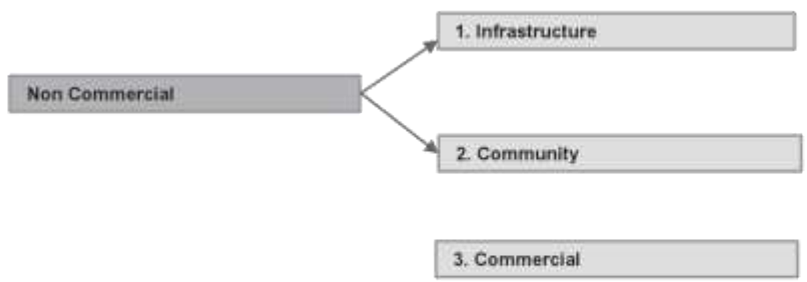
Asset recycling

- Our discussions with AC management have highlighted that:
  - There is no systematic opportunity cost analysis applied to assets despite AC's capital constraints
  - There is limited rigorous testing for whether there is a ownership / control imperative to support Council ownership
  - There is no systematic cost of capital applied and when there is, it typically uses AC's borrowing rate as the hurdle rate
  - Due to scrutiny of expenses there is (perhaps understandably) a focus on capital solutions rather than solutions that increase expenses (e.g. ownership vs leasing)
  - Because proceeds from the sale of community assets at Ward level are typically returned to the general AC coffers there is a strong incentive to not sell assets

  All other things equal these factors create a bias towards asset ownership, 'inefficient' use of capital and difficulties identifying and implementing asset recycling financing options

- There are key differences between different types of assets that impact their appropriateness as financing options. Accordingly we classify AC's assets into three categories to assist with isolating the financing issues – infrastructure, community and commercial

- In terms of financing options it is useful for Council to think of its assets in three broad categories:



1. Infrastructure
   - Large scale / asset intensive / networks
   - Core essential services
   - Complex and long term investment / capital budgeting decisions
   - No alternative use
2. Community
   - Support the provision of community services
   - Higher number, relatively low individual value
   - Not typically run as businesses
   - Potentially higher value in alternative use
3. Commercial
   - Commercial businesses
   - Generate external revenues / return
   - Activity would be provided without AC ownership

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6. Observations and Conclusions

Asset recycling (cont.)

- Our observations in relation to asset recycling are as follows:
- Infrastructure Assets:
  - Develop processes around identifying and rigorously testing for surplus land
  - Actively consider these assets for PPP arrangements
  - Develop and test options for outsourcing asset management decisions and risks with the objective of reducing the 10 year capex path of $13.5 billion by introducing a commercial imperative and developing benefit-sharing models
- Community Assets:
  - Develop a central register of Community Assets that compares the value and use of Community Assets to their value in alternative use
  - Incorporate into Council processes, reviews of delivery of community services to see if aggregate cost (including cost of capital deployed) can be reduced
  - Identify individual situations where the value in alternative use is significant and determine whether the current arrangements or alternative arrangements would be a better balance of Councils obligations to the current users of the facility and to wider Auckland
  - Develop appropriate incentive arrangements with local boards whereby local boards share in any savings achieved by changes to service delivery and the release of capital where the total cost of delivery (including capital cost) is reduced
- Commercial Assets:
  - Investigate further the strategic rationale for ownership of material commercial assets. Divest assets that do not present compelling rationale for ownership
  - Further analysis of sale options (including counterparties) and expected proceeds

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6. Observations and Conclusions

Partnerships / Alternative procurement

PPPs

- All projects are capable of being procured through traditional means. However, there is evidence to suggest that project outcomes (especially for large infrastructure assets) and risks can be enhanced by procuring via PPPs. The choice of procurement model is driven by the following factors whole-of-life value for money (relative to the public sector comparator); service quality; risk transfer and budgeting certainty / flexibility

- PPPs are not a funding solution. A project:
  - Without external cash flows will require public sector funding
  - With external cash flows may be capable of attracting funding from other sources

- Because, all things equal funding sources don't change, PPPs don't create financing capacity. However, PPPs do potentially offer financing flexibility

- Due to the limited nature of New Zealand capital markets, the financing options available for PPPs potentially offer features that may be attractive to AC (subject to an assessment of counterparty risk):
  - AC can effectively 'lock in' payment streams that provide budget certainty (over the term of the contract)
  - Very long term financing can effectively be accessed
  - Cash flows can be manipulated to best suit AC requirements (e.g. weighted to the end of the contract term)

- We suggest that Council more fully investigates the use of PPP structures for infrastructure assets – including in situations where there is no material demand risk transfer and therefore limited external commercial funding:
  - The procurement and risk transfer outcomes can be superior
  - Currently very low costs of capital are being applied to PPP offerings that are supported by local government payments
  - The combined effect of these two points can offset the higher cost of funds (compared to AC's borrowing cost) and consequently deliver better value for money outcomes
  - The financing cost and repayment profile can be individualised to Council preferences

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Attachment A

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6. Observations and Conclusions

Partnerships / Alternative procurement (cont.)

Outsourcing

- Compared to companies with similar sized expenditure the extent to which AC's internal operations (e.g. IT, fleet, printing etc.) are outsourced seems low
- The methods of outsourcing are case-specific. However, general market experience suggests there is potential to monetise assets associated with these functions and have cost-saving offset any negative funding implications
- Council should more rigorously test these options
- Council is also a significant owner of commercial office space:
  - There is no strategic imperative for this
  - The ownership decision appears to be based on using AC's borrowing rate as a proxy for the cost of ownership. We believe this approach is incorrect and leads to poor asset decisions
  - We believe it is unlikely that AC is a natural owner of commercial office space
  - We recommend a more rigorous analysis of the ownership of commercial office space

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Appendix 1: S&P Rating Methodology

Appendix 1: S&P Rating Methodology

AC's key S&P factors

- As outlined, we have reviewed AC's 2014 S&P Credit Rating (4 November 2014) in detail and analysed these using S&P's rating methodology. This is summarised in the table below:

Factor	Comment	2014 Score	Forecast Score
Economy	2014 - GDP per capita US$43,700 (compared to the national average of US$38,600) S&P 2014 Rating Report (RR) – "Auckland economy is very strong and diversified… It represents the single-largest regional economy and accounts for about 35% of national GDP"	1	~1
Financial Management	S&P 2014 RR - "Very strong financial management to continue with sophisticated debt and liquidity management. We consider Auckland's fiscal strategy as prudent… strategy is outlined in the council's Treasury Management Policy and includes a number of key objectives that relate specifically to how the council manages its external risk, borrowings, and its debt repayments."	1	~1
Budgetary Flexibility	Based on two ratios - Modifiable revenues / adjusted operating revenue: 83% (2014); Capital expenditure / total expenditures: 36.3% (2014) S&P 2014 RR – "Auckland's budgetary flexibility is strong" with "no legal restrictions on the ability of Auckland to increase rates, other than political imperatives to keep increases low." However, the "presence of an infrastructure and maintenance backlog reduces the council's expenditure flexibility."	2	~2
Budgetary performance	Based on two ratios - Average balance after capital accounts / total adjusted revenues -19% (2014); Average operating balance / adjusted revenues 13.6% (2014) S&P 2014 RR – AC's "budgetary performance is weak due to its extensive capital expenditure program. In our view, Auckland can deliver its forecast capital program within the financial metrics compatible with an 'AA' rating."	4	~4
Liquidity	Based on one ratio - Free cash, liquid assets, and committed bank lines % of NTM debt service: 141% Liquidity (as measured by S&P) can be managed by AC and expected to remain strong	2	~2
Debt Burden	Based on two ratios - Tax supported debt / consolidated operating revenues: 250% ; Interest as % of operating revenues: 13% S&P 2014 RR – "The increasing debt burden is driven by capital-expenditure needs" which has risen rapidly in recent years. Downward rating pressure might arise if Auckland's debt increases to more than 270% of operating revenues as the council borrows to invest in infrastructure or if its operating position weakens because of lower-than-expected revenue."	5	~5+
Contingent Liabilities	S&P 2014 RR – "Auckland's reported non-debt and contingent liabilities are low… and it is important to note that about 80% of these contingent liabilities are guarantees relating to the borrowings of Watercare – a CCO. This exposure is reducing as Watercare funds more borrowing directly through the council."	2	~2

Source: S&P's Methodology for Rating Non-US Local and Regional Governments

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Appendix 1: S&P Rating Methodology

AC S&P key observations

- The S&P methodology:
  - Is heavily influenced by S&P's view of the national framework, which it rates as "one of the best of the world" and receives the top grade as "extremely predictable and supportive". As outlined earlier this is reflected in the relatively high credit ratings assigned to all New Zealand Local Authorities
  - Applies equal rating to five factors and consequently has limited sensitivity to changes in individual factors
- The only factor which could change is the debt burden. This would happen if AC's tax-supported debt as a percentage of consolidated operating revenue were to exceed 270% (as stated in AC's 2014 S&P RR). This would still only have limited effect and result in a maximum movement of one rating
- An AA- rating remains a very strong credit quality and would have only a marginal impact on the cost of debt funding for AC
- The New Zealand Local Authorities' credit ratings only span three rating notches. The lowest S&P credit rating currently applied to the New Zealand Local Authorities is A+. Of the 20 rated local authorities, 10 have AA credit ratings, five have a AA- credit rating, and five have A+ credit ratings
- As a cross reference, we compare AC to the other rated New Zealand Local Authorities. We note that there are five other New Zealand Local Authorities that have debt related ratios at similar levels to AC. Of the five only one other (Taupo District Council) has an AA credit rating while the other four have A+ credit ratings

	Rating	Debt	Interest	Comments
Taupo District Council	AA	200.0%	14.6%	Upgraded to AA in 2015 to reflect expectation of reducing debt to <200%
Horowhenua District Council	A+	210.0%	10.0%	Debt to peak in 2016
South Taranaki District Council	A+	219.5%	11.5%	Debt expected to remain steady
Kapiti Coast District Council	A+	233.0%	14.9%	Debt to peak in 2016
Tauranga City Council	A+	243.0%	15.0%	Less than adequate coverage of upcoming debt maturities and interest expense

Source: S&P

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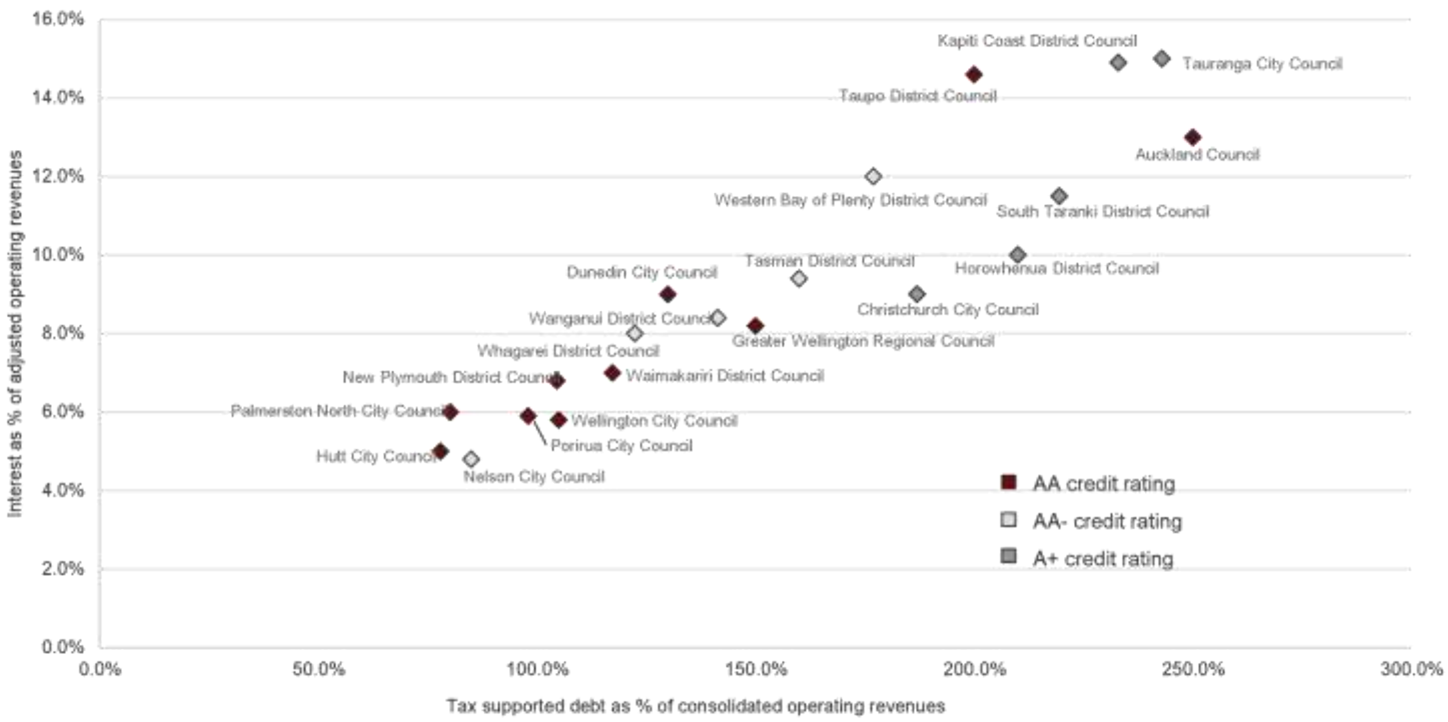
Appendix 1: S&P Rating Methodology

AC S&P key observations

- The correlation between debt levels and credit rating is high. However, large changes in debt levels results in only small changes to the credit rating

New Zealand S&P Credit Rated Local Authorities



Source: S&P

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Appendix 1: S&P Rating Methodology

Overview

- Key features of S&P's methodology:
  - Is heavily influenced by its views on New Zealand's institutional Framework which it considers to be "one of the best in the world" and this ensures that all New Zealand Local Authorities are considered to have high credit quality
  - Limits the impact of changes in any one factor so for example, within reasonable bounds, a significant change in debt levels will only have a limited impact on AC's Credit Rating

- An S&P Credit Rating is its "opinion about the ability and willingness of an issuer…to meet its financial obligations in full - and on time". S&P's Credit Ratings range from 'AAA' (its highest rating and denoting an extremely strong capacity to meet financial commitments) to 'D' (its lowest rating and denoting payment default)

- S&P has a standardised methodology it uses to assign Credit Ratings to Local and Regional Government Authorities globally (S&P's "Methodology for Rating Non-U.S. Local and Regional Governments" dated June 2014). This methodology assesses a number of factors as follows:
  - National institutional framework (the same for all entities at the same level of Government within a country i.e. state level or municipal level).
  - Profile of the individual entity based on seven factors:
    - Economy
    - Financial Management
    - Budgetary Flexibility
    - Budgetary Performance } Grouped
    - Liquidity
    - Debt Burden
    - Contingent Liabilities } Grouped

- A score between 1 and 5 is assigned to each factor. The average of the scores is then applied to a matrix that derives an indicative Credit Rating

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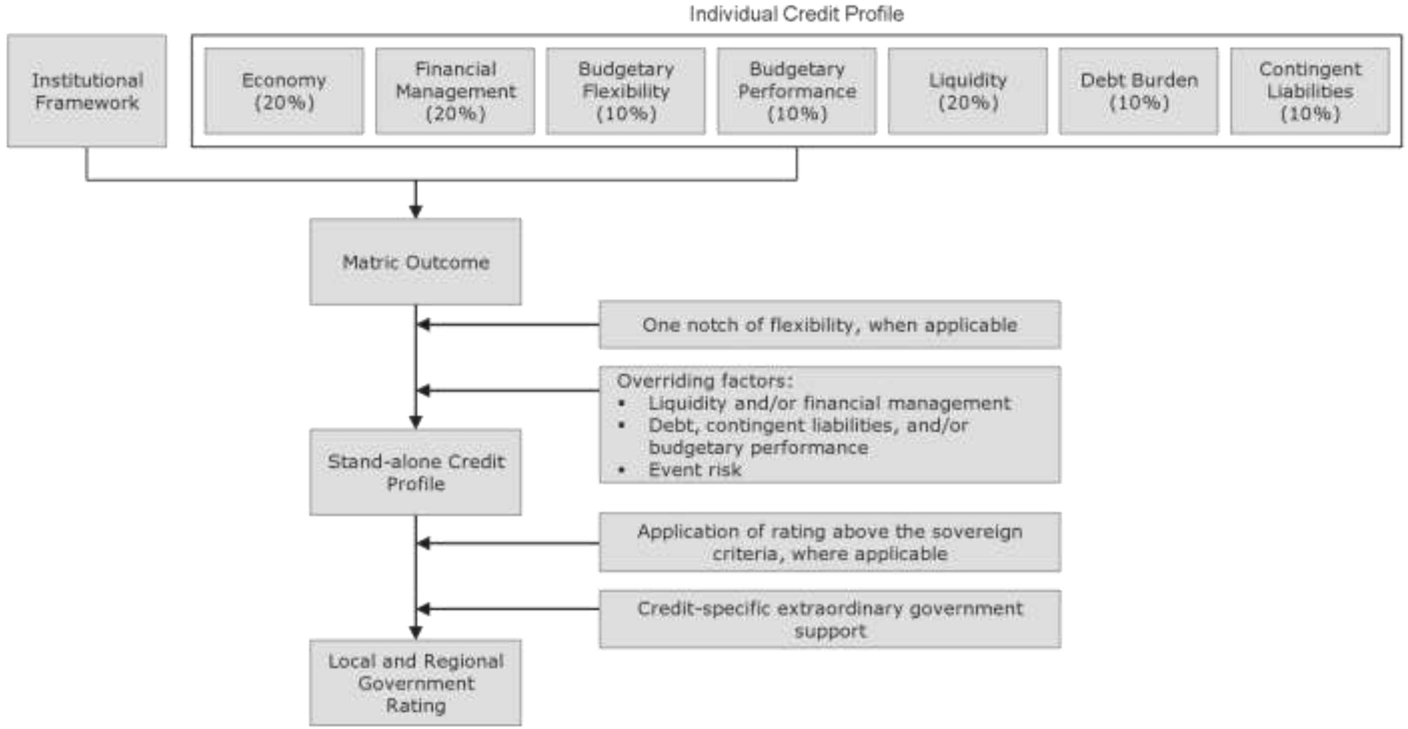
Appendix 1: S&P Rating Methodology

Rating methodology

- The blow diagram demonstrates the rating methodology used by S&P:



Source: S&P's Methodology for Rating Non-US Local and Regional Governments

- The majority of the factors which influence the rating 'score' are quantitative, although adjustments for qualitative factors may be made

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Appendix 1: S&P Rating Methodology

Economy & financial management

Economy

- Primarily driven by GDP per capita, with potential adjustments driven by the diversification of the economy, demographic profile, and growth prospects

GDP Per Capita (US$)	>38,000	>27,000	>16,000	>5,500	<5,500
Anchor Score	1	2	3	4	5

Source: S&P's Methodology for Rating Non-US Local and Regional Governments

- Qualitative factors may influence / adjust the anchor score by one rating notch (two in exceptional circumstances). These include:
  - Above average growth prospects
  - Exceptionally broad diversified economy
  - Negative budgetary impact from demographic profile
  - Very volatile/concentrated economy
  - Very high unemployment
  - Limited growth prospects

Financial management

- Assessed across nine main categories, with largely qualitative assessments. Categories are:
  - Transparency and disclosure
  - Budgeting
  - Long-term capital and financial planning
  - Revenue and expenditure management
  - Debt management
  - Reserve and liquidity management
  - Management of government-related entities
  - Political and managerial strength
  - External risk management

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Appendix 1: S&P Rating Methodology

Assessing budgetary flexibility

- Anchor score based on the ratios below:

	Modifiable revenues as % of adjusted operating revenues				
Capital expenditure as % of total expenditures	>70%	>50%	>30%	>10%	<10%
>15%	1	2	3	4	4
<15%	2	3	3	4	5

Source: S&P's Methodology for Rating Non-US Local and Regional Governments

Note: Adjusted operating revenues are adjusted for material noncash or pass-through items

Modifiable revenues represent revenues (taxes, fees, rents, among others) that a government may increase or decrease if required

- Qualitative factors may influence / adjust the anchor score by a notch (two in exceptional circumstances). These include:
  - Demonstrated capability and willingness to cut operating spending
  - Ability to increase operating revenues
  - Demonstrated ability to postpone capital expenditure
  - Above-average capability to generate revenues from asset sales
  - Highly limited leeway to adjust modifiable revenues
  - Highly limited ability to cut expenditures

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Appendix 1: S&P Rating Methodology

Budgetary performance

- Anchor score based on the combined metrics below, based on the average of two-year actual data, the current year budget or estimate, and two years of S&P forecasts

	Balance after capital accounts as % of total adjusted revenues				
Operating balance as % of adjusted operating revenues	>0	<(5%)	<(10%)	<(15%)	>(15%)
>5%	1	2	3	4	4
<5%	2	3	3	4	5
<0%	N/A	4	4	5	5

Source: S&P's Methodology for Rating Non-US Local and Regional Governments

Notes:

Balance after capital accounts is the operating balance plus capital revenues less capital expenditures

The operating balance is adjusted operating revenues less adjusted operating expenditures

- Qualitative factors may influence / adjust the anchor score by a category (2 in exceptional circumstances). These include:
  - Expected structural improvement
  - High cash reserve levels
  - Expected structural deterioration
  - Pronounced volatility in performance
  - Underestimated cash flows

Appendix 1: S&P Rating Methodology

Liquidity

- Anchor score based on the metrics below:

	Free cash and liquid assets as a % of NTM debt service	Free cash, liquid assets and committed bank lines as % of NTM debt service			
	>100%	>120%	80%-120%	80%-40%	<40%
Anchor Score	1	2	3	4	5

Source: S&P's Methodology for Rating Non-US Local and Regional Governments

- Qualitative factors may influence / adjust the anchor score by a category (two or three in exceptional circumstances). These include:
  - Access to external liquidity is exceptional or strong
  - The Local and Regional Governments ("LRG") controls a bank and its debt can be repurchased at the central bank
  - Internal cash flow generation capability is very robust
  - Access to external liquidity is limited
  - Expected funding needs are very large
  - Expected volatility in the 12-month coverage ratio
  - Debt repayment is not defined by law as a priority payment for the LRG

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Appendix 1: S&P Rating Methodology

Debt burden

- Anchor score based on the combined metrics below, allowing for two years of forecasts:

	Tax-supported debt as % of consolidated operating revenues				
Interest as % of adjusted operating revenues	<30%	<60%	<120%	<180%	>180%
<5%	1	2	3	4	N/A
5%-9%	2	3	4	4	5
>9%	N/A	4	5	5	5

Source: S&P's Methodology for Rating Non-US Local and Regional Governments

- Qualitative factors may influence / adjust the anchor score by a category (two in exceptional circumstances). These include:
  - Debt burden mitigated by an exceptionally high operating balance
  - Debt burden mitigated by self-supporting on-lent debt
  - Potential significant volatility in the debt burden owing to high exposure to market risks
  - Large share of unfunded pension liabilities
- *Tax supported debt* is made up of:
  - Direct debt of the LRG
  - Guaranteed debt of GREs (government related entity) or other entities that are not self-supporting
  - Non-guaranteed debt of GREs that are not self-supporting
  - Debt of non-bank GREs, when S&P equalise the long-term rating on the GRE with the long-term rating on the LRG, based on an opinion of "almost certain" likelihood of support from the LRG to the GRE
  - Debt of PPPs and securitizations, when the risk transfer to the private sector is not material enough to treat the public sector entity's financial commitment as a contingent liability
- *Consolidated operating revenues* consist of the LRG's operating revenues and the commercial revenues generated by GREs that the LRG owns or controls and for which debt is included in the LRG's tax-supported debt ratio. Generally, material GRE income that is generated directly from the LRG is deducted

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Appendix 1: S&P Rating Methodology

Contingent liabilities

- These are based on a largely qualitative assessment of potential contingent liabilities, with particular focus given to:
  - Contingent liabilities from a large non-financial company (e.g. a GRE)
  - Financial companies
  - Public-private partnerships
  - Securitizations
  - A multitude of small companies
  - Litigations
  - Other unfunded post-employment benefits
  - Other contingent risks

Appendix 1: S&P Rating Methodology

Benchmarking with other New Zealand LRGs – AA rated

	Auckland Council	Porirua City Council	Palmerston North City Council	Greater Wellington Regional Council	Wellington City Council	Hutt City Council	Taupo District Council	New Plymouth District Council	Dunedin City Council	Waimakariri District Council
Date of rating report	4/11/2014	8/09/2015	21/05/2015	19/11/2014	23/11/2014	31/08/2015	25/05/2015	14/10/2014	8/12/2014	13/05/2015
Key Rating Metrics and Ratios										
GDP Per Capita (US$)	$43,700	$23,000	$35,000	$47,000	$70,000	$31,000	$36,800	$60,000	$30,600	$22,511
Modifiable Revenues % of Adjusted Operating Revenues	83.0%	95.0%	97.0%	49.0%	92.0%	91.0%	90.0%	60.8%	45.0%	91.5%
Capital expenditure as % of total expenditures	36.3%	26.4%	20.5%	15.0%	28.0%	24.0%	24.0%	23.3%	22.5%	42.6%
Balance after capital accounts % of total adjusted revenues	-19.0%	-7.5%	8.6%	-14.1%	-2.8%	-0.5%	2.5%	-2.0%	2.2%	-8.8%
Operating balance as % of adjusted operating revenues	13.6%	15.0%	21.6%	5.5%	18.3%	20.0%	19.5%	14.8%	20.1%	12.9%
Free cash, liquid assets and committed bank lines as % of NTM debt service	141.0%	200.0%	214.0%	136.0%	144.0%	118.0%	115.0%	126.0%	88.8%	107.2%
Tax supported debt as % of consolidated operating revenues	250.0%	98.0%	80.2%	150.0%	105.0%	78.0%	200.0%	104.6%	130.0%	117.3%
Interest as % of adjusted operating revenues	13.0%	5.9%	6.0%	8.2%	5.8%	5.0%	14.6%	6.8%	9.0%	7.0%
Rating Criteria										
Economy	Very Strong	Strong	Strong	Very Strong	Very Strong	Average	Average	Average	Average	Average
Financial Management	Very Strong	Strong	Strong	Very Strong	Very Strong	Very Strong	Very Strong	Strong	Strong	Strong
Budgetary Flexibility	Strong	Strong	Strong	Weak	Very Strong	Strong	Very Strong	Strong	Average	Strong
Budgetary Performance	Weak	Average	Average	Weak	Strong	Strong	Very Strong	Average	Very Strong	Average
Liquidity	Strong	Strong	Strong	Strong	Strong	Adequate	Strong	Strong	Adequate	Strong
Debt Burden	Very High	High	High	High	High	Moderate	Very High	High	High	High
Contingent Liabilities	Low	Low	Low	Low	Low	Low	Low	Very Low	Low	Low
Rating Score										
Economy	1	2	2	1	1	3	3	3	3	3
Financial Management	1	2	2	1	1	1	1	2	2	2
Budget	3	3	3	4	2	2	1	3	2	3
Liquidity	2	2	2	2	2	3	2	2	3	2
Debt and Contingencies	4	3	3	3	3	3	4	3	3	3
Average Score	2.1	2.3	2.3	2.2	1.8	2.3	2.1	2.4	2.6	2.5
Rating										
Predicted Rating from Average Score	AA+	AA	AA+	AA+	AA+	AA	AA+	AA	AA	AA
Actual Rating	AA	AA	AA	AA	AA	AA	AA	AA	AA	AA
Outlook	Stable	Stable	Stable	Stable	Stable	Stable	Stable	Stable	Stable	Stable

Source: S&P

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Appendix 1: S&P Rating Methodology

Benchmarking with other New Zealand LRGs – AA- and A+ rated

	Nelson City Council	Tasman District Council	Wanganui District Council	Western Bay of Plenty District Council	Whagarei District Council	South Taranki District Council	Tauranga City Council	Horowhenua District Council	Kapiti Coast District Council	Christchurch City Council
Date of rating report	11/12/2014	5/10/2014	2/07/2015	11/10/2015	21/05/2015	4/06/2015	31/10/2014	5/05/2015	29/10/2014	16/12/2014
Key Rating Metrics and Ratios										
GDP Per Capita (US$)	$31,200	$26,100	$28,000	$33,300	$35,000	$49,000	$31,400	$26,000	$22,000	$37,200
Modifiable Revenues % of Adjusted Operating Revenues	90.0%	74.0%	90.0%	89.3%	91.7%	80.0%	95.0%	96.0%	90.0%	40.0%
Capital expenditure as % of total expenditures	31.0%	27.0%	27.0%	29.0%	32.3%	32.0%	31.0%	40.9%	43.0%	41.7%
Balance after capital accounts % of total adjusted revenues	-4.4%	-2.5%	-3.0%	3.0%	2.9%	-9.0%	2.0%	-26.9%	-21.2%	-10.0%
Operating balance as % of adjusted operating revenues	24.0%	18.0%	18.0%	23.5%	23.7%	18.0%	24.0%	17.8%	21.6%	9.5%
Free cash, liquid assets and committed bank lines as % of NTM debt service	170.0%	550.0%	80.0%	133.0%	111.0%	144.0%	64.0%	133.0%	400.0%	214.0%
Tax supported debt as % of consolidated operating revenues	85.0%	160.0%	141.4%	177.0%	122.4%	219.5%	243.0%	210.0%	233.0%	187.0%
Interest as % of adjusted operating revenues	4.8%	9.4%	8.4%	12.0%	8.0%	11.5%	15.0%	10.0%	14.9%	9.0%
Rating Criteria										
Economy	Average	Average	Average	Average	Average	Average	Average	Average	Average	Strong
Financial Management	Strong	Strong	Strong	Strong	Very Strong	Average	Strong	Strong	Strong	Average
Budgetary Flexibility	Very Strong	Strong	Strong	Very Strong	Very Strong	Strong	Strong	Strong	Strong	Average
Budgetary Performance	Average	Average	Average	Strong	Strong	Average	Strong	Weak	Weak	Weak
Liquidity	Strong	Strong	Adequate	Strong	Adequate	Strong	Less than adequate	Strong	Strong	Strong
Debt Burden	Moderate	Very High	Very High	Very High	High	Very High	Very High	Very High	Very High	Very High
Contingent Liabilities	Low	Low	Low	Very Low	Low	Very Low	Very Low	Very Low	Very Low	Very High
Rating Score										
Economy	3	3	3	3	3	3	3	3	3	2
Financial Management	2	2	2	2	1	3	2	2	2	3
Budget	2	3	3	2	2	3	2	3	3	4
Liquidity	2	2	3	2	3	2	4	2	2	2
Debt and Contingencies	3	4	4	3	3	3	3	3	3	5
Average Score	2.3	2.6	2.8	2.3	2.3	2.7	2.8	2.6	2.6	3.1
Rating										
Predicted Rating from Average Score	AA	AA	AA-	AA	AA	AA	AA-	AA	AA	AA-
Actual Rating	AA-	AA-	AA-	AA-	AA-	A+	A+	A+	A+	A+
Outlook	Positive	Stable	Stable	Stable	Positive	Positive	Stable	Stable	Stable	Negative

Source: S&P

Appendix 2: POAL Valuation

Appendix 2: POAL Valuation

Indicative market valuation

- Until POAL has a settled future determined by the current Council review and the business plan impact of that review can be assessed, it is difficult to determine an indicative valuation with any confidence. However, set out below are the Value / EBIT multiples of some comparable ports that are publicly listed or have recently been the subject of a transaction

Company	Primary Operations	Financial Year End	Market Cap	Enterprise Value	Revenue LTM	EBITDA LTM	EBITDA Margin		EV / EBITDA	
							LTM	t+1	LTM	t+1
The Port of Tauranga Ltd	NZ	Jun 15	2,321	2,618	268	142	52.9%	50.5%	18.4x	19.0x
South Port New NZ Limited	NZ	Jun 15	125	131	35	14	41.6%	n/a	9.1x	n/a
Logistec Corp	Canada	Dec 14	627	674	389	59	15.0%	n/a	11.5x	n/a
Hutchison Port Holdings Trust	Singapore	Dec 14	7,660	16,758	2,571	1,158	45.0%	53.7%	14.5x	11.5x
China Merchants Holdings (Int) Company	Hong Kong	Dec 14	12,133	15,410	1,704	1,673	98.2%	51.3%	9.2x	16.3x
CIG Yangtze Ports PLC	Hong Kong	Dec 14	101	174	36	14	38.8%	n/a	12.3x	n/x
Cosco Pacific Ltd	Hong Kong	Dec 14	6,078	8,082	1,307	952	72.9%	51.9%	8.5x	11.2x
Tianjin Port Development Holdings Ltd	Hong Kong	Dec 14	1,547	5,909	6,256	867	13.9%	10.4%	6.8x	8.2x
EUROKAI GmbH & Co. KGaA	Germany	Dec 14	718	845	561	151	27.0%	16.2%	5.6x	9.2x
Hamburger Hafen und Logistik AG	Germany	Dec 14	1,808	2,431	2,108	480	22.8%	23.7%	5.1x	4.9x
Global Ports Investments PLC	Cyprus	Dec 14	1,200	2,978	770	545	70.8%	68.1%	5.5x	6.6x
Piraeus Port Authority SA	Greece	Dec 14	664	702	181	32	17.7%	22.1%	21.9x	16.7x
Thessaloniki Port Authority Societe Anonyme	Greece	Dec 14	417	296	100	53	53.4%	n/a	5.6x	n/a
						Mean	43.8%	38.6%	10.3x	11.5x
						Median	41.6%	50.5%	9.1x	11.2x

Date	Country	Target	Acquirer	Target EV	% Acquired	Transaction Value	EV / EBITDA
Aug 2014	NZ	Lyttleton Port Company Ltd	Christchurch City Holdings Ltd	401	20%	82	12.4x
Mar 2005	NZ	Ports of Auckland Ltd	Auckland Regional Holdings	694	20%	169	11.0x
Apr 2015	Australia	Newcastle Port Corp	Hastings Funds Mgmt & China Merchants Group	Na	100%	1,888	27.0x
Nov 2013	Australia	Port of Brisbane Corp	Caisse de depot et placement du Quebec	5,870	27%	1,567	28.0x
Apr 2013	Australia	Port Kembla Pty. Ltd and Port Botany	Funds Consortium	6,215	100%	6,215	25.0x
Nov 2010	Australia	Port of Brisbane Corp	Q Port Holdings Consortium	3,619	100%	3,639	27.8x
						Mean - all	21.9x
						Median - all	26.0x

Source: *Capital IQ*

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Appendix 2: POAL Valuation

Indicative market valuation

- The key metrics to observe are as follows:
  - POT, POAL's major competitor is currently trading on a multiple of FY16 EBITDA of 19.0x and FY15 EBITDA of 18.4x
  - Recent Australian transactions (generally where a lease on the port is granted for a 99 year plus period to an operator) have recorded transaction multiples in the 20's

- EBITDA multiples are essentially a function of expected growth (and the cost of that growth – including capex). In this regard, we observe the following:
  - As noted above, it is not clear to what extent the ability of POAL to grow will be constrained by the outcome of either the Council review or the wharf extensions POAL believes is required to handle the growth it could otherwise achieve
  - Our review of analyst reports of POT suggests that POT is regarded as likely to experience higher growth rates than POAL and has a lower cost associated with that growth
  - The Australian ports that are being privatised are likely to have more underlying opportunity for efficiency improvements than POAL and this will be reflected in the multiples being observed
  - Infrastructure based assets such as ports are currently benefiting from large funds flows from sovereign wealth funds and pension funds looking for relatively low returns given the low interest rate environment globally

- We believe a range of 15.0x – 16.0x FY15 EBITDA is an appropriate multiple. This suggests and overall indicative market value for POAL of $1,287– $1,373 million, implying an equity value of $1,078 - $1,164 million. This is marginally higher than the equity value referred to in the ACIL 2014 Statement of Intent of $1,079 million

- In FY15, AC received a total dividend of $41.7 million from POAL. On our estimate of market, this is a yield of 3.6% – 3.9%

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Appendix 2: POAL Valuation

Other valuation considerations

- By way of comparison, we have considered the value that could potentially be recognised from POAL's land and wharf footprint in alternative use (mixed retail, office, residential and public space and amenities – similar to the Wynyard development). The key assumptions we have applied after discussions with Panukua Development Auckland staff are:
  - Total land area – 52.3 hectares
  - Values observed per square metre for development sites at Wynyard (incl. contamination risk) - $4,000/m² - $5,500/m²
  - Discount of 40% to full development value to reflect:
    - Leasehold structure (as per Wynyard)
    - Significant public open space and amenity values
    - Strong design-led outcomes
  - Estimated value realised - $1,255 million
- The following should be noted about this estimate:
  - It ignores the value of the land that is reserved from development for public use and amenity value
  - It would have to be reduced by the costs of relocating or foregoing the port to determine a net position

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Auckland Council
Alternative Sources of Financing
11 November 2015

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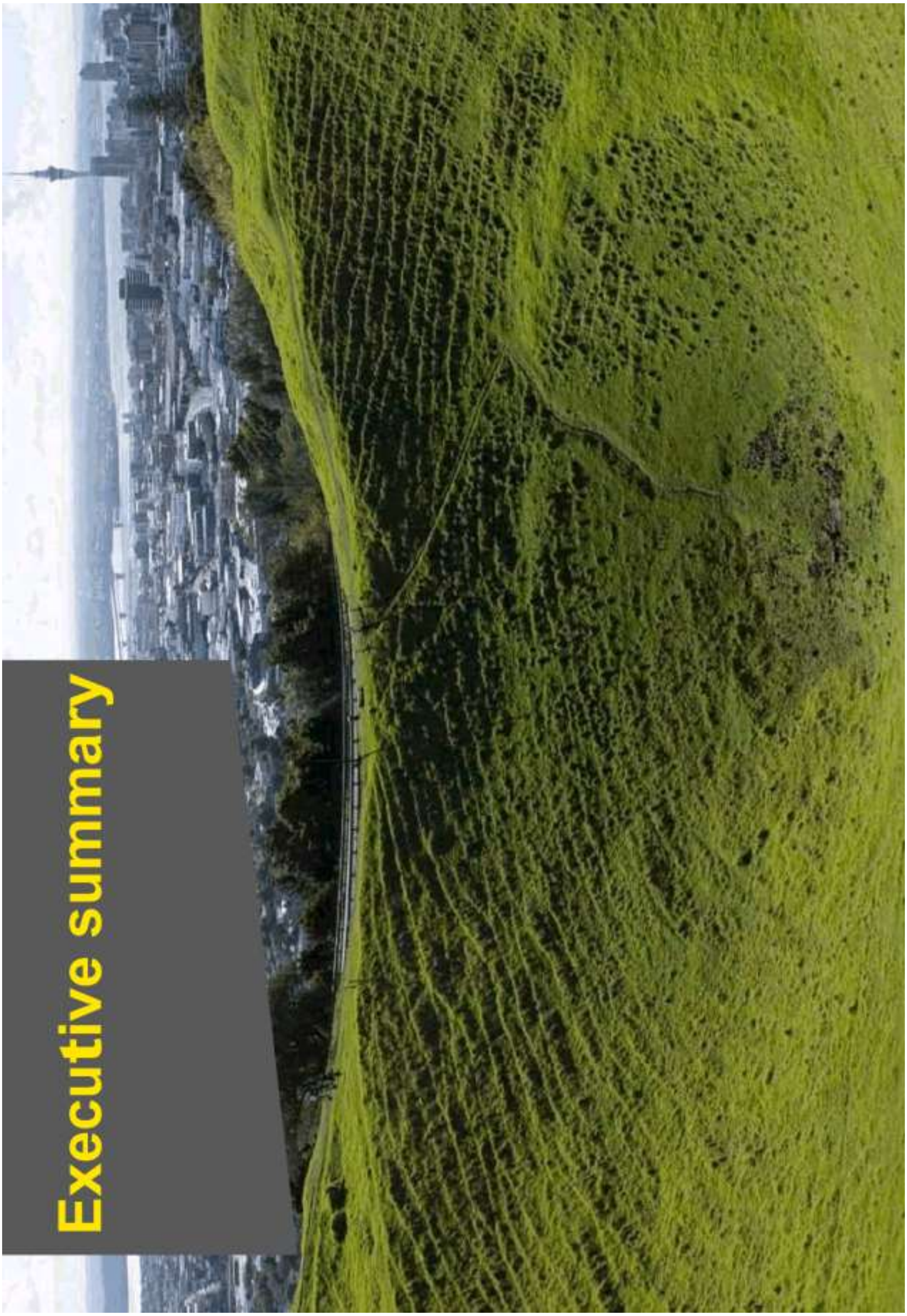
Executive summary

Context

1. Process

2. Asset optimisation


Executive summary

Executive summary

If Auckland wants to achieve its goal of being the world's most liveable city, Auckland Council must accelerate its infrastructure spend beyond the level outlined in the Long Term Plan. Optimising Auckland Council's balance sheet is a critical step to allow this.

Auckland's Vision

"Auckland's vision is to become the world's most liveable city. The goal of liveability expresses the shared desire to create a city where all people can enjoy a high quality of life and improved standards of living, a city which is attractive to mobile people, firms, and investors, and a place where environmental and social standards are respected."

This vision for Auckland's future is bright and ambitious. Dynamism and vibrancy dominate; people and businesses interact harmoniously over shared spaces; those living here want to stay and others want to move here. It is a compelling vision.

But delivering on a vision of this scale will be challenging and several difficult trade-offs must be made along the way.

Five years after Auckland Council's creation, it is timely to investigate its balance sheet to ensure it is still fit for purpose.

Auckland Council[1] plays a key role in achieving the Auckland vision. In particular, providing well-functioning infrastructure will improve economic, social, environmental and cultural outcomes and will be central to realising the vision of Auckland as the world's most liveable city. This again is recognised in the Auckland Plan.

"From fast and efficient public transport services delivering the Auckland of the future, to fundamental water services delivering a basic human right; from public libraries providing local communities with access to knowledge, to ports and airports connecting Auckland to the world; infrastructure is the platform upon which Auckland is built". [2]

Population growth will continue to put pressure on the ability of Auckland Council to provide core services. Statistics New Zealand projects the Auckland region will account for three-fifths of New Zealand's population growth between 2013 and 2043 - with a net increase of 740,000 people from just under 1.5 million now, to 2.2 million (medium projection). Auckland's population is estimated to reach 2 million around 2033.[3]

Auckland Council services will also face pressures – primarily from changing demographics. The scale, nature, location and delivery of public services will all be constructively challenged as the immigrant population continues to grow, and the general population continues to age. Consumer preferences are dynamic, and Auckland Council, like all other public institutions, must remain cognisant of this.

Auckland Council's development through the amalgamation of eight legacy councils in 2010 provides a significant platform for future growth. Amalgamation has raised the potential for scale efficiencies but has also revealed significant duplication of asset holdings and services in the short and medium term.

[1] Auckland Council in this report refers to: The local government of Auckland established on 1 November 2010. Auckland Council is made up of the governing body, 21 local boards, Auckland Council operations staff and is inclusive of the Council Controlled Organisations.
[2] Auckland Plan. Accessible from: http://theplan.theaucklandplan.govt.nz/
[3] Statistics New Zealand (2015) Subnational Population Projections: 2013(base)-2043. Accessed from: http://www.stats.govt.nz/browse_for_stats/population/estimates_and_projections/SubnationalPopulationProjections_HOTP2013base.asp

Auckland Council is one of the biggest entities in New Zealand. This presents an enormous opportunity for improved capital deployment and asset management practices. Examples of the size and scale of Auckland Council include:

- Manages assets over $40b (over five times the size of Fletcher Building);
- Employs around 11,000 people (similar to Air New Zealand); and
- Auckland Council (on a cash basis) invested $1.6b in capex in 2014/2015 and generated revenues of $3.0b.

Auckland Council has made some big gains in service delivery but we believe there is an appetite and an opportunity to become even more commercially robust.

Like most local authorities[4], Auckland Council performs a variety of roles: it is a promoter, investor, regulator, and provider of public goods and services. This requires complex decisions across myriad functions, from dog licensing to billion-dollar infrastructure investments. This complexity leads to unavoidable trade-offs and inherent tensions.

Providing public services (core and non-core) costs money and the unique funding arrangements and incentives for growth across Auckland Council (like most local authorities) adds another layer of complexity. Local authorities in New Zealand also operate under legislative constraints and business requirements (best practice or otherwise) that create a real challenge to their ability to perform their functions. For example, a local authority:

- Publically consults on all future spending through its Long Term Plan (LTP);
- Invests in significant and lumpy long-term infrastructure – but largely relies on a revenue base that is inflexible; and
- Operates in a fairly constrained debt environment where debt raising capacity is effectively tied to the inflexible revenue base.

[4] Local authorities is defined in the Local Government Act 2002 as a regional or territorial authority

In short, there is often a timing mismatch between the investments local authorities need to fund and the receipt of revenue required to fund this investment.

Additional considerations include:

- Previous rates and levy increases[5]: Auckland Council has undertaken a recent rate harmonisation programme and announced a quantified rates limit of 3.5% p.a. through its LTP. A transport levy (of $114 per household) has also been imposed – both of which reduce the appetite for further increases.
- New funding sources: New revenue sources, such as tolls and local income taxes are not a part of the current mix. In the absence of extensive reform of the overall funding structure for local government, Auckland Council needs to ensure it is best placed to make the most of the funds it currently receives.

Up-front investment in infrastructure projects is critical to this whole vision.

"Bottlenecks could limit New Zealand's economic expansion, especially housing and infrastructure shortages in Auckland" – *OECD Economic Survey of New Zealand 2015*

If Auckland wants to achieve its goal of being the world's most liveable city, it must accelerate its infrastructure spend beyond what is outlined in the Long Term Plan. Failing to do this risks existing residents becoming frustrated and leaving the area. Business productivity will also suffer. Equally, it becomes increasingly difficult to attract new migrants (and expats). This not only deters the very people Auckland needs to achieve its vision, but if people leave the city, there is potentially a detrimental effect on the rating base.

Put simply, increasing infrastructure spend earlier than planned will mean spending less somewhere else, releasing capital or raising more revenue. This report offers information and a framework to help councillors make these difficult trade-offs.

[5] Auckland Council (2015) Long term plan

The request

Two independent consultants– EY[6] and Cameron Partners – were commissioned to undertake separate independent assessments of the Auckland Council balance sheet to identify ways /explore options to:

- Reduce the proportion of Auckland Council revenue funded from rates;
- Maximise the return on Auckland Council's investments;
- Explore alternative sources of financing; and
- Review the holding of assets that are aligned with Auckland Council's core business and/or the broader strategic growth priorities for Auckland

The time period for analysis provides for an initial scan of Auckland Council's assets and this report is EY's response to the stated brief.

Our approach

We undertook a preliminary top-down and bottom-up scan of the Auckland Council to identify areas where the balance sheet could be optimised.

Our top-down assessment is born out of similar engagements in international jurisdictions. We supplemented this knowledge base with a bottom-up investigation of Auckland Council's balance sheet. In particular, our evidence-gathering process has consisted of:

- An interrogation of Auckland Council's finances, policies, plans and publicly available information; and
- More than 25 separate face-to-face interview (sometimes with multiple stakeholders) from Auckland Council. This involved more than 150 person-hours and has substantially informed our findings.

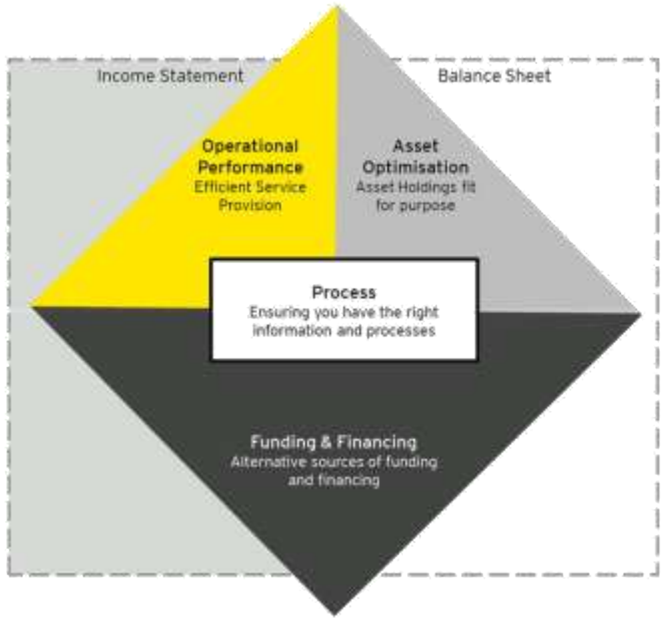
These findings are therefore not merely opinion, analysis and judgment, but have been developed after interviews with a wide range of expert stakeholders who know Auckland Council processes and assets intimately.

[6] With specialist real estate support from Jones Lang LaSalle

Our approach to this engagement is to outline a number of concepts that could be applied to improving the council's balance sheet, supporting this with a specific Auckland Council example (and often a case study where this approach has been applied elsewhere). This approach is designed to give decision makers enough information to make informed choices about which initiatives are worth pursuing in more detail.

We have grouped these opportunities under four substantial banners. While there is often overlap between these opportunities, this grouping offers a transparent and robust framework for our analysis.

Figure 1: Conceptual Framework



Each banner seeks to provide for the following objectives:

- Process: Ensure that information provision and decision making is consistent, and aligned with desirable principles. This will not achieve the goals of the review in the short-term, but will help to achieve these goals in the long term and embed the tools required for enhanced investment decision making and governance going forward;

- Asset Optimisation: Ensure the balance sheet is fit for purpose – that the assets align with Auckland Council's core business and/or the broader strategic growth priorities for Auckland;
- Operational Performance: Improve the efficiency of existing expenditure to reduce the need for future spending – and thus reduce the proportion of revenue funded from rates. This also maximises the return on Auckland Council's investments and protects against value from asset optimisation 'leaking' once it is reinvested. To link our options back to the balance sheet, we have also focussed on operational areas where there is a trade-off around capital and operational expenditure; and
- Alternative funding tools and finance: Exploring alternative sources of revenue can reduce Auckland Council's need to debt-fund investments. It can also reduce the proportion of revenue funded from rates.

Our criteria and our principles

We have analysed all options against a common set of criteria (strategic alignment, ease of implementation and value) to ensure we are comparing all options consistently.

Beyond a consistent set of criteria, we applied a set of fundamental principles that underpin many of our recommendations.

- Transparency: Being fully transparent about cost transfers and levels of subsidies (for example) gives ratepayers more visibility over funding. This includes being explicit about opportunity costs;
- Contestability: Ensuring contestability of service delivery and advice can support efficient outcomes;
- Equity: As much as possible, the costs of decisions should be borne by the beneficiaries of those decisions;
- Efficiency: Services should be provided to consumers at lowest cost while maintaining appropriate quality standards;
- Mandates matter: The intention of legislation and formal policy should be accommodated within operating structures; and
- Value ecosystem: It is valid to consider replacing one asset or revenue stream with another asset so long as the long term consequences of this exchange are considered, understood and financially sustainable for the city.

Our findings

We have identified 18 general options (each with at least one Auckland Council example or case study) that could help Auckland Council achieve its funding and financing objectives. Some of these options will require difficult trade-offs; some will be much easier to adopt.

They all provide a starting point for future action and we believe all may offer opportunity over the lengthy timeframe of infrastructure investment required in the city.

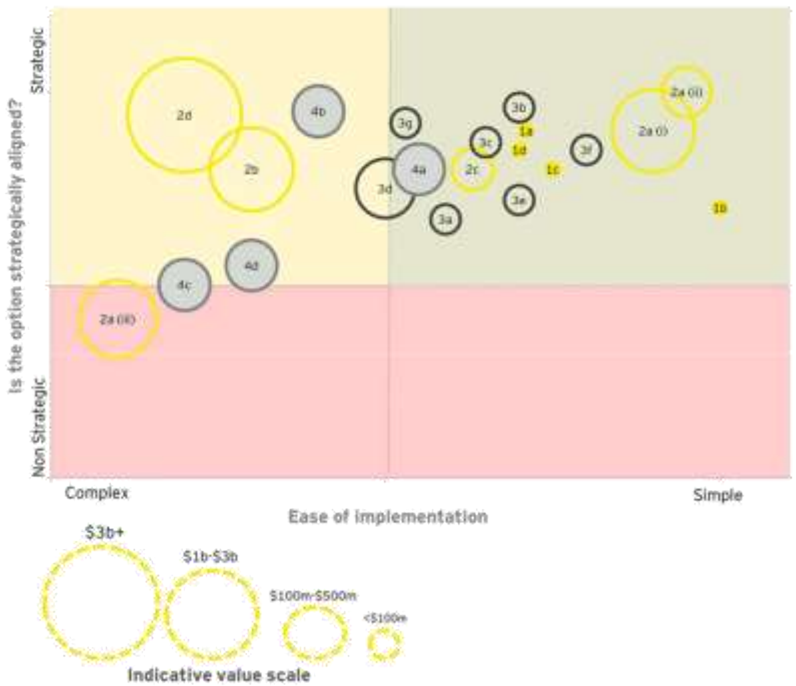
Ultimately, we are giving Auckland Council an evidence base to enable difficult trade-offs to be considered consistently. This will support progress towards the Auckland Vision.

Figure 2 summarises our findings for each key option identified. The criteria (in particular whether the option is strategically aligned with Auckland Council and the ease of implementation), determines the threshold for whether the option is:

- Green: Relatively simple and straightforward implementation process and/or the outcome is strategically aligned to support future LTP iterations;
- Amber: The outcome is moderately strategically aligned to support future LTP iterations and/or has moderately complex implementation considerations; or
- Red: The outcome is not strategically aligned to support future LTP iterations, and/or has complex implementation considerations.

We have only shown those options which fall into the Green or Amber quadrants. Appendix F notes those options which we considered, but ultimately did not have supporting information to analyse, were largely being undertaken by Auckland Council already, or were considered out of scope for this engagement.

Figure 2: Option evaluation of Auckland Council examples



Furthermore:

- The vertical axis represents an indication of strategic alignment: including the amount of control Auckland Council has over the option, whether the option aligns to Auckland Council's core role, the legislative/regulatory impacts, and Māori considerations.
- The horizontal axis represents the ease of implementation of a proposed option.
- The size of the bubble is indicative of the financial value of the option.

Options evaluated[7]

Process

1a Consistent information base
1b Asset Health Check
1c Better Business Case disciplines
1d Infrastructure Acceleration Fund

Asset Optimisation

2a (i) Partial or full sell down - Auckland International Airport Ltd
2a (ii) Partial or full sell down - Diversified Financial Assets Portfolio
2a (iii) Partial or full sell down - Auckland Energy Consumer Trust
2b Long-term lease - Ports of Auckland Ltd
2c Sale of surplus land
2d Better realisation of commercial value from CCOs - Watercare

Operational Performance

3a Shared back office functions
3b Network analysis and shared facilities
3c Accommodation strategy
3d Development of existing land and buildings
3e Pricing review
3f Fleet review
3g Align CCO and Council Synergies

New Funding tools and Finance

4a Sale and lease back - Property Portfolio Transaction
4b Self-Funding PPPs – Street lighting
4c Tax Increment Financing
4d Alternative sources of funding

We recommend that Auckland Council use this information to prioritise areas it wants to investigate in more detail, in order to reduce rates, reduce debt or accelerate investment

[7] We note that AECT is controlled by a Trust Deed that expires in 2073.


Context

Local authorities – roles and responsibilities

Local authorities have a wide range of interests to manage and their performance strongly influences the direction and trajectory of a locality.

As a promoter, an investor, a regulator and a provider of public goods and services, local authorities' role is byzantine and requires complex decisions to be made across a myriad of functions. This complexity leads to a number of trade-offs and inherent tensions. Trade-offs are starkest in local authorities' dual roles as providers of local public services (in a cost effective manner) and enablers of local democracy.

Balancing competing interests is not new territory for local authorities and there is always a residual risk that over the course of history, the balance has been shifted too far in one direction or the other. As New Zealand dynamically grows, the need to ensure that public expenditure is fit for purpose will only increase.

> *"The purpose of local government is to enable democratic local decision-making and action by, and on behalf of, communities; and to meet the current and future needs of communities for good-quality local infrastructure, local public services, and performance of regulatory functions in a way that is most cost-effective for households and businesses.*
>
> *'Good-quality' in relation to local infrastructure, local public services, and performance of regulatory functions, means infrastructure, services, and performance that are–efficient; effective; and appropriate to present and anticipated future circumstances".*
>
> *Local Government Act 2002 – Clause 10*

Local authorities generally have a separated decision making structure. In simple terms, they can be thought about as having:

- A governing body. This makes local decisions on behalf of local communities and often consists of publicly elected officials (mayors , and/or councillors) considering matters through committees; and
- A bureaucracy. These are officers carrying out decisions on behalf of governing body(ies) and in accordance with the requirements of the Local Government Act.[8]

There are a range of different operating structures for local authorities in New Zealand. Some local authorities also separate out commercial and/or operating entities.

Council controlled organisations

A Council Controlled Organisation (CCO) is any organisation in which one or more local authorities owns or controls 50% or more of the voting rights or has the right to appoint 50% or more of the directors, trustees etc.

The principal objectives of CCOs are to:

- Achieve the objectives of its shareholders, both commercial and non-commercial, as specified in the statement of intent;
- Be a good employer; and
- Exhibit a sense of social and environmental responsibility by having regard to the interests of the community in which it operates and by endeavouring to accommodate or encourage these when able to do so.

A Council Controlled Trading Organisation (CCTO) is a CCO that operates a trading undertaking for the purpose of making a profit.[9]

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[8] An analogy here is with Central Government and the distinction between Ministers, Ministry's/Departments and officials.
[9] Local Government Act 2002

Auckland Council context - Local Boards and the Governing Body

Auckland Council's governance structure broadly comprises the governing body (mayor and 20 ward councillors) and 21 local boards. The specific details of this relationship are complex but in simple terms both are responsible for decision making:

- The governing body makes decisions on regional wide issues, develops Auckland wide plans and has authority over regulatory activities; and
- Local boards represent local communities, provide local leadership and make decisions on local issues and activities.

Auckland Council's role in this governing model is to ensure appropriate information flows, that due process is being followed and, as the ultimate asset owner, that decisions are made in accordance with good business practice.

The three substantial parties involved in this decision making model present several inherent tensions – principally when locally desirable outcomes are not necessarily consistent with optimal regional outcomes. Our role is not to consider the efficacy of this structure rather to ensure that our report's findings are consistent with this status quo.

Auckland Council context - Cultural overlay

We acknowledge that local authorities must remain cognisant of a range of cultural overlays. Prime amongst these are the requirements of the Treaty of Waitangi (the Treaty).

While reference to Treaty obligation permeates all decision making in New Zealand, the main area which may impact on this review is in relation to Treaty claims over land – and in particular mana whenua Rights of First Refusal (RFR). [10]

We have not been made aware of any such land through the course of our review, but we recommend that all decisions made on the back of this review explicitly consider the potential impact on mana whenua.

We are also aware of Auckland Council's commitment to improve its responsiveness to Māori. In this specific context the letters of intent sent to the CCO's by Auckland Council expressly asked each CCO to contribute toward Auckland Councils' responsiveness to Māori and contribution toward Māori well-being. This would need to be reflected each CCO's strategic priorities, work programme and performance measurement in their Statement of Intent.

Another specific overlay is the provision in the Local Government (Auckland Council) Act 2009 for the establishment of an Independent Māori Statutory Board (IMSB). The IMSB assists the Auckland Council to make decisions, perform functions, and exercise powers by

- Promoting cultural, economic, environmental, and social issues of significance for mana whenua groups; and mataawaka of Tāmaki Makaurau; and
- Ensuring that the Council acts in accordance with statutory provisions referring to the Treaty of Waitangi.

We recommend that all decisions made on the back of this review are presented to the IMSB to ensure that they are in accordance with the expectations of section 81 of the Local Government (Auckland Council) Act 2009.

While we have provided an explicit cultural assessment of each opportunity, where appropriate, we have not consulted or otherwise engaged with mana whenua on any options. Engagement with mana whenua should be carried out if any option is carried forward.

[10] Crown land subject to a RFR can in certain circumstances be disposed of for public works purposes, including transfer to local body authorities (say, for a park). If that happens the local body authority is the new land owner, but the land remains encumbered with "RFR" status (which is recorded on the title), meaning if the Council ever wanted to sell the land at a later date, it would need to offer that land first to the RFR holder.

Local authorities - funding and financing arrangements

Local authorities in New Zealand have several specific constraints and obligations that present a real challenge to their ability to perform their functions.

Under the Local Government (Rating) Act 2002, local authorities have the flexibility to set, access and collect rates from landowners and these revenue sources act as a primary source of funding. Rates do not always align well with the fundamental drivers of expenditure. Other funding options exist and can include: user charges for water, other user pays (building licences and dog registration) fines and infringements, and dividends from commercial entities.

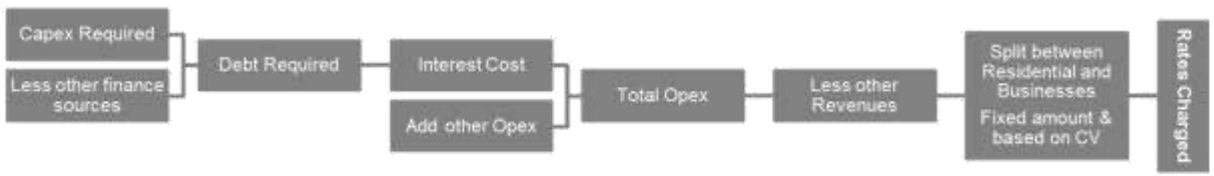
Expenditure consists of operating costs and capital costs, and must be publically consulted on as part of the long-term planning (LTP) process. The recent introduction of the Local Government (Financial Reporting and Prudence) Regulations 2014 (inclusive of the need to account for 100% of depreciation) has sought to standardise reporting processes for all local authorities, and have imposed the need for 30-year infrastructure planning. In this context, it is important to remember that local authorities must always remain cognisant of future obligations – i.e. it is more difficult to defer expenditure in one category in order to fund another category.

In general, local authorities have fairly steady and predictable operating costs and these costs move more or less in line with population growth and rates takes. However, capital costs are often large and lumpy and are more difficult to plan for in a financial sense (e.g. intergenerational equity). Traditionally these capital costs are met with increases in debt, as this provides Councils with flexibility that rates cannot provide. This also helps ensure that the intergenerational costs of capital investment are better aligned to the beneficiaries of that investment.

Local authorities do, however, operate within a constrained debt environment. Historically there has been reluctance around debt funding because the cost has been high. Recent years have seen a change in this due to market condition and the establishment in 2011 of the Local Government Funding Agency (LGFA). The LGFA raises debt funding to New Zealand local authorities with funding from the wholesale capital markets. By aggregating local authorities it provides a more favourable pricing than each local authority could achieve individually. Central government holds 20% of LGFA's share capital while the participating local authorities hold the rest. Shareholding is not based on population size and is spread evenly across authorities – for example, Auckland Council holds a 7.46% shareholding stake. Further discussion of LGFA is detailed on page 15.

The setting of rates is therefore an interrelated function of projected expenditure levels, debt and other revenue (and consulted on through the LTP). Budgets must be balanced and so commitments made around rates caps ultimately mean local authorities must balance trade-offs around reduced expenditure, debt raising or raising revenue or capital through other sources. Figure 3 demonstrates this relationship.

Figure 3: Simplified budget flow diagram for Local authorities



"If a local authority places a cap on rates, then trade-offs must be made around reducing expenditure, raising debt or raising revenue or capital through other sources"

Auckland Council - context

Auckland Council has the size and scale to make step-change decisions that help support the Auckland Vision. This presents an enormous opportunity for improved capital deployment and asset management practices.

"Auckland's vision is to become the world's most liveable city. The goal of liveability expresses the shared desire to create a city where all people can enjoy a high quality of life and improved standards of living, a city which is attractive to mobile people, firms, and investors, and a place where environmental and social standards are respected."

The Auckland Plan is the authoritative vision for Auckland. Bright and ambitious, it was the result of several years' consultation and extensive written submissions. The picture is dominated by dynamism and vibrancy, where people and businesses interact harmoniously over shared spaces, where people who live here want to stay, and where those who don't aspire to live here. It is a compelling vision.

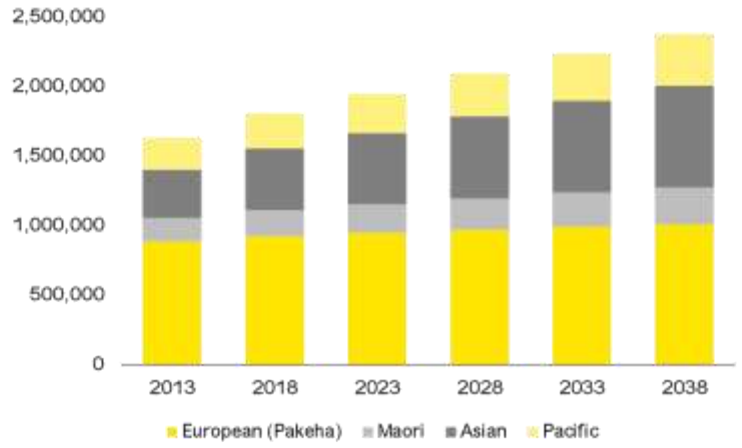
It is challenging to deliver on a vision of this scale and several difficult trade-offs must be made along the way.

Auckland Council plays a large role in achieving this vision. In particular, well-functioning infrastructure will be essential to improving economic, social, environmental and cultural outcomes and to realising the vision of Auckland as the world's most liveable city. This is recognised in the Auckland Plan.

"From fast and efficient public transport services delivering the Auckland of the future, to fundamental water services delivering a basic human right; from public libraries providing local communities with access to knowledge, to ports and airports connecting Auckland to the world; infrastructure is the platform upon which Auckland is built".

Population growth will continue to put pressure on the ability of Auckland Council to provide core services. Statistics New Zealand projects that the Auckland region will account for three-fifths of New Zealand's population growth between 2013 and 2043 - with a net increase of 740,000 people from just under 1.5 million now, to 2.2 million (medium projection). Auckland's population is estimated to reach 2 million around 2033.[11]

Figure 4: Auckland's demographic projections



Auckland Council services will also face pressures – primarily from changing demographics. The scale, nature, location and delivery of public services will all be constructively challenged as the immigrant population continues to grow, and the general population continues to age. Consumer preferences are dynamic, and Auckland Council, like all other public institutions, must remain flexible and open minded to the challenges ahead.

[11] Statistics New Zealand (2015) Subnational Population Projections: 2013(base)-2043. Accessed from:http://www.stats.govt.nz/browse_for_stats/population/estimates_and_projections/SubnationalPopulationProjections_HOTP2013base.asp

The development of the Auckland Council through the amalgamation of eight local Councils in 2010 provides a significant platform for future growth. There is however a significant amount of path dependency with the current status quo: amalgamation raises the potential for scale efficiencies, but also can provide duplication of asset holdings and services in the short-term.

Auckland's ambitious and maturing governance arrangements are unlike any across Australasia and enable the Auckland Council to put forward a united voice on regional issues. Critically, Auckland Council now has the size and scale to make step-change decisions. This presents an enormous opportunity for improved capital deployment and asset management practices. Examples of the size and scale of Auckland Council include:

- Manages assets of more than $40b (over five times the size of Fletcher Building);
- Employs around 11,000 people (roughly the same number as Air New Zealand); and
- Auckland Council (on a cash basis) invested $1.6b in capex in 2014/2015 and earned revenues of $3.0b.

Auckland Council has made some strong strides in service delivery but we also believe there is an appetite and an opportunity to become even more commercially robust.

If Auckland wants to achieve its goal of being the world's most liveable city, it needs to accelerate its infrastructure spend. Not doing so means existing residents could become frustrated and leave the area. Business productivity could also suffer. Equally, it becomes increasingly difficult to attract new migrants (and expats). This not only deters the very people Auckland desperately needs to achieve its vision but it could detrimentally affect the city's rating base.

The Organisation for Economic Cooperation and Development (OECD) notes the effect of insufficient infrastructure on a country's economy. Further evidence supporting this view is provided in Appendix D.

"Bottlenecks could limit New Zealand's economic expansion, especially housing and infrastructure shortages in Auckland" – OECD Economic Survey of New Zealand 2015

Legislative restrictions on introducing new revenue sources reinforce the existing asymmetric cost and benefit distribution for new infrastructure spend. The immediate costs of growth are felt acutely by local authorities (capital expenditure), yet much of the immediate gain from growth falls on central government (GST intake and taxation). Long- term gains eventually accrue to local authorities (rates) but there is a timing mismatch between the required expenditure and the revenue sources. This is exacerbated in a debt constrained (conscious or otherwise) environment.

New sources of funding (revenue or capital) must be found and this starts with an interrogation of the existing balance sheet, and what it needs to look like to achieve the Auckland Vision.

If Auckland wants to achieve its goal of being the world's most liveable city, it needs to accelerate its infrastructure spend. Ensuring Auckland Council's balance sheet is optimised is a critical component of this

The Auckland Council Vision is also supported by a range of Outcome targets and transformational shifts required to get there. These are displayed in Figure 5.

Figure 5: Achieving the Auckland Vision

Auckland Council - financial outlook

New sources of funding and financing are required to meet Auckland's vision because of the quantified growth limit on rates and the desire to constrain debt

Expenditure[12]

The LTP outlines capex of $18.7b over the next 10 years. This will include the construction of new infrastructure assets as well as replacing existing assets to satisfy the forecast growth of Auckland. The LTP forecast 23% of council funding will come from external debt, as illustrated in Figure 6. Figure 7 and Figure 8 highlights the proportion of new capex that will go towards meeting additional demand and improving services while renewals will be to replace existing assets.

The top five infrastructure projects over the LTP include:

Project	Description	Cost
City Rail Link	Connecting Britomart and the central city with a loop through to the western rail line in Mt Eden	$2.5b
Central Interceptor Spine	New wastewater conveyance and storage pipeline	$966m
AMETI	Transport Improvements in Glen Innes, Panmure, Pakuranga, Botany corridor	$552m
Waikato Water Treatment Plant No.2	Additional treatment plant capacity from the Waikato River	$400m
Huia Water Treatment Plant	Replacement of the Huia Water Treatment Plant	$241m

12 Please note that figures relating to the LTP are in relation to the 10 year budget 2015 to 2025. FY2015 and FY2014 figures are draft received as at 10 September 2015.

Figure 6: Auckland Council – LTP funding sources including proportion to total funding ($m; %; 2016 – 2025)

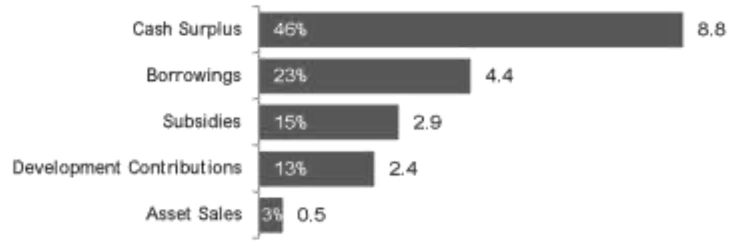
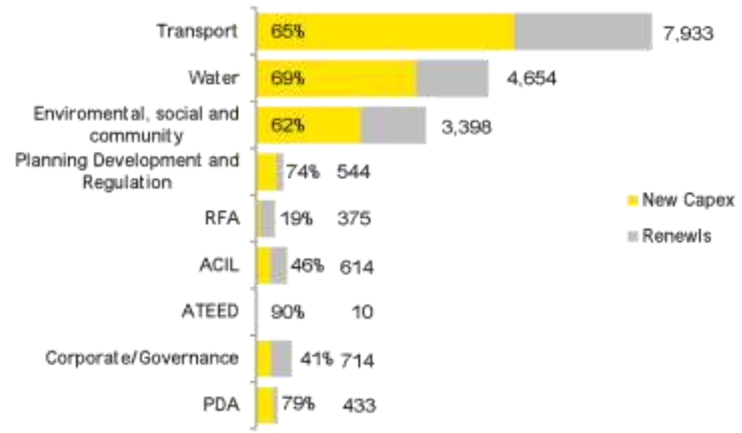


Figure 7: Auckland Council – LTP Capex ($m) including proportion of New Capex (%) (2016 – 2025)



A description of the groupings of categories is detailed in Appendix A.

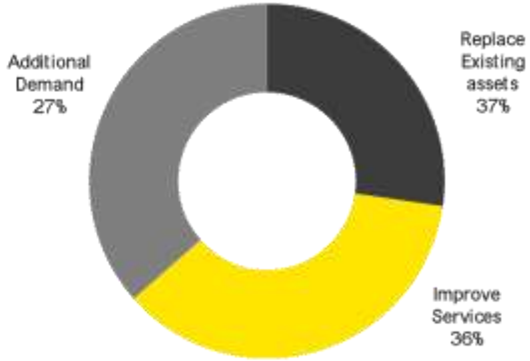
Auckland Council
Alternative Sources of Financing

EY 13

Attachment B

Item 15

Figure 8: Auckland Council – Proportion of LTP Capex (%; 2016-2025)

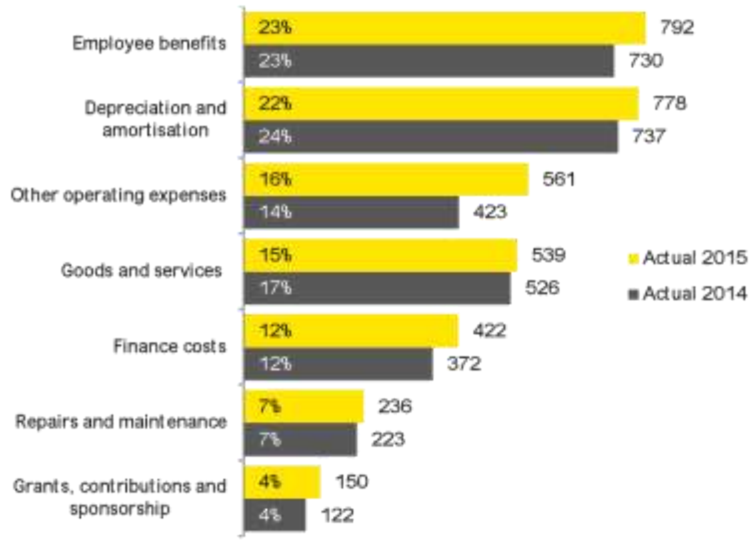


Operating expenditure is funded from rates and other revenues, meaning any reduction in operating expenditure will likely have a positive impact on future rate impositions, or allow more debt servicing.

Reducing operating expenditure in a growing city is difficult and requires smart, but often tough, decisions. An estimated $183m of annual cost savings were made in FY2014/2015 and budgeted savings are expected to be $224m in FY2015/2016. But, despite this conscious effort, total group expenses in accrual terms have still increased by $345m (11%) over FY2015 as shown in Figure 9. The expenditure is primarily due to an increase of $138m in other operating expenditure. Most of this comes from increases to provisions in weather tightness and contaminated land, a non-cash item.

Operating costs should continue to be reduced and capital expenditure could be accelerated in order to achieve the Auckland Council vision

Figure 9: Total expenses and proportion of expenses to total expenses ($m; FY2015; FY2014)[13]



On a cash basis, total expenses increased $171m (7%) to $2,607m over FY2015. Largely this came from an increase in payments to staff and suppliers of $132m (6.4%) and finance costs of $52m (14.7%), partially offset by decrease of $13m in other expenses.

Looking forward ten years on a cash basis, total operating expenditure is projected to increase. Notably, finance costs are projected to grow at a compound annual growth rate (CAGR) of 3.7% to $655m in 2025. Finance costs are 18% of total expenditure and 29% of total rates revenue in aggregate. Figure 10 shows growth in expenses over the LTP on a cash basis.

[13] Figure 9 above is on an accrual basis

Figure 10: Auckland Council –LTP Operating Expenses Bridge ($m; 2016–2025)

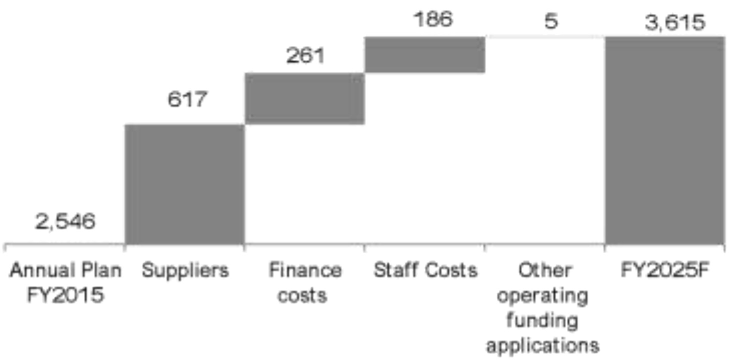
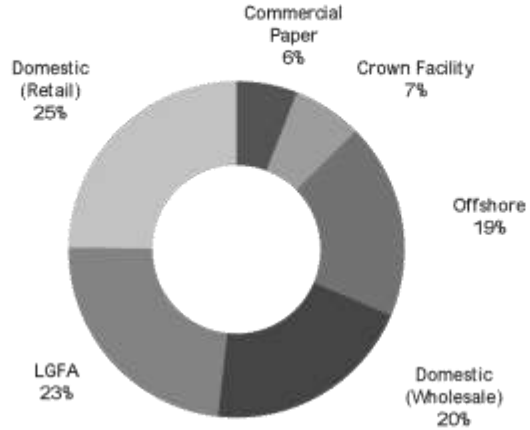


Figure 11: Auckland Council debt portfolio (%; FY2015)



Debt

Debt is primarily used to fund capital projects. It presents a good vehicle for this expenditure because it is flexible and aligns the intergenerational costs of infrastructure projects with the beneficiaries. The downside of debt is the interest payments incurred and the risk of adverse interest rate or inflation movements (although this is somewhat mitigated through hedging).

Auckland Council has a sophisticated treasury and debt management function, and a diversified source of debt financing, including domestic funding (both retail and wholesale); offshore funding (Euro Medium Term Note programme, Australian Dollar Note programme); central government funding (electric trains) and through the Local Government Funding Agency. This diversity is represented in Figure 11:

As at 28 September 2015, Auckland Council's borrowings totalled 35% ($1,875m) of the LGFA book. LGFA provides the benefit of an enhanced credit rating, hence better priced debt compared to what Auckland Council could achieve in isolation. But Auckland Council is limited to 40% of LGFA's total book. It can also source funding internationally; however limitations exist due to the size of Auckland Council's issuance, and the infrequent trading of the NZD in comparison to the international bond and currency markets. A range of prudential limits are in place to ensure the lowest and best cost debt can be sought.

Council's ability to access cheaper debt will continue to be assisted by its strong credit rating (AA with stable outlook). This is driven by its strong institutional framework, strong financial management, and budgetary flexibility. We note under current Treasury Management Policy, Auckland Council can leverage more debt, down to A+ rating. However this can result in an increase of 20-30 bps per year or c$20m to c$30m additional interest costs per year[14].

[14] Average additional interest cost per year based on average forecast LTP debt balance 2016-25.

The following charts demonstrate that while Auckland Council has some debt headroom (in FY2016 about $2b in additional debt and $102m in annual interest)[15], it is nearing prudential limits. To accelerate infrastructure spending, something other than debt may be required. Figures 12 and 13 illustrate the current LTP prudential limits and forecasts.

Figure 12: Auckland Council LTP Net debt as a percentage of total revenue (%; 2016-2025)

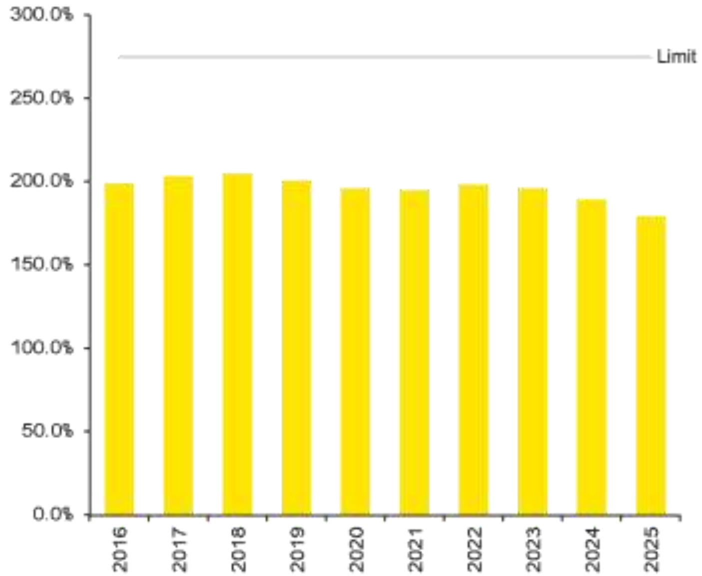
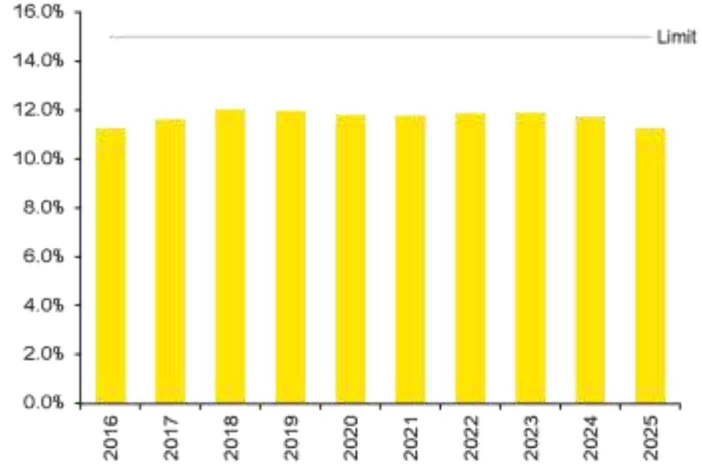


Figure 13: Auckland Council LTP Net interest as a percentage of total revenue (%; 2016-2025)



Auckland Council should not consider increasing net debt too far beyond current levels. The existing debt headroom provides flexibility to deal with unexpected financial shocks and there are other mechanisms to fund necessary expenditure

[15] Based on LTP prudential ratios and estimates

Revenue

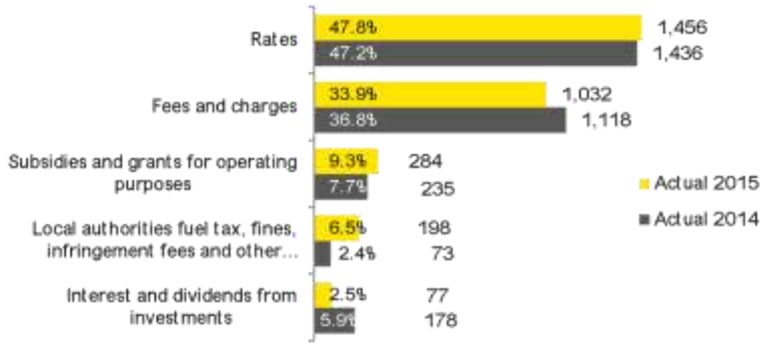
Auckland Council has steady and predictable revenue streams. Demographic growth will assist with revenue growth (through more dwellings and businesses) but pressure on these revenue streams will grow because of debt obligations, the need to increase major capital expenditure and future operating costs flowing from this capital expenditure.

Auckland Council has implemented a 3.5% p.a. rates rise limit of the period of the LTP.[16] This places some limitations on how accelerated infrastructure funding can be supported.

Total revenue on an accrual basis during the FY2015 has increased by $275m (8%) on FY2014 to $3,558m. This is mainly attributed to the increase in its other revenue sources, of which an increase of $107m (66%) is vested assets to Auckland Council; a non-cash item. Figure 14 represents the revenue on a cash basis where total revenues have increased by 0.2% over the same period.

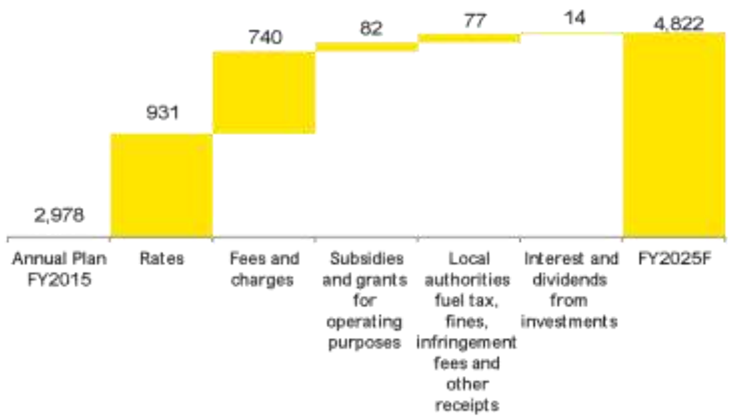
Rates revenue makes up about 48% of total revenue although this proportion has increased by 0.6% from FY2014. This is a lower proportion of total revenue than many other local authorities and is influenced by the user-pays approach to water. Interest and dividend income have also decreased by $101m (-56%) over the period.

Figure 14: Auckland Council – Total Revenue and Proportion to Total Revenue (%; $m; FY2015; FY2014)



In aggregate, there is pressure on revenue generation as total expenses will be 79% of total revenues in the next decade. Revenues will be highly dependent on rates which are forecast to contribute 48% of total revenue for 2016-2025 and will be the largest contributor to the increase in revenue. Increases in total revenue are expected to be 62% over the LTP, compared with a 42% increase in total expenses during the same period. Figure 15 shows contributions to revenue over the LTP.

Figure 15: Auckland Council – LTP Revenue bridge ($m; 2016-2025)



We note Auckland Council has attempted to increase its ability to expand revenue sources in two substantial ways. Neither of these options has to date gained traction but represent a strong motivation to enhance future outcomes:

- LGNZ: Local Government Funding Review 2015; and
- Consensus Working Group on Transport Funding

There is a quantified rates limit in place over the LTP period, however new sources of funding and finance could be pursued.

[16] A 2.5% p.a. average limit is in place for 2015/2016; then a 3.2% p.a. average rates limit for 2016/2017 then a 3.5% p.a. average rates limit for the remaining LTP years

Assets

Auckland Council has a large and diverse balance sheet. Many of these assets are the result of legacy arrangements and theoretically provide a good source of diverse future revenue.

In determining whether this mix of assets is appropriate, there are fundamental questions about whether:

- These assets are fit-for-purpose to serve the current and future needs of Auckland?
- These would represent 'core council business' - if we had a blank sheet of paper would we hold this mix?

Some 92% of Auckland Council assets are property plant and equipment (PPE). These assets represented in Figures 16 and 17, primarily include infrastructure assets such as roads and footpaths, rail infrastructure, water and wastewater infrastructure, parks, reserves and buildings and stormwater pipes.

Figure 16: Auckland Council – Total assets and liabilities and proportion to total assets and liabilities respectively ($m; %; FY2015; 2014)

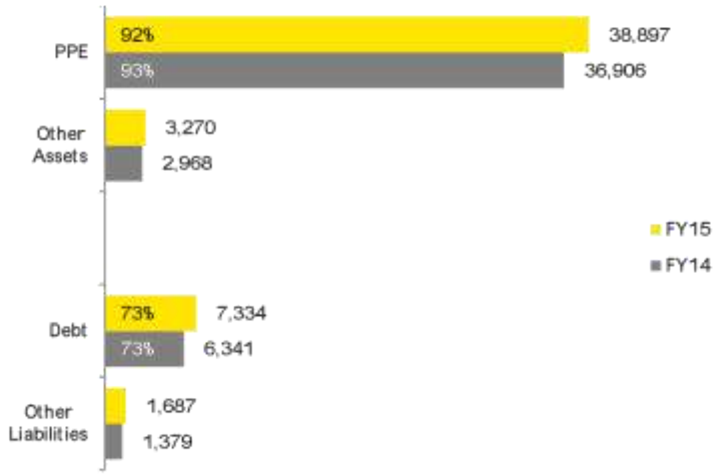
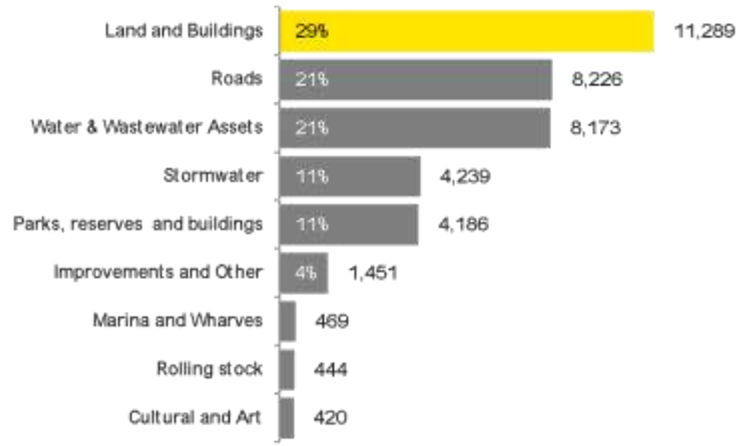


Figure 17: Auckland Council PPE Breakdown and proportion to total PPE ($m; %; FY2015)



For the purposes of this exercise, we have taken the Auckland Council book value as the starting point. We have become acutely aware through our discussions that many of these assets are not truly reflective of their opportunity cost value.

By better understanding and acknowledging the true value of their assets, Auckland Council will be in a position to:

- *Realise the value of surplus- to-service assets in the short-term, giving Auckland Council the resources required for progress*
- *Accelerate infrastructure investment. This will help Auckland realise its vision to become the world's most liveable city*
- *Pay down debt with the commensurate impacts on financial stability and reduced rates (through reduced interest payments).*

The Request

A preliminary scan of the Auckland Council balance sheet will identify ways of ensuring it is fit-for-purpose to meet current and future needs and ultimately help support the Auckland Vision

After five years of operating as Auckland Council it was considered timely to commission two independent consultants- EY[17] and Cameron Partners – to undertake separate independent assessments of the Auckland Council balance sheet to:

- Reduce the proportion of Auckland Council revenue funded from rates;
- Maximise the return on Auckland Council's investments;
- Explore alternative sources of financing; and
- Review the holding of assets that are aligned with Auckland Council's core business and/or the broader strategic growth priorities for Auckland

Our work has been conducted across a nine week period, from 1 September to 11 November 2015. The nature and content of this report is reflective of the specific scope of our engagement, the amount and accuracy of information provided to us and the timescale within which the report was prepared.

The content of this report is primarily based on publicly available information. We have not sought to establish the reliability, accuracy or completeness of the publicly available information. Consequently, we give no assurance on such information. No independent valuation has been conducted.

This report ultimately provides indicative advice and analysis to support consideration as to future actions for Auckland Council. The purpose of this document is to support decision making[18] .

[17] Specialist real estate advice was provided by Jones Lang LaSalle

[18] Refer to page 2 for our full Disclaimer

Our Approach

We have undertaken an analysis of Auckland Council to identify areas where the balance sheet could be optimised and our findings have been informed by a wide range of expert stakeholders who know Auckland Council processes intimately

We have undertaken a scan of Auckland Council to identify areas where the balance sheet could be optimised. This scan incorporates an assessment of profit and loss statements as well, but we have always reverted back to what an optimised balance sheet could look like.

We have undertaken a top-down and a bottom-up exercise for this engagement.

Our top-down assessment has been born from similar engagements in international jurisdictions. International best practice is relevant here as many cities face the common challenges of aging and changing demographics, constrained fiscal environments, the need for investment in infrastructure that best serves the needs of communities in a changing technological world and the need to balance cultural, social environmental and economic factors.

We have supplemented this knowledge base with a bottom-up investigation of Auckland Council's balance sheet. In particular, our evidence gathering process has consisted of:

- Interrogation of the council's finances, policies, plans and publicly available information; and
- Face to face interviews with more than 25 stakeholders from Auckland Council. This involved more than 150 person- hours and has significantly contextualised our findings.[19]

Our findings are, therefore, not just the result of our opinion and judgment, but have been informed by a wide range of expert stakeholders who know Auckland Council processes intimately.

Our principles

We have applied a set of fundamental principles that underpin many of our suggestions. These principles should reflect best-practice for asset management, policy making, commercial investment and decision making:

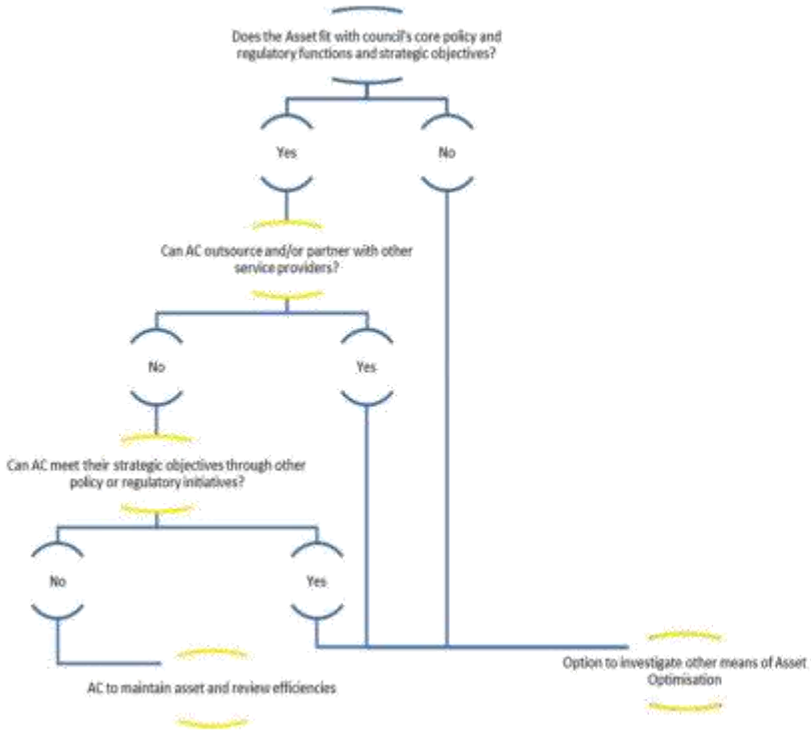
- Transparency: Transparency is especially vital in local government where there are dual requirements to promote democracy and provide public services efficiently. Being fully transparent about cost transfers and levels of subsidies (for example) ensures decision makers and ratepayers have better visibility over funding, whether it is appropriate and ultimately provides greater accountability. A substantial subset of transparency is opportunity costs. Understanding the opportunity cost of decisions means the community can better scrutinise decisions;
- Contestability: Ensuring contestability of service delivery and advice will support efficient outcomes. This is not to say that the private sector is best at providing everything. Rather, it reflects that contestability and competition is an important consideration when seeking to drive efficiencies;
- Equity: As much as possible, the costs of decisions should be borne by the beneficiaries of those decisions. This is not possible in every instance (particularly for pure public goods or because of difficulties with measurability) but it should be a desirable end goal;
- Efficiency: Council services should be provided to consumers at lowest cost while maintaining appropriate quality standards. The opportunity cost of not doing this, is that other services required by the community cannot be provided;
- Mandates matter: Legislation is the heart of democratic institutions. We believe the intention of legislation and formal policy should be accommodated within operating structures. We defer to this direction when there is ambiguity around roles; and
- Value ecosystem: New revenue sources (either through sale of surplus assets, improved efficiencies with existing investment or through explicit new revenue sources) needs to be invested in assets, interests and services the city needs to grow. As much as possible these assets should be accompanied by a value capture mechanism to ensure Auckland Council is not simply selling the crown jewels but, rather, is recycling them to the form most appropriate mix for the needs of tomorrow.

[19] These discussions were held on a confidential basis and all responses have been considered as part of our findings. No responses have been attributed to individual stakeholders. Formal acknowledgements are provided in Appendix C.

Categorising options

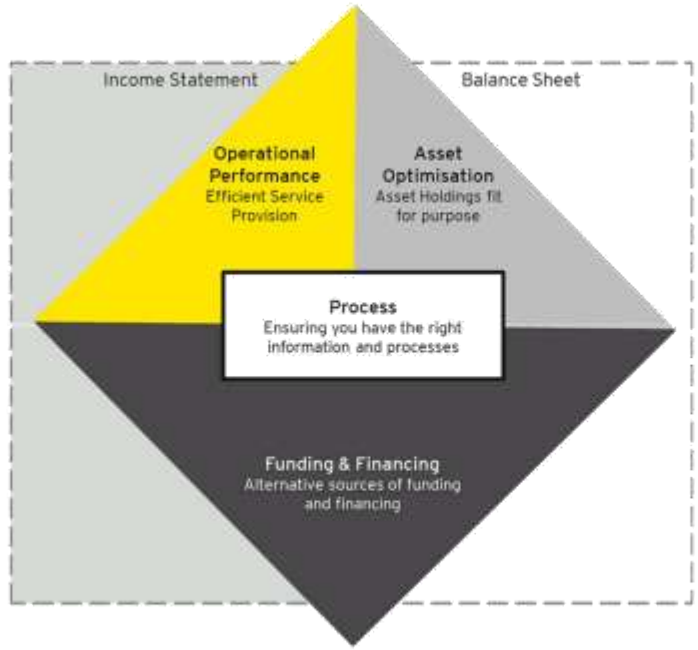
The size and diversity of Auckland Council presents real challenges when considering how best to consider this request. We undertook an initial filtering process across all asset categories to determine what we believe to be 'core' against what is 'non-core'. The high-level filter we applied has been adapted from previous experiences internationally and is noted in Figure 18.

Figure 18: Decision tree for determining core vs non-core assets and interests



In general, if an asset or interest is deemed to be non-core, we have identified a range of options to optimise this asset holding. If an asset or interest falls into the 'core' category, we have looked for ways to improve the operational performance of the asset, interest or entity. We have also identified a range of ways to raise new sources of funding and financing tools which can aid with the timing of investments as well as operational performance by managing risk better. Figure 19 is the conceptual framework for our report.

Figure 19: Conceptual Framework



At the centre of the framework is a need to undertake Process which consists of:

- Getting the information base consistent;
- Ensuring the opportunity cost of decisions are understood;
- Normalising a business case mentality; and
- Ensuring that expenditure is appropriate.

The remainder of the report is then broken down into three substantive chapters. Each provides general and specific commentary about how Auckland Council can find alternatives sources of funding and finance and maximise returns on investments:

- Asset optimisation: A structured review of Auckland Council's portfolio of assets to determine which categories and interests align with 'core' business and with strategic objectives. Those assets and interests that are deemed to be 'non-core' are then considered for divestment;
- Operational performance: Core assets are considered in the context of 'doing more with less'. How can Auckland Council continue to deliver high quality series to Aucklanders at a lower cost?; and
- Alternative funding tools and finance: Alternative source of finance are considered to realise efficiencies in project delivery. Alternative sources of funding are considered to improve the Auckland Council's Income Statement.

Opportunity profiles

We have provided a suite of generic options to investigate and have supported these options with tangible examples from the Auckland Council balance sheet where possible. This could help build a 'case for further investigation'.

This approach explicitly reflects the fact that Auckland Council and councillors have some hard choices to make in supporting the Auckland Vision and that there are always relative advantages and disadvantages of each decision. This report provides an objective evidence base to help enable informed discussions about what is needed to achieve Auckland's vision.

Structurally, the remaining chapters should all have a similar look and feel as this will aid comparability.[20] The rough basis for our substantive analysis is described below:

- What is the conceptual opportunity: Examples from this report include: long-term leases; development of an accommodation strategy; extraction of new revenue(s) from an existing asset base;
- What is the SWOT of each opportunity: In general terms, what are the strengths, weaknesses, opportunities and threats of each opportunity?
- What is an international example of this opportunity: Have comparable jurisdictions undertaken a similar exercise? What was the result?
- What is an example of the opportunity for Auckland Council: Specific Auckland Council example(s) have been highlighted to show the possibilities in Auckland;
- What are the specific implications: In almost all instances, conceptual options and/or specific Auckland Council examples have been analysed against a common set of criteria to indicate the implications they will have on aspects such as Credit Rating, rates and customer service.
- What are the options and next steps if council wanted to progress each example: If a decision is made to pursue the conceptual opportunity or the Auckland-specific example, what steps would need to be undertaken? What are other pertinent considerations?
- What other asset classes might benefit from further analysis: Which asset classes present similar characteristics and so warrant further investigation to determine whether additional value could be realised?

Prioritisation

While we are not making any recommendations about which options to pursue and which not to pursue, we have collated the findings of our investigation and applied a traffic light concept to show Auckland Council where the relevant risk and reward trade-offs lie.

We have plotted all the 'green light' and 'amber light' opportunities on a chart highlighting value, timing, and implementation risk.[21] Again, these opportunities are not necessarily in the order in which they might be pursued, but they do give an indication of the risk/reward trade-off and where the greatest value might lie.

'Red lighted' opportunities are provided in Appendix F.

[20] While there will be a similar look and feel, each profile has a different analytical requirement – owing to availability of information and significance of each option – and so there will ultimately be some differences in the way each profile is presented; particularly the depth to which options have been analysed.

[21] This chart is provided on page 6


1. Process

Overview - process

Our suggestions are underpinned by a need for a more consistent and transparent evidence base to enable better decision making – an improvement in Auckland Council processes is warranted.

We appreciate the amalgamation of eight councils into one presents several procedural and architectural challenges, particularly in having a shared evidence base for decision making. Remedying these existing problems will not immediately provide Auckland Council with new revenue sources or reduced expenditure but it will build on the existing culture and disciplines which will lead to better decision making in the long-term and result in tangible savings.

By undertaking the following actions, we believe Auckland Council may be in a better position to achieve the Auckland Vision:

- Getting the information base consistent;
- Ensuring the opportunity cost of decisions is understood;
- Normalising a business case mentality with all decisions; and
- Ensuring any funds from an asset optimisation programme are spent on regionally significant infrastructure projects.

By undertaking these steps, we believe decision making on assets and the balance sheet could be even more transparent and consistent. Auckland Council will therefore increasingly be making decisions in the best interests of its current and future communities, and ensuring value created remains within Auckland Council.

Option 1a: Consistent information base

Developing an authoritative and consolidated asset register across agencies (including a harmonised approach to valuation techniques) would enable Auckland Council to have a consistent view of its portfolio to enable more informed decision making.

Robust data should be at the heart of all decision making. Without this evidential support, decisions can become unpredictable, ad hoc and sub-optimal.

We recognise that Auckland Council has had to grapple with some inconsistencies in information systems through the amalgamation of eight council entities. Looking ahead, a conscious drive towards consistent information bases, and the utilisation of these to drive decision making should be a cultural requirement of the organisation.

We have identified a case study that we believe is symptomatic of a wider challenge that needs addressing. We recommend that any internal strategy initiatives explicitly encourage movement towards consistent approaches to decision making ensures that robust evidence is at the heart of all decisions.

Figure 20: Advantages and disadvantages of a consistent information base

Advantages	Disadvantages
Improved outcomes Putting evidence at the heart of all decision making will improve outcomes for all Aucklanders as better, more informed decision making leads to better allocation of resources. Future revenue source Collection of rigorous and consistent datasets the public and private sectors trust raises the opportunity to commercialise the information.	Cost This objective will create potential cost pressures on Auckland Council, either through time and resources spent improving internal systems, or in creating new information management systems. This short term cost should be outweighed by long term improvements in decision making (and ultimately outcomes).

Auckland Council Example – Property portfolio

The recent creation of Panuku Development Auckland involved, among other things, the combining of property assets from Waterfront Auckland and property being managed by Auckland Council Property Limited. These assets were diverse and represent investment properties, assets being prepared for divestment and assets under management (but with the intention of being divested in the future, or for future development).

We understand there is an inconsistent approach to how these properties have been valued. Some are based on rateable value, some at market valuation and some have valuations clouded by ownership interests (i.e. Auckland Council owns 30% of an interest but the valuation is at 100% on the books).

Ensuring this information base is consistent could help Auckland Council better understand its portfolio, thus enabling better decision-making about retention and divestment.

Next Steps

If this option is pursued, Auckland Council could:

- *Undertake an independent review of its property portfolio;*
- *Develop a universal property valuation handbook, building on the content of the existing Waterfront Auckland handbook. This outlines the valuation techniques to be applied to all properties within the council group; and*
- *Review Auckland Council's land holdings, including parks and reserves,*

Attachment B **Item 15**

Option 1b: Asset Health Check

Clarity around the opportunity costs of investments will support more informed decision making

Numerous asset management decisions across the Auckland Council balance sheet would benefit from greater scrutiny to determine whether holding those assets fits within the definition of 'core assets or services'.

An objective way of identifying core assets or services would be to assess those assets council is significantly subsidising (to enable debate about whether this is appropriate) and/or those assets where observed deferred maintenance sends a signal that continuing to hold this asset is unimportant.

One way of ensuring this level of scrutiny could be an Asset Health Check which would report annually on a list of significant asset classes exhibiting:

- The biggest variance between the opportunity (cost) value and book value; and
- Depreciation costs higher than capital expenditure[22].

The data requirements for this initiative are already captured as part of the Annual Report and Long Term Plan process and so may not require a significant resource allocation. Some ad hoc valuation work may be needed with some minor cost implications.

Figure 21: Advantages and disadvantages of an Asset Health Check concept

Advantages	Disadvantages
Better Decision Making By shining a light on areas receiving significant subsidies and areas where significant deferred maintenance is occurring, decision makers can have an informed debate about where the balance of efforts could go. This could lead to better decision making in the medium-long term. This objective evidence base could also help to depoliticise decisions. Better allocation of resources Better decision making leads to better allocation of resources, particularly when it is supported by objective evidence. Highlights where potential risks lie Highlighting areas with deferred maintenance (in particular) transparently describes the decisions Auckland Council is making about priority investments.	Bureaucratic burden This initiative by definition creates short-term bureaucratic costs as new systems need to be implemented. However, the short term effort could be mitigated by medium-long term improvements in decision making and resource allocation at large. Lack of formal authority This initiative will not be a binding mechanism; decisions will still need to be made about retention or divestment of assets and so may still be subject to political involvement. Value is subjective Ensuring a commonly held view of value will be difficult. As a subjective measure, effort will be needed to ensure a universally accepted valuation approach is adopted.

[22] Local Government (Financial Reporting and Prudence) Regulations 2014 clause 5(4) ensures that Auckland Council must report depreciation and amortisation by asset category – but it does not require individual assets to be identified.

Auckland Council Example – Golf Course subsidisation

Council has traditionally providing land for sports and recreation as they are a public good. Often these assets become the exclusive domain of the sports or community group which creates property rights unscrutinised by council.

As one example, Remuera Golf Course is a private club and the land it occupies could have a market value of c$275m if used for other purposes.[23] Rental from this course for the land only equates to $130,000 p.a. This represents a significant subsidisation to private interests and raises questions about whether at least parts of this asset – the land the golf course occupies – could be considered for higher value uses. A fair market ground rental for this property would likely be in excess of $16m per annum, with renewals on a 7 yearly cycle.

We pass no judgment about whether this is the 'right' use of this land. However, we assert the Auckland public is likely to be unaware of the significance of this subsidy. By making this subsidy and others like it, transparent, Aucklanders can make their own minds up about whether this represents fair value and, ultimately, whether capital locked away in this investment could be put to uses that serve the wider vision for Auckland.

We also note Auckland Council has 13 other golf courses on its books and so this rationale can be extended across the wider portfolio.

Other areas for investigation:

- View shafts: Protection of view shafts is undoubtedly an important element of Auckland's unique offering. Is the opportunity costs of minor relaxations of these rules and requirements well understood? For example, the Auckland Council recently noted the net cost of the Mt Eden view shaft to be potentially $440m[24]; and
- Community Loans: There have been numerous instances of sporting clubs defaulting on loans from Council. Increased transparency would make these subsidies transparent and potentially improve consideration of how appropriate these loans and associated write-offs are.

Next Steps

If this option is pursued, Auckland Council could:

- *Develop the specific parameters of this initiative including: materiality thresholds, valuation definitions, and mechanisms to acknowledge historic obligations or long-term implications of decisions; and*
- *Consult on this concept with a view to implement in future annual reports.*

23 See Appendix A for assumptions about this market value
24 Housing supply, choice and affordability: Trends, economic drivers, and possible policy interventions (Auckland Council 2015) citing from Rohani, Nunns, and Balderston (forthcoming) Cost benefit analysis of the Auckland volcanic viewshafts overlay of the Proposed Auckland Unitary Plan: Case study of 14 viewshafts across the region.

Option 1c: Better Business Case Disciplines

By applying scalable business case disciplines to more investment/divestment decisions, Auckland Council can better realise value from existing asset bases in a politically neutral way, while ensuring key decisions are beneficial to Auckland with risk fully understood.

We understand adoption of a Business Case type process is being actively considered by Auckland Council. We also note that both Auckland Transport (AT) and Panuku Development Agency (PDA) have their own business case approaches. The Auckland Plan states (paragraph 827):

> *"Implementing the Auckland Plan hinges on all of the Auckland partners working together to align priorities and ensure the directives and targets in the Plan are realised including Central government agencies and departments (e.g. Treasury) to develop a shared decision-making framework for capital project investment, such as the 'better business case' approach outlined in the National Infrastructure Plan (NIP) to coordinate investment programmes across the public sector".*

We understand this framework would be targeted for application in large scale infrastructure projects – for instance, City Rail Link, AMETI, Interceptor etc. However, we propose the framework should be applied (with some degree of scaling) across most of Auckland Council's capital expenditure decisions. This would give a suitable framework for challenging some entrenched traditional project development methods and encourage consideration of mechanisms to improve efficiency.

Developing business cases in conjunction with the relevant local boards will also add value. One critical factor considered within a business case process includes consideration of the optimal use of existing infrastructure after the project is completed. As well as providing a valuable voice for the local community, the local board could consider the existing community facilities indirectly impacted by a project, and whether these could be leveraged to realise additional revenue streams or cost saving. The current systems, without this as an explicit requirement, may offer an incentive for local boards to retain surplus assets.

The traditional five cases of Treasury's Better Business Case (BBC) methodology, and how they could add value to the council's decision making process, is outlined in Figure 22.

Figure 22: Better Business Case Methodology and how they add value to Council

	Key Focus under BBC	Value to Auckland Council
Strategic Case	Is the proposed investment supported by a compelling case for change that fits within the strategic context and meets business needs?	A valuable framework to determine the problems being addressed, and the suitability of Auckland Council developing the project relative to the Auckland Plan and the broader role of local government.
Economic Case	Does the preferred investment option optimise value for money?	Rationalises the impacts of the project (including economic, environmental, social and cultural) to inform decision making.
Commercial Case	Is the proposed deal commercially viable?	Investigates the most valuable commercial arrangement for delivering the proposal, which may be non-traditional methods such as public private partnerships or tax increment financing detailed within this report.
Financial Case	Is the proposed spend affordable, what are the risks and how can it be funded?	Provides an opportunity to explore funding streams expressly recognising risk held by Auckland Council, which may be non-traditional methods including hypothecated funds.
Management Case	Is the proposal achievable and can it be delivered successfully?	Clearly outlines a plan for successfully delivering success on the project, including governance and timeframes.

In aggregate, the business case is a tool to allow more informed decision making and to facilitate an 'apples-with-apples' comparison across various (and very different) investments.

Inherent trade-off exists in ensuring robust analysis and optimising the use of Auckland Council resources. The diverse scale of Auckland Council projects means a scalable template and process would be critical (as consistent with Treasury's BBC). However, it is essential that relatively minor decisions, such as local property transactions or small development projects, are still required to go through the business case process in some form (for instance, see the template for the Treasury 'Single-stage (light) business case'). We acknowledge a challenge in the implementation process to ensure this motivates genuine analysis, rather than becoming a box-ticking exercise.

We understand Panuku Development Auckland has adopted business case-like requirements for undertaking assessments for the rationalisation of assets, including requirements for local boards to submit business cases for retention of assets tagged as surplus in their community. We see this as a big step in the right direction and encourage further refinement in the process and wider adoption across Auckland Council.

Figure 23: Advantages and disadvantages of a scalable better business case approach

Advantages	Disadvantages
Improved decision making Improving the quality and comparability of information provided to decision makers reduces the possibility of deficient decision making.	Administrative burden There might be a disproportionately high administrative burden, particularly for smaller scale or more routine projects.
Risk management A structured approach to decision making reduces the risk of perverse outcomes or unforeseen consequences.	Standardisation is difficult It will be challenging (but not insurmountable) to standardise an appropriate methodology across major infrastructure and service delivery projects.
De-politicisation An objective business case process also removes the influence of political decisions – or at least makes them clearer.	

Domestic Case Study – Ōtāhuhu Library

In March 2012, Māngere - Ōtāhuhu Local Board approved the final master plan for Ōtāhuhu Recreation Precinct, including a new $5.8m library. The plan detailed in the local board's minutes considers the cost and design of the project. However, it did not detail any consideration of the impact on, and possible future of, the former library (12 High St).

12 High St is held as a service asset in the local facilities portfolio, meaning the local board has decision making authority over it. There is a range of uses (and vacancies) for spaces in this building:

- The former library space, which constitutes a substantial part of the ground floor of the building, is vacant due to the library's recent relocation;
- The Ōtāhuhu Town Hall and Community Centre Trust occupy the lower conference room on the ground floor through a licence to occupy agreement which is renewable annually;
- Three community groups on the first floor with leases until 2016; and
- Two vacant spaces on the first floor.

This asset has only recently undergone a needs assessment to determine what the utilisation of the asset is – and was considered in the Māngere-Ōtāhuhu Local Board meeting of 21 October 2015.

We understand this assessment was partially on the back of Panuku Development Auckland's recent property review and rationalisation process which is targeted at identifying the appropriate future use of facilities - be it community use or rationalisation. This is part of a relatively recent process, targeted at driving efficient use of property assets, and places the onus on the owner to justify ongoing need for the asset. We note this process appears to be reflective of ex-post analysis.

We consider it would have been more valuable to assess the use and value of the existing facility explicitly in the economic case of the initial business case for the Recreation Precinct which could influence the required scale of the new facility (i.e. options could have included retaining some back-office functions in the facility rather than in the new centre). Consideration of a financial case is also relevant as decision-makers could have had the option of considering whether sale of land could offset the cost of construction of the new facility. Early assessment and consideration of these trade-offs could allow a more effective process for re-appropriating or rationalising a facility after use.

Next Steps

If this option is pursued, Auckland Council could:

- *Review current project development processes and benchmark against best practice;*
- *Engage across Auckland Council's departments to determine the specific needs of the adopted process, including appropriate scalability;*
- *Work with business case specialists (including Treasury) to develop an appropriate model for progression; and*
- *Consider the best way of prioritising investment – both up front, and on an ongoing basis – across different categories of expenditure.*

Option 1d: Infrastructure Acceleration Fund

Creating a contestable fund, which is explicitly capitalised from the proceeds from any Asset Optimisation Programme, would help to accelerate investment in regionally specific infrastructure projects and ensure that funds are used appropriately and apportioned to the best/ maximum value.

The proposed Infrastructure Acceleration Fund (IAF) is a dedicated infrastructure fund focussed on investing and financing priority infrastructure projects. Like other funds, it will invest only in new or upgraded regional infrastructure assets which create net benefit for Auckland's economy. It ensures any asset optimisation programme proceeds are ring fenced to allow benefits of asset recycling to be realised.

This can be done by restricting the IAF to fund only core infrastructure projects such as public transport, roads, and infrastructure required for the economic competitiveness of the Auckland region (including the movement of freight, inter-modal facilities and access to water). The IAF should explicitly not be available for normal annual repair maintenance. It could also be governed independently and applications to access the funds will require substantial information and undergo a rigorous process to ensure any approved project will provide a net benefit to the Auckland economy. It will allow "competition" between major projects to demonstrate the greatest net benefit to the region

Its funding will come from proceeds from the divestment of non-core assets. There is also a significant opportunity to commence discussions with central government on expenditure on any nationally significant infrastructure initiatives located in Auckland, including the provision of central government funding.

Auckland has already identified the need for certain large infrastructure projects - but have yet to financially commit to them. Auckland Light Rail is an example where there is an infrastructure need to manage the expected growth of transporting Aucklanders in the city centre and beyond. Auckland Light Rail would be a multibillion dollar project where funding could be prioritised under the IAF.

Figure 24: Advantages and disadvantages of an Infrastructure Acceleration Fund

Advantages	Disadvantages
Improved decision making	*Administration costs*
Increased governance around infrastructure projects provides a better decision making framework for infrastructure projects.	There will inevitably be costs of implementation including the governance of the fund.
Value capture	*Complexity and overlap*
Ensuring that proceeds from the asset optimisation programme are ring-fenced into infrastructure assets gives confidence that value is being transferred and captured rather than leaked.	Adding a rigorous business case process can create a timely and costly process. There will be a learning curve in terms of how this process fits with existing funding, budgeting and governance processes. This could be reduced with discussions with parties who have done this before.
Achievement of Auckland vision	
Enabling the acceleration of infrastructure spend in order to realise the benefits earlier directly supports the Auckland Vision.	
Delivery optimisation	
The transparency and accountability inherent in such a fund would provide additional resource and scrutiny to ensure world class client side delivery capability is assembled and retained across major projects in the region.	

International Case Study – Restart NSW

In June 2011, the NSW Government established Restart NSW to fund a range of high priority future infrastructure projects. The fund holds the proceeds of recycled assets and windfall revenue from the NSW Government. It is governed by the Restart NSW Fund Act 2011.

The objective of Restart NSW is to improve the economic growth and productivity of the state by funding essential infrastructure, including:

- Public transport;
- Roads;
- Infrastructure that may improve the competitiveness of the State;
- Local infrastructure in regional areas that are affected by mining operations; and
- Health facilities.

Infrastructure NSW, an independent body, provides advice to government around infrastructure planning, project selection, funding and delivery. It is governed by a board of senior leaders from both the public and private sectors. Infrastructure NSW is responsible for independently assessing and making recommendations to the NSW Government for the use of the funds to ensure they are allocated where they are needed most.

There is a rigorous process for projects seeking Restart NSW funding. This is required to identify the projects strategic case and basis for the projects development.

In its 2014-15 NSW State Budget, the NSW Government committed and reserved $6.7b in priority projects with around $2b for Regional projects.

A range of similar funds also exist in New Zealand and elsewhere:

- Future Investment Fund – New Zealand Government;
- Regional Infrastructure Fund – Bay of Plenty, New Zealand;
- Asset Recycling Fund –Australia Federal Government; and
- Infrastructure Tasmania Fund – Tasmania, Australia.

Next Steps

If this option is pursued, Auckland Council could:

- *Investigate the relevant components of the fund, including:*
  - *the guiding principles of the fund, operational procedures, and governance arrangements;*
  - *the evaluation criteria framework (business case requirements) for applying to the fund and approval process;*
  - *resourcing required for the fund and which functions can be utilised by existing resources in council;*
  - *communication approaches to potential fund users; and*
  - *What delivery arrangements might be required in order for the fund to invest appropriately.*
- *Consult with central government and pan-regional partners about other potential funding sources as well as potential priority projects.*


2. Asset optimisation

Overview – Asset optimisation

Auckland Council owns a significant portfolio of assets. We have assessed the capital that could be realised if non-core assets were divested.

We have reviewed the Auckland Council balance sheet and formed an initial view about the components which are 'core business' or are aligned with strategic objectives. We have also identified a range of assets or interests that can be deemed 'non-core'.

Non-core assets and interests, or those assets and interests that do not align with strategic objectives, represent a fiscal drag on the council, both in terms of opportunity cost and, in many instances, in terms of operating costs.[25] Non-core assets could be considered for divestment, or at least better utilisation, as this can create up-front value for Auckland Council to achieve the wider Auckland Vision. In particular, capital freed up from non-core assets can be used to:

- Pay down debt –providing headroom for further capital expenditure and to reduce future rates burdens by lowering interest payments;
- Accelerate infrastructure investment –achieving the vision of Auckland as the world's most liveable city; or
- Reduce rates – an explicit goal of this review.

We have highlighted several options open to council to better realise value from its non-core assets:

- Partial or full sell down of assets;
- Long term leases;
- Sale of surplus property assets; and
- Better realisation of commercial value from CCOs.

Council Controlled Organisations (CCOs) have been nominally included in the asset optimisation investigation because of their size and potential commercial value. We have not done a full root -and -branch investigation of CCOs but we think there is considerable value from rationalising some functions, a consistent focus on commercial disciplines and a proper alignment of incentives.

Figure 25: Advantages and disadvantages of Asset Optimisation

Advantages	Disadvantages
Greater Value Asset optimisation in its simplest form realises market value for an asset (and could be considered when market value is higher than retention value of the asset). Achieving the Auckland Vision Auckland Council is able to focus its scarce financial resources on more important investment priorities in order to meet the Auckland Vision: for example proceeds from asset optimisation can be reinvested to wider priority projects or to accelerate infrastructure investment, such as City Rail Link. Greater innovation Private sector involvement in these asset categories can increase innovation in the sector, provide greater access to skills and expertise, and drive efficiencies which could lead to better outcomes and services. Risk Improvement Asset optimisation can improve risk management for Auckland Council by transferring the existing operating or market risk to the party that is best placed to bear it.	Loss of ongoing revenue Divestment of an income generating asset can adversely affect the Councils ability to borrow and in theory puts pressure on rates. However, we would not recommend divestment of any assets unless the up-front proceeds from an asset divestment appropriately reflect the future income stream (or reflect fair market value) and so Auckland Council should not be worse off from an asset divestment over the long term. Our 'value eco-system' principle should also ensure that proceeds from any divestment are recycled into another value generating asset. Potential natural monopoly Asset optimisation may lead to the potential divestment of an asset which is a natural monopoly. Appropriate oversight is then required to ensure that service standards and pricing continue to be applicable. Loss of local government control & public interest By definition, asset divestment means the potential loss of direction, influence, or public interest in a particular asset. Any divestment should only occur if the strategic objectives/outcomes of the asset (if any) are able to be managed though another mechanism such as regulation, or contract.

[25] We have broadly followed the framework identified on Page 21 when determining whether assets are 'core' or are aligned with a strategic interest.

Option 2a: Partial or full sell down

A partial or full sell down of non-core assets and interests would provide Auckland Council with up front capital for reinvestment in other strategically important priorities.

Partial or full sell down options range from a trade sale to a sole party to a public share float. Consideration of the nature of the asset, its size, the target market, and sale risks should be taken into account to ensure maximum value is realised with each sale option.

Several key overarching benefits and disadvantages from asset optimisation have been mentioned earlier in this report. The specific benefits of a partial or full sell down are the liabilities, costs and risks associated with the asset are transferred to the purchaser. This can include the debt associated with the asset, annual maintenance or capital investment costs, and the market risk associated with the asset. The key disadvantages are that the assets, returns, rights and control associated with the asset are also transferred to the purchaser. It is important to reiterate that Auckland Council should divest assets only when there is a benefit to the council from the sale (i.e. net proceeds and benefits are greater than retention value of holding the asset).

The key determinant between the merits of a partial or full sell down is usually dependent on the strategic objectives of the asset holding. A partial sell down option can be used if Auckland Council wants to retain an amount of rights and control while unlocking a portion of the value, including subjecting the organisation/interest to efficient capital market disciplines. There are also accounting impacts for partial sales – where in some cases the requirement of consolidation is to recognise all the asset and liabilities of the interest.

Under our framework we have identified several opportunities and asset categories that are considered to be non-core, not aligned with strategic priorities, or the value would be better served achieving the Auckland Vision, and their partial or full sell down could better optimise the balance sheet:

- Auckland International Airport shareholding;
- Diversified Financial Asset Portfolio;
- Auckland Energy Consumer Trust; and
- Ports of Auckland Limited.

Furthermore, we question whether Auckland Council should have a stake in other commercial entities e.g. commercial joint ventures such as landfill operations and quarries, city parks, print shop and cafe operations.

If partial or full sell down is considered appropriate, we would recommend a detailed investigation and review of the asset(s) identified to ensure maximum value is realised. Important considerations include:

- A determination of the optimal strategic holding;
- Consultation with appropriate stakeholders;
- Robust financial analysis on impact of sale, including appropriate WACC; and
- A determination of the appropriate share value, sale strategy, and application of proceeds to maximise value and return.

Using the council's current investment in Auckland International Airport Limited (AIAL) as an example, we have provided the 'case for further investigation'. We believe there are weak strategic reasons for retaining AIAL shares and significant value could be realised if the shareholding was sold down.

Attachment B

Item 15

Auckland Council Example: Auckland International Airport Limited shareholding

Description

AIAL provides airport facilities and supporting infrastructure in Auckland. The company offers airfield landing, passenger, terminal, airport retail concessions, and car parking services. It also leases space for facilities, such as terminals and cargo buildings, investment properties, and hangars. The company has investments in some Australian airports and Queenstown Airport and also operates the Novotel hotel at Auckland Airport.

SWOT analysis for Auckland International Airport

Strengths and Opportunities	Weaknesses and Threats
Growth outlook is strong and continued passenger movements expected	Share market risk - volatility and market risk
Largest international airport in New Zealand	Operational risk – AIAL invests into Australian airports, property and has hotel management
Value change is aligned with the growth of Auckland	Dividends uncertainty – if substantial future capital investment required, or it achieves poor economic performance

Financial Analysis[26]

Implied value: Total shares 266,328,912 @ 4.99 = $1,329M (as at 17-09-2015). We note that over the term of this engagement, AIAL shares have fluctuated from $4.77 – $5.41 per share.

	FY2015 ($m)
Revenue	499.8
EBITDA	376.4
EBIT	311.6
Capital BV	4,789.3
Enterprise Value	7,410.4

Figure 26: 10 year gross share price index of NZX and AIAL

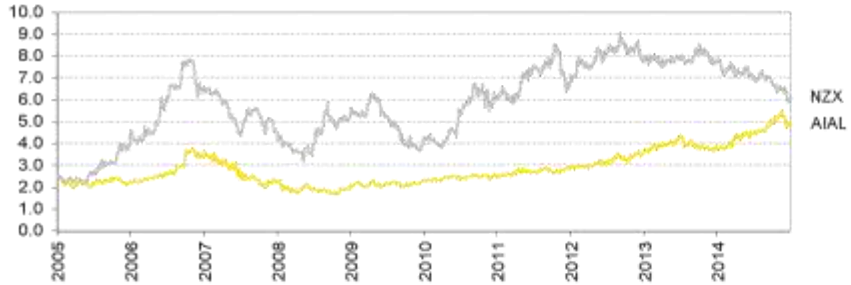
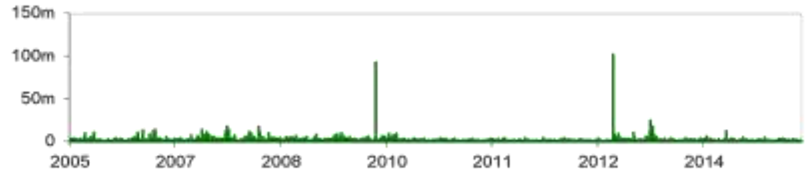
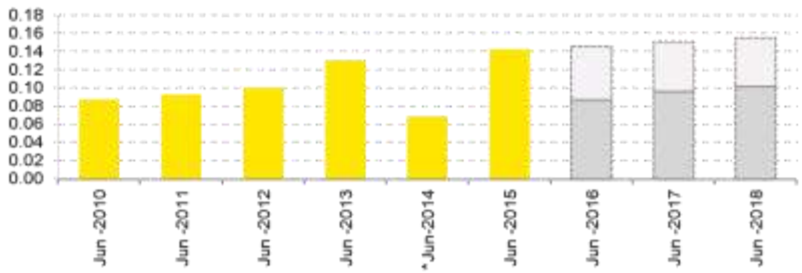


Figure 27: 10 year volume of AIAL shares traded



Source: S&P Capital IQ and EY

Figure 28: Historical and forecast dividends paid per share



* Jun 14 – special dividends of $453.1m capital buyback. Forecast dividends ranges are dividends sourced from the ACIL 2015-2018 SOI, and the FY2015 dividend grown at LTP GDP rate.

[26] Source: Capital IQ

Auckland Council
Alternative Sources of Financing

EY 36

Auckland Council Example: Auckland International Airport Limited shareholding

Option identification

There are a range of historic reasons for holding AIAL shares, but these may have diluted as time has progressed.

- There is clearly some strategic value in having a nominee on the AIAL Board, however arguably the strongest influence Auckland Council has on AIAL performance is its role as urban planner (as it controls zoning, development and consenting).
- Auckland Council's blocking stake for any takeover bid offers some residual value, however the OIO already offers protections against full takeovers of strategic assets from foreign buyers and it is debatable what the existing shareholding would offer Auckland Council in a scenario where one party owned the remainder of the shares.
- The revenue Auckland Council receives from AIAL dividends is an often cited reason to maintain this interest but the opportunity cost of paying down debt, accelerating infrastructure investment or reducing rates is greater than the current returns. For illustration purposes, if the gross proceeds from the airport shares were $1.3b this could equate to savings in interest payments of over $70m per annum compared to the approx. $29m -$44m dividend received p.a.[27] We also note that the share price from AIAL has historically been lower than the NZX50 benchmark over the past ten years as shown in Figure 26.
- We are demonstrating the need to think more closely about the differences between interest savings (for paying down debt) and dividends received from AIAL shares – because there could be material value that is being foregone.
- We understand that there may be complex tax incentive structures associated with the shares (such as the use of imputation credits) that have been used to serve a specific purpose/benefit. However we also understand that these structures have recently changed and that consideration should be given to reassess whether these objectives are still being served.

We suggest Auckland Council would better achieve the vision for Auckland by divesting its AIAL shareholding and reinvesting the funds in interests that better enable the achievement of the Auckland Vision including paying down debt, reducing rates or accelerating infrastructure investment.

International case study: Sydney (Kingsford Smith) Airport

Sydney Airports Corporation Limited (SACL) was sold to Southern Cross Airports Corporation Pty Ltd in June 2002 for $4.233b. The 100% trade sale had the objective of optimising sale proceeds within the context of broader Government policy objectives (including minimising the Commonwealth's exposure to the residual risks and liabilities).

Prior to the sale SACL was an equity asset on the Commonwealth balance sheet. The sale reduced equity investments by $794m and proceeds were used to repay and reduce Commonwealth debt by $4.233b, which in turn reduced public debt interest payments by $250m per year.

Auckland Council Example: Auckland International Airport Limited shareholding

Assessment of option against criteria

Criteria	Assessment	Considerations
Is the option strategically aligned?	Strategic High	Alignment to Council Role Auckland Councils current investment in AIAL indirectly meets the purpose of local government as defined in the Local Government Act 2002. AIAL investment provides funding support for the council in order to meet the local infrastructure, local public services, and performance of regulatory functions. We would challenge whether the investment in AIAL is the *most effective* method of support for this objective – the counterfactual being if it were the optimal solution, then consideration could be given to the purchase of *more* shares or the investment of scarce capital into *other* overseas airports. Or put more simply – if the Auckland Council did not own a stake in the airport would it actively go out to invest in it? We recognise that airports are key drivers of economic growth – which naturally aligns with some roles and functions of Auckland Council. However, as Auckland airport, and the city, grows the need to centrally influence the direction of the airport for wider economic growth objectives diminishes.
		Customer Service Impact No discernible customer service impact expected.
		Legislative / Regulatory Section 5 of the Local Government Act 2002 defines Auckland Council's shareholding in AIAL as a strategic asset. Under section 97 of the Local Government Act 2002, a transfer of ownership or control of a strategic asset can only occur if the decision to do so is provided for in a local authorities' long-term plan. If the option is considered, Auckland Council must use the special consultative procedure set out in the Local Government Act 2002 to make any significant amendments to the current holding policy. From a competition perspective, we consider there is very low risk of the option leading to a monopolistic market, as there are a number of airports listed in the public market and other international airports in New Zealand. Furthermore, the Commerce Commission already has a level of oversight over airports in New Zealand.
		Māori considerations Several mana whenua iwi have traditional and contemporary interests in the land surrounding Auckland airport. Engagement should be carried out with these iwi, should any decision to divest this shareholding be made.
Ease of Implementation	Simple	Ease of implementation A partial or full sell down of AIAL shares will be fairly simple and can be initiated quickly. The appetite for this share would be expected to be fairly strong, and Figure 27 shows the significant volume of trades since 2005. The main hurdle for this option would be the requirement to consult through the LTP – i.e. a timing constraint. There could be low costs associated with a sale of AIAL shares with any review/selling costs being recoverable from proceeds.

[27] An average of forecast dividends based on a range between the net dividends (as reported in the ACIL SOI (2015-2018)) and the FY2015 actual dividends received (as reported in the 2015 Annual Report). We have grown both of these at LTP GDP rates.

Auckland Council Example: Auckland International Airport Limited shareholding

Operating risks

By owning the shares of AIAL, Auckland Council indirectly has exposure to the operational risks associated with the airport industry. AIAL's investment in various Australian airports and Novotel hotel, for example also creates associated operational risks. By divesting the investment there is a reduction in the operational risks.

The volatility of the share market in general creates risks around value lost. Figures 26 and 27 shows the volatility of shares in the NZX and AIAL. Figure 26 also shows that over the past ten years, AIAL shares have been consistently outperformed by the NZX benchmark index (albeit AIAL represents a less risky investment than many equities included in the NZX benchmark index).

Other considerations

N/A

Value — Medium – High

Market appetite

There is likely to be a mature and strong market appetite for a partial or full sell down of AIAL shares.

Wider Economic Benefits

We consider that Auckland Council ownership of the AIAL does not facilitate wider economic benefit to the airport in the same way that could be expected for smaller and rural airport - where the infrastructure needs to be economically supported by Government and/or council. Wider economic benefits including employment and agglomeration effects will occur regardless of the Council's shareholding.

Income Impact

Divestment of the shareholding will mean there will be a loss of annual dividends in exchange for the up-front payment (for the value of the future dividends). Further investment analysis and valuation could be taken to determine the fair market price of the shares.

The impact of a full sale of the shares on debt is provided in Figure 30.

Credit rating impact

Based on initial preliminary assessment utilising Moody's rating methodology for Regional and Local Governments, selling the revenue generating asset will likely result in the following impacts on the credit rating:

- In the event that proceeds from the sale (assumed to be ~$1.3bn) are used to repay its existing short-term debt, whilst this provides greater headroom in borrowing capacity and financial flexibility, it is unlikely that a positive notch upgrade will occur given Auckland Council's rating is effectively capped at the overall New Zealand Sovereign credit rating (AA+ by Standard and Poor's). Greater financial flexibility occurs given the improved financial credit metrics arising due to improvements in gearing and debt servicing ratios.
- It is considered that the release of capital to meet future funding commitments will assist to alleviate the existing downward pressure on the credit rating (as noted by Standard & Poor's credit rating report 4/11/14) due to the forecast increase in debt required to fund future projects.

Further detailed assessment on a case-by-case basis would be needed to confirm this view.

Case study 1: Auckland International Airport Limited shareholding

Long Term Plan Impacts

For illustration purposes only, we have scenario tested the impacts to the long term plan if the remaining 22.4% interest in AIAL is sold. The charts to the right illustrate the impact to the annual loss of dividends, the savings in interest, and the reduction of debt from proceeds. It should be noted that debt capacity is reduced as revenue raising decreases, however if the proceeds are used to fund capex instead of debt then there are interest cost savings overall.

The total in the potential interest cost savings less the potential income loss from dividends is estimated to be between $270 and $427m over the lifetime of the LTP.

Key Assumptions

- 100% of shares priced at $5 per share sold in FY2016 (this date is indicative only);
- Proceeds reflect the fair market price – (eg. NPV of future dividends);
- Proceeds are used to reduce Auckland Council's debt requirements for FY2016 and FY2017[28];
- Interest rates have been based on the LTP; and
- The dividend range represents the net dividends as reported in the ACIL SOI (2015-2018) (Scenario 1) and the FY2015 actual dividends received as reported in annual report (Scenario 2). We have grown both of these at LTP GDP rates.

Conclusion

The strategic reasons for holding AIAL shares look weak. The upfront value that could be realised could be better served in

- Paying down debt;
- Reducing rates; or
- Accelerating infrastructure investment that better meets the Auckland vision.

Figure 29: LTP dividends and interest revenue vs. scenario full sale

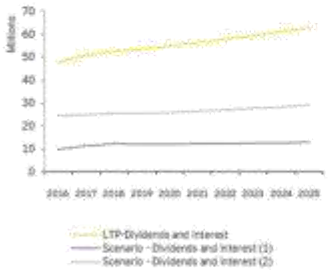


Figure 30: Debt vs. scenario full sale

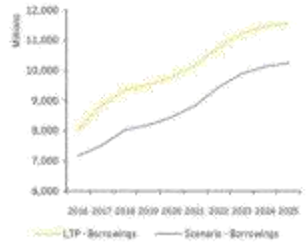
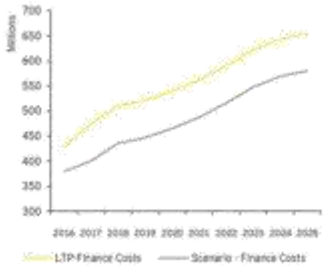


Figure 31: LTP finance costs vs. scenario – full sale



[28] We note book value debt of $174m, Council has confirmed that this is an accounting adjustment only and is eliminated in consolidation.

Next steps

If Auckland Council decides to modify its stake in AIAL, it could:

- *Determine the optimal strategic holding:*
    - *100% share divestment of the shareholding of AIAL;*
    - *55% share divestment of the shareholding of AIAL (balance of 10.01% shareholding to remain); or*
    - *Another proportional divestment.*
- *Undertake consultation with appropriate stakeholders;*
- *Commission robust financial analysis on impact of sale, including appropriate WACC; and*
- *Determine the appropriate share value, sale strategy, and application of proceeds to maximise value and return.*

Option 2ai and 2aii: Other commercial assets not part of core council functions

Other commercial assets exist which also do not directly support core Council functions. Additional strategic priorities could be achieved if capital in these assets was released.

Auckland Council Example – Diversified Financial Asset Portfolio

Auckland Council holds a portfolio of equity assets held in reserve to meet any unforeseen liquidity or funding events. This is a legacy asset. In FY2014 this fund, the Diversified Financial Asset Portfolio (DFAP) has produced a gross return of 12.1% and now represents a $345m asset as at Feb 2015.

The DFAP was transferred from ACIL to Auckland Council's Treasury function in early 2015. We note that the approach taken by Auckland Council Treasury team largely mirrors the approach taken by ACIL. It is managed under an Investment Policy and has a Long term target return of 4% pa above the consumer price index[29]. We note that Auckland Council has currently invested over two thirds of this fund in growth assets – which has a higher risk : return ratio.

The DFAP indirectly meets the role of local government. The main arguments for retaining the fund include:

- This fund is generating a good return - why would we sell a cash generator? Markets are cyclical and so there will always be peaks and troughs in earnings profiles. Selling assets at the top of the cycle intuitively feels like a better use of capital than at the bottom of the cycle (i.e. when it is generating low returns). The question must also be asked, if it is generating such good returns, why doesn't the Council borrow substantially to invest more in the fund? The answer to this question lies in the risk attached to the reward. The role of Council is not to take on significant amounts of risk. We would not expect ratepayers to accept this; and
- The fund is a "rainy day" fund. If a "rainy day" did occur it is likely that the shock has occurred in the global economy (for example the aftermath of the GFC). This global shock would place downward pressure on the value of the DFAP and Auckland Council would effectively be selling towards the bottom of a cycle. The Auckland Council Treasury function must minimise the risks associated with its investments to avoid placing the capital value of the investment at risk. No unnecessary or speculative investment activity should be undertaken as noted in the Investment Policy. The fund investments can be liquidated through a readily available secondary market so retrieving capital can be easily done. It also should be noted that currently Auckland Council has a number of other financial tools available, for example short term credit facilities.

The rationale for holding the DFAP look even weaker than the rationale for holding AIAL shares. Auckland Council could divest its interest in this fund and reinvest the proceeds in paying down debt, reducing rates or accelerating infrastructure investment to better achieve the Auckland Vision.

Next steps – option 2ai

If Auckland Council decides to modify its stake in DFAP, it could:

- *Determine the optimal strategic holding:*
- *Undertake consultation with appropriate stakeholders;*
- *Commission robust financial analysis on impact of sale, including appropriate WACC; and*
- *Determine the appropriate share value, sale strategy, and application of proceeds to maximise value and return.*

[29] As per the Diversified Financial Asset Portfolio statement of investment policy and objectives

Auckland Council Example – Auckland Energy Consumer trust

The Auckland Energy Consumer Trust (AECT) was established in 1993 to keep control in the hands of electricity consumers. AECT was the sole owner of Vector until it allowed a public float of 24.6% to raise capital. AECT therefore now owns 75.4% of shares in Vector and holds shares on behalf of Vector's 300,000+ customers. It distributes dividends to over 300,000 beneficiaries across parts of Auckland.

A Trust Deed is in place to make sure their assets are protected and managed in a way that delivers maximum benefit for their beneficiaries. The Trust Deed is due to be terminated on 27 August 2073. At termination the assets will be distributed to the local authorities or to the Crown.

We do not recommend investigation into any breakup of the current structure. There are a number of legacy issues at play here, not least of which being the ownership interests by sub-regions of Auckland.

We do raise the possibility of a share sell-down. AECT could potentially sell their current 75.4% share down to a 51% ownership position. This will allow them to still be a majority shareholder and have an impact on the operations of Vector – Auckland's energy distributor. Proceeds could then be donated to Auckland Council with the explicit intention of paying down Auckland Council debt, reducing rates or accelerating infrastructure investment to better achieve the Auckland Vision. At current market rates a 24.4% sell down will amount to 242,964,239 shares valued at $3.16 (NZX 12/10/15) resulting in a total sell down value of $768m. This receipt could be used as an initial funding tranche for the proposed Infrastructure Acceleration fund proposed at 1d.

This exercise would need to be undertaken in full consultation with the Auckland Community – as they are the stated beneficiaries of the Deed. We are unclear on what public appetite might be but we do note that: the current dividend is taxable; and while consumers receive a dividend, they effectively pay for it through their power bills.

The sell down of the AECT ownership stakes from 100% to 75.4% ownership in 2005 shows that there has been similar appetite in the past (this sell down was to fund the purchase of gas company NGC Holdings). The experience with Air New Zealand (where the Crown sold down its ownership stake from 73% to 52%[30] but dividends have doubled) demonstrates that this option can achieve positive results for all parties.

We note this option will be highly contentious, and would require a high-level of cooperation with the AECT.

What we are signalling is that the beneficiaries of the Trust may wish to see a portion of their dividend go towards wider Auckland goals. Neither AECT nor Auckland Council can truly understand the consumer perspective unless they work together to put forward an alternative to the status quo.

Next steps – option 2aii

If Auckland Council wanted to pursue this option, it could:

- *Discuss this concept with AECT to gauge the likely level of support for the concept amongst AECT beneficiaries;*
- *Undertake a full analysis of a partial sale with the intention of informing an AECT-led community consultation around this specific asset; and*
- *Any analysis should fully consider the legislative barriers (including Trust Deed implications), legacy issues around sub-regional interests and operating efficiency implications (if any) on Vector.*

[30] There are many factors that determine dividend payouts.

Attachment B

Item 15

Option 2b: Long-term Lease

A long-term lease of non-core assets and interests would provide the Auckland Council with up front value for reinvestment in other more strategically important priorities – and also ensures the asset stays in Auckland Council control longer term.

A long-term lease is a contractual arrangement that guarantees the lessee use of an asset and guarantees the lessor a payment from the lessee. Ownership is not passed in this arrangement, only the right to use, maintain, and invest in the asset(s) for an agreed period of time (lease term).

There is no universal lease structure and there are a range of material considerations. In many instances there will be a distinction between land and the operational asset sitting on the land. In cases where the land is strategic (either because it has high alternative use value or it is needed to protect for future use) it is advisable that the lessor (Auckland Council) retain ownership of the land holdings, with the operational assets to be leased for a period of time. At the end of the lease term the ownership of the operational assets will then revert back to Council.

The key benefits of leasing assets are to unlock capital funding whilst having the benefit of the asset reverting to back to Auckland Council. A lessee may also have the potential to have greater access to capital to support the development and growth of the asset and the expertise in the asset to bring new innovations and service delivery. An added benefit is that operational risks associated with the asset will be transferred to the lessee.

The key disadvantage may be the lessor loses control of the operations, investment decisions and capability during the lease term. However it should be noted that the lease contract can set out specific details of the arrangement e.g. requirement for allocated capital expenditure and or to maintain assets to a certain standard. The lessor also loses the existing dividend stream (if there is one).

The lease of the asset should only be considered if the asset has been identified as non-core or where there is potential for additional value to be recognised. Under our framework we have identified a number of opportunities where a lease arrangement could be applicable and would better optimise the balance sheet:

- Ports of Auckland Limited;
- Property assets; including 135 Albert Street, the Bledisloe Building, Westhaven Marina and land fill sites.
- Stadiums and event centres – either separately or as a package;
- 3 Holiday parks, (Orewa Top Ten Holiday Park, Martins Bay Holiday Park, Whangteau Holiday Park); and
- 28 baches and lodges, and 24 caravan campgrounds.

If a lease is considered, we would recommend a detailed investigation and review of the asset identified to ensure maximum value is realised under a lease arrangement. Using the Auckland Council's investment in Ports of Auckland Limited as an example, we can illustrate what a review would comprise of, and how a lease structure can optimise the value from the asset whilst maintaining the need for strategic ownership.

We also note that the Future Port Study will shortly commence and we recommend that no action be taken until this study has been completed.

Auckland Council Example: Ports of Auckland

Description

Ports of Auckland Limited (POAL) operates seaports that handle containerised imports and exports in New Zealand. The company provides cargo handling and logistics services to importers and exporters. Its facilities include container terminals, multi-cargo, road exchange, rail exchange, inter-wharf transfer, pack/unpack, and a freight hub; and services include cargo handling, marine services, bunkering, and hydrographic surveys. The company also offers a range of other non-containerised and bulk cargo facilities. POAL has grown with the emergence of Auckland as New Zealand's dominant city. In terms of container throughput, it is currently the leading port in New Zealand. POAL is currently 100% owned by Auckland Council Investments Limited. The current dividend payment policy is 80% of post-tax profits.

Historical context

In 1988 POAL shares were allotted 80% to the Auckland Regional Council, and 20% to the Waikato Regional Council. Waikato sold their shares in a public float and POAL was listed. There were some significant efficiency gains in the subsequent period from 1988 to 1993, including average turnaround times fell from 38.4 to 15.7 hours. In 2005, Auckland Regional Council made a successful on-market bid for the 20% of shares it did not own, and took POAL back fully under Auckland Regional Holdings control. From public documents, the takeover bid for POAL appears to have been motivated mostly by a desire to simplify some land transfers between the Port Company and the Auckland Regional Council.

SWOT analysis for Ports of Auckland

Strengths and Opportunities	Weaknesses and Threats
▸ Increasingly efficient port operation ▸ Expansion plans – both behind the fence and beyond the fence	▸ Capital requirements can be foreseen in the future ▸ Reliance (to some degree) on a supply chain which it does not control ▸ Continued uncertainty and mandate to operate in current location ▸ Subject to changes in the economic cycle, technology changes, and other operating risks

Financial Analysis

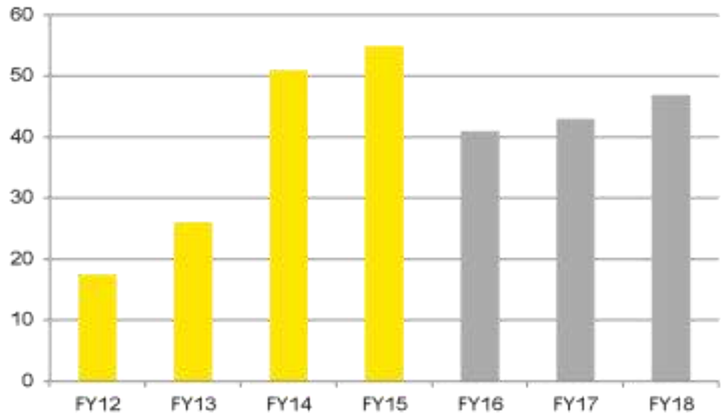
	FY2014 ($m)[31]
Revenue	219.9m
EBITDA	102.6m
EBIT	80.8m
Net income	74.0m
Asset FV	1079.0m
Asset BV	776.3m
Equity	493.4m
RoA	9.5%
RoE	14.9%

[31] At the time of this review, FY2015 Annual Review was not publically available. Source: Capital IQ

Auckland Council Example: Ports of Auckland

Financial Analysis (continued)

Figure 32: Historical and forecast dividend ($m)



Source: POAL annual reviews and ACIL SOI

Indicative Value

Using recent lease transactions in Australia

Currency: NZ$m	Low	Mid	High
Capitalisation multiple	22.0x	24.0x	26.0x
POAL EBITDA	80	80	80
Enterprise Value	1,776	1,938	2,099

POAL's earnings before interest, tax depreciation and amortisation (EBITDA) in the 13/14 financial year was NZD $102.6m. Applying a 25 times multiple suggests a valuation of at least NZD $2.5b for a 99 year lease. However, the 2014 year was a standout year for POAL. A figure of NZD $2.5b for a 99 year lease may therefore be at the high end of any valuation range. For the purposes of this review we have used a previous 3 year average EBITDA of NZD $80m to maintain relevance of performance and to reduce fluctuations from year to year performance. Also to be taken into consideration is the optimal lease term – the multiple paid will decrease as the term of the lease decreases.

Using recent market transactions

Using other relevant international port transactions we have applied transaction EBITDA multiples to POAL. The EBITDA multiples identified in these transactions were adjusted for control premiums of between 10-30% to reflect control (differing ownership stakes sold in the transaction).

Currency: NZ$m	Low	Mid	High
Capitalisation multiple	13.0x	15.0x	17.0x
EBITDA	80	80	80
Enterprise Value	1,049	1,211	1,372

Please see Appendix A for more detail on comparable lease transactions.

Auckland Council Example: Ports of Auckland

Option identification

Auckland Council ownership interests in the Ports of Auckland are a contentious issue and strong perspectives exist on all sides of this debate. In particular, there are explicit concerns about Auckland Council's tripartite role as shareholder, regulator and voice of the community. We express no view on the most appropriate course of action, and defer any commentary to the upcoming Port Future Study which will investigate the economic, social, cultural and environmental costs and benefits of a range of options around the future port location.

For the purposes of this review, we have entertained the situation where POAL operations are leased over the long term to a private operator with the underlying land retaining under Auckland Council ownership. This is consistent with recent actions that have been taken over the Asia Pacific region and provides some balance to the competing objectives of unlocking value while maintaining a strategic interest in the asset.

A further extrapolation of this option would be to create an operating company and an asset company. This would provide a vehicle to separate out the operating interests from the strategic interests.

There are also a number of other ownership models and structures that may be applicable regarding the divestment of POAL. This report does not detail the comparison of different transaction models, or what the optimal structure is, however we note the other relevant models may include:

- Mixed ownership models;
- IPO or public floating consistent with other New Zealand port and infrastructure companies;
- Trade sale of shares to another investor(s)/owner(s); and
- Distributed ownership where there is a sale or gift of shares to the citizens/public only (eg. AECT).

International case study: Long term lease of Port of Darwin – Oct15

Transaction Structure

- Long term lease where the Government retained ownership of any land holdings with the leased port assets to return to the Government at the end of the lease period;
- Ongoing capital development of the port is funded by the lessee; and
- Lessee incentivised to invest in the future growth and development of the port.

Lease Term

- 99 Years

Employees

- Maintain established workforce at the Port of Darwin with no forced redundancies during the term of the Enterprise Agreement (terminates June 2018).

Protecting economic regulatory regime

- The Territory will retain a range of oversight and regulatory functions including responsibility for price and access regulation.

Protecting the public sector

- The State will retain responsibility for key safety functions including Regional Harbourmaster Role;
- Lessee will be required to maintain the port to agreed standards. Regulating via licensing of stevedores; and
- Lessee will be subject to key planning and environmental regulation as was previously the case under State ownership.

Price& Value

- Leased for AUD $506m. 20% has been held by the Government with an intention to transfer to an Australian investor/s in time;
- The Territory will receive a share of future revenue where it is better than expected trade performance; and
- The Lessee has committed to provide sponsorship to community initiatives.

Auckland Council Example: Ports of Auckland

Assessment of option against criteria

<table>
<tr><th>Criteria</th><th>Assessment</th><th>Considerations</th></tr>
<tr><td>Is the option strategically aligned?</td><td>Strategic
Medium-High</td><td><u>Alignment to Council Role</u>

Auckland Council's current ownership stake in POAL indirectly meets the purpose of the local government as defined in the Local Government Act 2002 but, it is questionable whether the investment in POAL is the most effective method of support for this objective.

Auckland Councils tripartite role as shareholder, regulator and voice of the community creates complexity when assessing the 'alignment to government roles'.

There is some obvious strategic value in being the owner of POAL as it allows the Council to appoint the Directors of the Board.

<u>Customer Service Impact</u>

Based on our analysis and recent market transactions there is a potential to increase level of service provided by the Port by applying even greater commercial incentives on its performance. This would likely result in better outcomes for customers.

<u>Legislative/Regulatory</u>

The Port Companies Act 1988 states that no party shall necessarily be prevented from operating any port whether as a private or public facility. Furthermore, due to the fact that ports were publically listed previously, we do not foresee any show-stopping legislative impairment to a long term lease.

Land extensions and development is regulated by existing development controls.

<u>Māori considerations</u>

The Waitemata harbour is an area of great traditional, cultural and spiritual importance to the mana whenua iwi. We note that mana whenua may be negotiating for recognition of their interests with the Crown (as per the Tamaki Collective Deed). We further note the Waitemata forms part of the Hauraki Gulf Marine Park. The Hauraki Gulf Marine Park Act 2000 acknowledges the important traditional and contemporary relationship of mana whenua to the Hauraki Gulf. We have not consulted or engaged with mana whenua on the content of this report.</td></tr>
<tr><td>Ease of implementation</td><td>Complex
Medium-High</td><td><u>Ease of implementation</u>

The implementation of a long-term lease for POAL is complex. In international cases the port company is split between a port operating company and a landowner company where functions are divided appropriately. Significant due diligence would need to be undertaken for this option. Any costs could potentially be recovered from transaction proceeds.

<u>Operating risks</u>

Currently Auckland Council is exposed to many economic variables both macro and micro. By transferring operating risk to the lessee, Auckland Council is able to receive a predetermined amount of return regardless of the market movements.</td></tr>
</table>

Auckland Council Example: Ports of Auckland

Value

Medium - High

Other considerations

POAL can be seen as critical infrastructure for Auckland. The proposed lease arrangement could set out key parameters to ensure that strategic objectives to achieve the Auckland Vision are considered.

Market appetite

Recent market transactions in the Asia Pacific region have proved that there is a strong potential appetite for this asset, including investment funds, and specialist operating companies. See Appendix A for further details about recent port transactions.

Wider Economic Benefits

The wider economic benefits of this option will depend on any change in direction for POAL and therefore these can only be considered once the Future Port Study provides recommended options.

Income Impact

A long term lease of POAL enables an up-front payment to reflect the forecasted annual dividends received from POAL. In a simple sense the potential added value is if the upfront proceeds are greater than the forecasted dividends if retained. Therefore Auckland Council would not be advised to proceed with a transaction if the proceeds are less than the retention value.

There would be a short term impact on the revenue line of the budget with ~$40m p.a. being removed. But this would be replaced by a reduction debt and interest costs, or a direct reduction in rates as can be shown in Figures 33-35.

Credit rating impact

Based on initial preliminary assessment utilising Moody's rating methodology for Regional and Local Governments, selling the revenue generating operating business will likely result in the following impacts on the credit rating:

- In the event that proceeds from the sale are used to repay its existing short-term debt, whilst this provides greater headroom in borrowing capacity and financial flexibility, it is unlikely that a positive notch upgrade will occur given Auckland Council's rating is effectively capped at the overall New Zealand Sovereign credit rating (AA+ by Standard and Poor's). Greater financial flexibility occurs given the improved financial credit metrics arising due to improvements in gearing and debt servicing ratios.
- It is considered that the release of capital to meet future funding commitments will assist to alleviate the existing downward pressure on the credit rating (as noted by Standard & Poor's credit rating report 4/11/14) due to the forecast increase in debt required to fund future projects.

Further detailed assessment on a case-by-case basis would be needed to confirm this view.

Auckland Council Example: Ports of Auckland

Long Term Plan Impacts

To illustrate the potential impacts of a long term lease for POAL we have scenario tested the impacts of the long term plan if a value of $2b was obtained for the lease. The charts to the right illustrate the impact to the annual loss of dividends, the savings in interest and the reduction of debt from proceeds.

The total in the potential interest cost savings less the potential income loss from dividends is estimated to be $414m over the lifetime of the LTP.

Key Assumptions

- $2b received for long-term lease – based on 25x 3 year average EBITDA from FY2012 - 2015;
- Lease transaction to be effective 1/7/16 (this date is indicative only);
- Proceeds to reduce debt requirements noted in LTP;
- Interest rates from LTP; and
- Forecast dividends from ACIL SOI to 2018 then at LTP GDP rate.

Figure 33: LTP dividends and interest revenue vs. scenario full sale

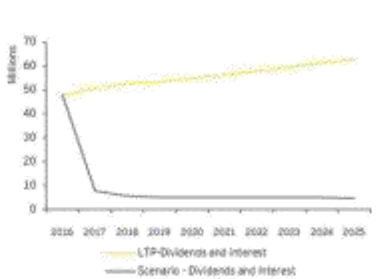


Figure 34: LTP finance costs vs. scenario full sale

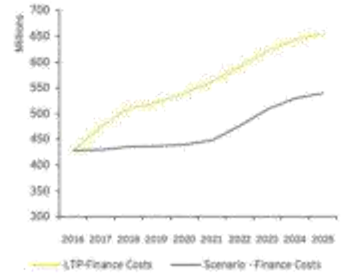
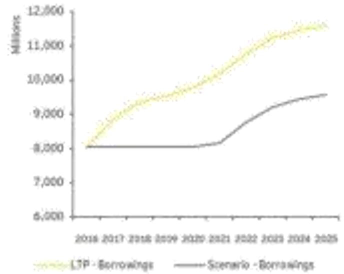


Figure 35: LTP debt vs. scenario full sale



Conclusion

From a purely financial perspective, there appears to be value in investigating the potential for a long-term lease of Ports of Auckland. This could potentially include a structural separation between the commercial operation of the port and the land holding/management of the port land.

Next steps

We do not recommend any further investigation of options until the pending Future Port Study has been completely digested by relevant decision makers.

Option 2c: Sale of surplus land

Auckland Council own significant property assets. The identification and rationalisation of surplus land and building assets is likely to yield significant upfront value as well as having the potential to generate cost savings in the long run.

Panuku Development Agency (PDA) manages a large portfolio of Council property assets (circa $1.6b) which have been earmarked for disposal. This comprises of some $1b of assets from the old Auckland Council Property Limited (ACPL) portfolio. Of these $770m are labelled 'non-service' or future service (i.e. is being earmarked for an as yet undefined future project). A further $173m are described as 'in service' meaning for the most part these assets are located in parks and or other assets owned by the Auckland Council. The balance of the portfolio (circa $600m) comprise of ex Waterfront Auckland assets and Joint Venture assets.

Target disposal rates for Auckland Council properties are $70m per annum or 4.4% of the total portfolio. This is in excess of current disposals, which are running at circa $30-40m per annum or 2% of the total portfolio.

Given their constraints, PDA is relatively efficient at disposing of properties once they are of no use to Auckland Council. This is particularly the case where there is limited if any economic upside to Council for retaining the properties. However, there remain considerable bureaucratic processes to dispose of these properties and any attempt to streamline this process is likely to lead to a clearer path for the sale of assets.

In analysing the PDA portfolio it is clear there is a limited rationale for a number of PDA assets being on their books, suggesting the long term pipeline of asset sales can be increased. Furthermore, it is unclear as to what portion of PDAs portfolio is clearly surplus to requirements as opposed to assets which are being held for strategic reasons. For example, there are several food and beverage sites in Auckland Council parks which form part of the portfolio and are unlikely to be sold down to the private sector. Correspondingly there appears to be several large multi-unit residential holdings which offer little if any strategic value to the Council and on the face of it represent potential sell down opportunities.

There are several initiatives which would likely increase the sell down rate of PDA assets:

- A full and transparent review of the portfolio. This portfolio review would need to detail the rationale for holding each property and establish if and where properties can be divested;
- Potential consideration could be given to a wholesale disposal of PDA assets via a portfolio sale. This would involve combining groups of assets into a single holding and letting the private sector bid on these assets; and
- Mandating PDA to prioritise liquidating assets as opposed to maximising the dollar value of assets for Auckland Council. This would likely require a policy change.

There is also merit in better realising undefined value held in existing properties. The sale of air rights over rail corridors, billboard advertising on the side of Auckland Council structures and charging for existing facilities (e.g. toilets in parks / resident parking permits) represent opportunities.

Figure 36: SWOT analysis for the sale of surplus land

Strengths and Opportunities	Weaknesses and Threats
Greater operating efficiencies Reducing surplus assets from Auckland Council's balance sheet would represent an opportunity for both greater efficiency in service delivery as well as a reduced cost, particularly in terms of the property footprint.	Loss of strategic value By selling 'future service' assets, Auckland Council is potentially relinquishing assets with strategic value.
Provision of new income streams Council has a range of assets with as yet undefined property rights. Several of these assets are easily identifiable, have limited administration costs and could also be useful in altering other behaviours which Council is attempting to influence.	Defining as yet undefined property rights is complex Because several of these initiatives are new there is likely to be a perceived risk associated with some of these initiatives (such as investors being cautious over the use of air rights) and public risk of opposition to other initiatives which have traditionally been low or no cost (such as charging for resident parking permits).
Appropriate transfer of risk Council has on its books several assets which represent 'projects' to be completed. The scale, scope and potential risk of several of these assets calls into question the role of Auckland Council in developing them. Facilitating timely sale would ensure the market prioritises projects most likely to succeed and prices the risk accordingly.	

Auckland Council could also consider altering the entire approach of Council's property sale program.

- Currently PDA is an organisation which manages a large portfolio of commercial assets for Auckland Council with the goal of disposal. This disposal process will occur at the behest of PDA which has in the past resulted in a sub optimal disposal program.
- An opportunity exists to take the initiative of sale away from PDA and hand this over to the private sector. In this initiative PDA would detail its holdings to the market, with market participants having the opportunity to bid on PDA assets at any time.
- Instead of PDA initiating developments, sales and / or value add activities, properties would be disposed of where the market saw fit to add value. This would require PDA providing transparent access to its portfolio. Payment to Auckland Council could take some form of risk sharing / profit sharing exercise, a Joint Venture where Auckland Council puts in the land or a straight sale.
- Strategic properties could be ring-fenced or could have conditions placed on them in such a way that any sale would ensure the delivery of desired Auckland Council outcomes.

Through this disposal process Council is in a position to impose development timelines, hurdles and prescribed outcomes for the sites, which would ensure Council's other objectives would be largely met by the private sector, whilst the risk of development is born by the private sector. There are several examples of land holdings in PDAs portfolio where significant progress could be made under a regime of this kind.

Auckland Council Example – Northcote Shopping Centre (NSC).

NSC is a leasehold, strata titled asset inherited from the North Shore City Council. There is little ongoing investment into the built environment in NSC due to the nature of the tenure. This is a result of the limited scope for long leases in NSC (due to the perpetually renewable ground lease in place), there is chronic underinvestment in the asset by the leasehold title owners, leaseholders struggle to get finance on their assets and the combined value of the 'encumbered freehold' and leasehold titles is less than the total freehold value of the NSC.

The act of freeholding the site would require a complex administrative process for Council and would open considerable discussion on which parties are entitled to bid for the assets. In theory the wider market should be able to bid on these assets however the leasehold title holders are likely in the best position to further enhance NSC through ongoing investment.

Under this process the freehold underneath NSC could be sold down (preferably to the leasehold title holders) at a premium to book value on a first right of refusal basis.

Ultimately this would likely significantly enhance the collective retail offer at NSC, lead to a release of capital in excess of any current rational valuation and result in a better level of amenity for the users of NSC.

Assessment against criteria:

We note that Auckland Council already has rigorous processes to dispose of surplus land. Therefore the need to undertake a strategic assessment is not the same as for other options. Our option as noted above is effectively an improvement to process in order to realise more value from assets. Accordingly, we have not undertaken a formal assessment against criteria.

Next Steps:

If this option is to be pursued, Auckland Council could:

- *Undertake a full and transparent review of the portfolio, including other large CCO portfolios. This portfolio review would need to detail the rationale for holding each property and establish if and where properties can be sold;*
- *Undertake an assessment of alternative disposal mechanisms for their property assets - potentially via a portfolio sale. This would involve combining groups of assets into a single holding and letting the private sector bid on these assets;*
- *Assess of the undefined value held in existing properties (including the sale of air rights over rail corridors, billboard advertising on the side of Council structures and charging for existing facilities); and*
- *Undertake analysis of the disposals process. By putting clear delivery mechanisms in the process including perhaps regulatory timeframes and business case tests, many of these assets would likely pass through the process quickly.*

Option 2d: Better realisation of commercial value from CCOs

It is currently unclear whether current CCO structures are achieving optimally efficient outcomes. Applying better commercial disciplines on CCOs and potentially pursuing mixed ownership models could yield additional value for Auckland Council.

Auckland Council owns six substantive CCOs.[32] These were established as part of the amalgamation of the eight local councils of Auckland with the purpose to operate with a degree of separation from the Council, but to achieve the commercial and non-commercial objectives as outlined in their annual Statement of Intent. These CCOs preside over significant balance sheets and have an ability to drive significant value for Aucklanders.

Whilst a full root and branch investigation of each CCO was not possible we believe there are three potential pathways that exist to improve operational outcomes for each CCO. Considerably more investigation is required to determine the appropriate levels of commercialisation, governance, and operating efficiencies that could lead to greater returns.

We note that the options identified in Figure 37 are not mutually exclusive, for example creating a commercial mandate can lead to higher proceeds if asset divestment was an ultimate option in the longer term. We also note that each option has different timing considerations, and individual complexities.

Figure 37: Comparison of greater commercialisation of CCO Options

Option	Description/ assumption	Advantages	Disadvantages	CCO Relevance
Provide a stronger commercial mandate	Community services with clear public good characteristics are transferred to Auckland Council or priced at cost recovery to Council. CCO's main objective is then to make a commercial return (including the possibility of paying dividends).	Drives stronger commercial disciplines in commercial-like activities. Promotes higher returns to Council. Auckland Council continues to hold strategic assets.	Residual risks and costs still with Auckland Council. Risk of treating public good assets and interests like commercial interests – to the detriment of the public benefit.	▸ RFA ▸ Watercare ▸ PDA ▸ ATEED
Outsourcing – operating lease, PPPs, joint ventures.	CCO remains as the legal owner of strategic assets, but outsources the operations (opex) and revenue collection component. Auckland Council pays the provider a fee for the service and sets the service standards.	Cost savings Assets remain with Council. Lowers operational risk Potential reduction of debt.	Residual risk with the council Perception of lower services Lose community services Perception of lower capital investment to maintain dividends	▸ RFA ▸ Watercare ▸ AT
Asset Divestment or mixed ownership model	Partial/full Sale – operations, revenues and opex are private sector run.	Removes debt and risks from balance sheet. Potential to keep strategic assets. Upfront payment for CCO business components.	Potential to divest strategic assets Perception of lower capital investment to maintain dividends.	▸ Assets of ACIL ▸ Assets of PDA ▸ Watercare ▸ RFA

[32] Auckland Council Investments Limited; Auckland Transport; Auckland Tourism, Events and Economic Development, Panuku Development Auckland, Regional Facilities Auckland, Watercare.

If this option is to be pursued, Auckland Council could undertake the following actions as the potential scale of benefits of getting CCO's 'right' is significant:

- Determine the appropriate focus for each CCO individually and vis-à-vis each other (e.g. could greater alignment of roles and incentives yield better outcomes);
- Determine the appropriate Auckland Council role for each individual CCO (e.g. Undertake a full assessment of whether Auckland Council should continue to be shareholder, policy-setter, operator etc); and
- Determine the relevant option appropriate for the CCO (if applicable).

If a decision is made to pursue a more commercial approach to a CCO, then due consideration would need to be given to:

- Forecasting potential benefits vs costs including detailed financial analysis;
- Analysing residual risks and post transaction requirements;
- Confirming the optimal transaction structure and assess tax implications;
- Documenting community service obligations and legislative requirements;
- Resource a project managing/ transition team/ steering committee as appropriate;
- Create project plan including consultation plan for stakeholders; and
- Ensure monitoring of benefits continue.

To illustrate the potential case for investigation, we have used Watercare as a case study to assess whether potential value could be unlocked.

Auckland Council Example: Watercare

Background

Watercare is wholly owned by Auckland Council and is responsible for the delivery of potable water to Aucklanders and the collection and treatment of wastewater. Watercare draws water from multiple sources from inside and outside the region, treats it to a high standard and delivers it to homes and businesses via a vast network of pipes. It also collects, treats and disposes of wastewater, including trade waste from industry. It owns 12 dams, 15 water treatment plants, 89 water reservoirs, 9,066 kilometres of water pipes, 506 wastewater pump stations, 18 wastewater treatment plants, and 7,896 kilometres of wastewater pipes.

In 2010 as part of the wider Auckland Council amalgamation, Watercare Services limited merged and absorbed all the assets and liabilities in relation to the water supply and wastewater services in the Auckland area[33]. Watercare's key achievements as a result of the amalgamation include implementing a standardised tariff structure to improve consistency, introducing monthly billing to improve cashflow, improvements to process such as reading meters and customer call centre operations.

Watercare's current operating framework provides them with the ability and flexibility to charge for water rates. As prices are set annually, any unexpected additional costs can be recovered in the following year, and vice versa with profits also being returned for a lower price in the following year. Beyond mandated water quality standards through Ministry of Health guidelines, Watercare self-imposes operational service standards.

Watercare have low business risk due to the natural monopoly environment in which they operate in, however they are still exposed to demand risk (eg, increase in water tanks, efficient water use technology in white goods, legislation changes). In 2014, the report to the Finance and Expenditure Committee on the Auditor General Review of Watercare, prompted concerns about pricing affordability (in relation to its water connection fee) for residents, amid a common focus being made to reduce costs in the Auckland's Housing market.[34] Figure 38 shows an illustration of the current operating framework.

Figure 38: Current operating framework - Watercare

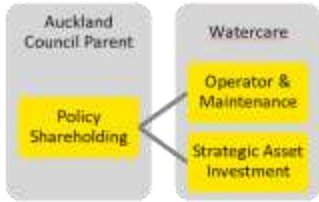


Figure 39: SWOT Analysis for current Watercare model

Strengths and Opportunities

- Self-funding and user pays model – does not draw on rates for funding
- Largest operator and market leader in NZ industry – has scale to make an impact on New Zealand
- Sets prices and regulates safety standards – has full autonomy

Weaknesses and Threats

- Incentives for efficiency are not strong for a natural monopoly
- Legislative restrictions – unable to pay a dividend/surplus to a shareholder – which potentially diminishes the incentive for operating efficiencies
- Lack of regulator raises risk of 'gold plating' of assets
- Any amendment to the status quo likely requires a national level conversation about the state of the urban water sector

[33] One exception is Papakura (Viola)
[34] Report to Finance and Expenditure Committee: Report from the Controller and Auditor-General, *Watercare Services Limited: Review of service performance* 2014

Auckland Council Example: Watercare

Financial Analysis

- Over the LTP, fees and charges are 83% of revenues;
- 38% of LTP Capex is funded by Debt - Finance costs are about 35% of total opex and about 20% of revenues;
- Finance costs grow at a compound annual growth rate (CAGR) of 5.9% compared to fees and charges revenue of CAGR of 4.7%
- Watercare represents about 25% of total Council's debt (on average).
- The increase in Watercare debt is around 40% of the increase in total Auckland Council's debt on a cash basis.

Figure 40: Watercare financial analysis

Currency: NZ$m	FY2015
Revenue	520.4
EBITDA	315.8
EBIT	107.1
Capital BV*	8,684.8
Total Debt	1,517

*includes of all assets. Source: Annual Report FY2015

Figure 41: Watercare 10 year LTP revenues and opex ($m)

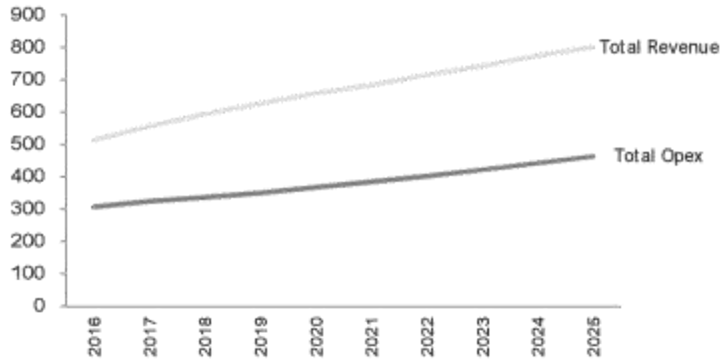
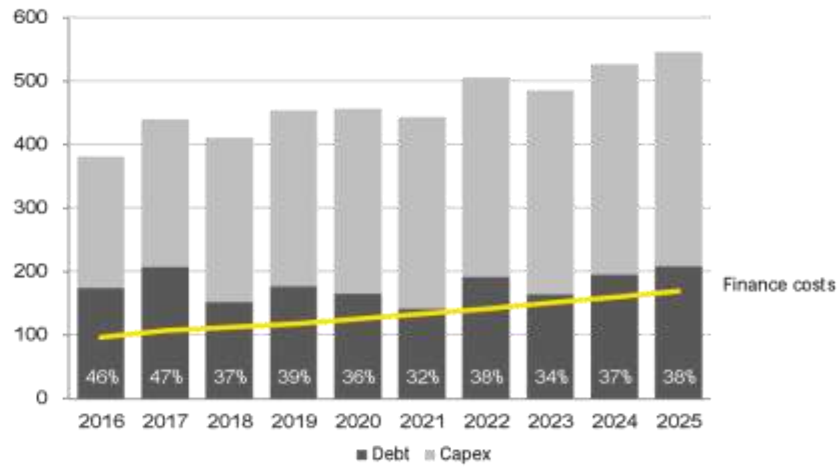


Figure 42: Watercare 10 year LTP interest cost, capex ($m) and % of capex funded by debt.



Indicative Value

- Valuations for regulated natural monopolies are normally based on Regulatory Asset Base (RAB);
- Typical multiple range is 1.0 – 1.3 RAB for water utilities. Recent transactions in the UK have been at RAB multiples of 1.1x to 1.3x. Company trading multiples are within the range of 1.2x to 1.5x. The industry rule of thumb is a multiple of 1.0x and 1.3x; and
- Watercare is currently unregulated and does not have a RAB value. However, Watercare's latest book value of water and wastewater assets only is $8,229m.

Auckland Council Example: Watercare

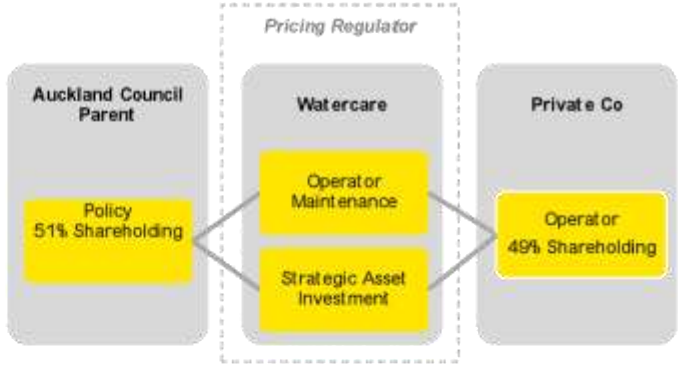
Option analysis

Our main observation with the current operating model is that it is difficult to assess whether Watercare is truly efficient. We note that the Watercare Board must sign off on all major expenditure and endorses the operational service standards so there is clearly a level of oversight. However, in the absence of competition and/or an independent regulator it is difficult for us to assess whether the risks of over capitalisation, and potential for inefficiencies in operations, are present in the system. Furthermore, a direct comparison to overseas operating models is difficult owing to the absence of an independent monitory, regulatory and pricing framework.

We have considered a range of potential mechanisms to address the perceived risks in the existing operating model including: outsourcing; establishment of a joint venture to provide commercial disciplines on Watercare operations; and the provision of an enhanced commercial mandate. However we believe that a mixed ownership model approach poses the most interesting questions around roles and responsibilities, service provision to the end consumer and ultimately the option that potentially provides the greatest return to Auckland Council. In particular, the mixed ownership model would consist of the following elements (Figure 43 describes this visually):

- Significant national level involvement – including Legislation change and the establishment of an independent regulator;
- Mandate changed to make a profit/ dividend and target payout ratio to the Council;
- Quality standards would be set by the independent regulator; and
- Divestment of 49% of Watercare shares - Auckland Council continues policy, shareholder function.

Figure 43: Organisational structure for mixed ownership model



We appreciate this option would be a significant national level exercise. By way of comparison, full privatisation of the water businesses occurred in the 1989 in the United Kingdom – Water Services Regulation Authority (Ofwat) was created for the regulation of the businesses. Other international countries have also privatised their water services, including USA, Europe and South America.

The privatisation of the UK water utilities in 1989 was perceived as a substitute of public funding for private funding to reduce the debt burden on the public sector accounts. Since the privatisation, the water companies' capital structures have evolved significantly. Finance has been raised internationally with some companies owned by financial firms. Debt levels have increased in some instances optimising leverage of the company but increasing interest costs, this change had an impact to the credit rating of the water companies. Moody's credit rating agency also changed their methodology in 2009 to factor and account for water suppliers that are privately financed. The investments post privatisation has resulted in higher water quality standards, but has also resulted in price rises in the early stages of privatisation.

Auckland Council Example: Watercare

Assessment of option against criteria

Criteria	Assessment	Considerations
Is the option strategically aligned?	Strategic High	**Alignment to Council Role** The provision of water to citizens will always have some level of government involvement – as it is an essential service. Whether Auckland Council's role is as owner, operator and regulator, or some combination of the above is less clear. As a natural monopoly, a number of high-level drawbacks could exist (gold plating infrastructure and potential lack of incentives for cost efficiencies), which warrant consideration of other operating models. The mixed ownership model approach enables the Council to continue to have a stake in the organisation. **Customer Service Impact** Current customer services levels have to remain as the baseline. Potential to realise efficiencies (passed on to customers in the form of price reductions) and the potential for additional services to customers exist under alternative operating models. **Legislative / Regulatory** The Local Government Act 2002 outlines the local authorities' obligations to maintain water services to meet certain obligations, including not to divest ownership in water services, not to sell, or lose control of significant infrastructure necessary for providing water, or use the assets for security for any purpose. The Local Government Act 2002 also stipulates that the councils' may outsource any operational aspects of the water service but not for longer than 35 years, with the condition that the council must be legally responsible for providing water services, and retain control over the pricing of water and policy related to water services. Provisions relating to joint venture arrangements also outlined in the Local Government Act 2002. **Māori considerations** As part of the requirements of Part 6 of the Local Government Act 2002 a full consultation process must occur including with engagement with Māori stakeholders. Furthermore section 17 of the Waikato-Tainui Raupatu Claims (Waikato River) Settlement Act 2010 requires Auckland Council to have particular regard to the vision and strategy when carrying out powers under the Resource Management Act 1991 if the functions or powers relate to the Waikato River or activities in the catchment that affect the Waikato River. There are on-going discussions with the Crown over Iwi interests in water. Furthermore some Iwi and hapu hold interests to lake and river bed which store or hold the water that Watercare utilises without receiving any commercial recognition.

Auckland Council Example: Watercare

Ease of implementation	Complex High	Ease of implementation Almost any amendment to the status quo would be complex and the Local Government Act 2002 Part 6 obligations would apply. Discussions with national government may also be required, as any system requiring heightened oversight would likely need to play out in a national context. Detailed investigation, project management and implementation would involve significant costs. There is precedent in developing a full regulatory regime for a network utility as evidenced by the energy sector (Commerce Commission; Electricity Authority; Gas Industry Company and the Ministry of Business, Innovation and Employment). Establishing a regulatory oversight body is a large undertaking. Operating risks By divesting the interest, Auckland Council reduces its exposure to the operational risks associated with the water service industry. Other considerations A pricing regulator will increase the transparency of the operating model. Monitoring, benchmarking and quality control will be fundamental to the success of the initiative.
Value	High	Market appetite There are numerous international privately run water service providers. Operationally these range from short outsourced contracts to mid-term lease contracts (one part of the system), long term concessions (whole system), and mixed ownership models. This practice has been seen in throughout the UK and Europe, USA, South America and more recently in China with mixed success. We note that utility companies are typically sought after on international markets. Wider Economic Benefits No discernible wider economic benefits. Income Impact There would be a beneficial income effect to Auckland Council as the mixed ownership model structure allows Auckland Council to realise a dividend. A new regulator would ensure that pricing is fair and the entity would be required to operate efficiently. Typically the dividend pay-out ratio for Australian regulated water utilities range from 50% to 100% of total net profit after tax. The upfront proceeds would also provide Auckland Council the ability to reduce Council's debts and/or fund priority infrastructure and capital projects.

Auckland Council Example: Watercare

Credit rating impact

Based on initial preliminary assessment utilising Moody's rating methodology for Regional and Local Governments, selling the revenue generating asset will likely result in the following impacts on the credit rating:

- In the event that proceeds from the sale (assumed to be ~$4.0bn) are used to repay its existing short-term debt, whilst this provides greater headroom in borrowing capacity and financial flexibility, it is unlikely that a positive notch upgrade will occur given Auckland Council's rating is effectively capped at the overall New Zealand Sovereign credit rating (AA+ by Standard and Poor's). Greater financial flexibility occurs given the improved financial credit metrics arising due to improvements in gearing and debt servicing ratios
- It is considered that the release of capital to meet future funding commitments will assist to alleviate the existing downward pressure on the credit rating (as noted by Standard & Poor's credit rating report 4/11/14) due to the forecast increase in debt required to fund future projects.

Further detailed assessment on a case-by-case basis would be needed to confirm this view.

Auckland Council Example: Watercare

Long Term Plan impacts

For illustration purposes only, we have scenario tested the impacts to the LTP if 49% of the shares are divested in Watercare.

The charts below illustrate the impact to the savings in Watercare's interest and the reduction of debt from proceeds. We note the transaction date we have assumed is indicative and is designed to show potential impacts only. The net total potential interest cost savings is estimated to be $2b over the lifetime of the LTP, which is the interest savings from paying down other Auckland Council debt.

Figure 44: LTP finance costs vs. scenario 49% sale

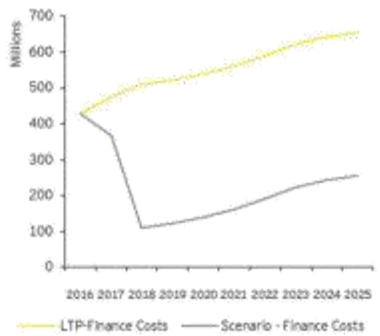
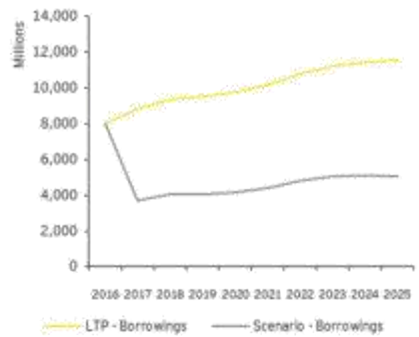


Figure 45: LTP debt vs. scenario 49% sale



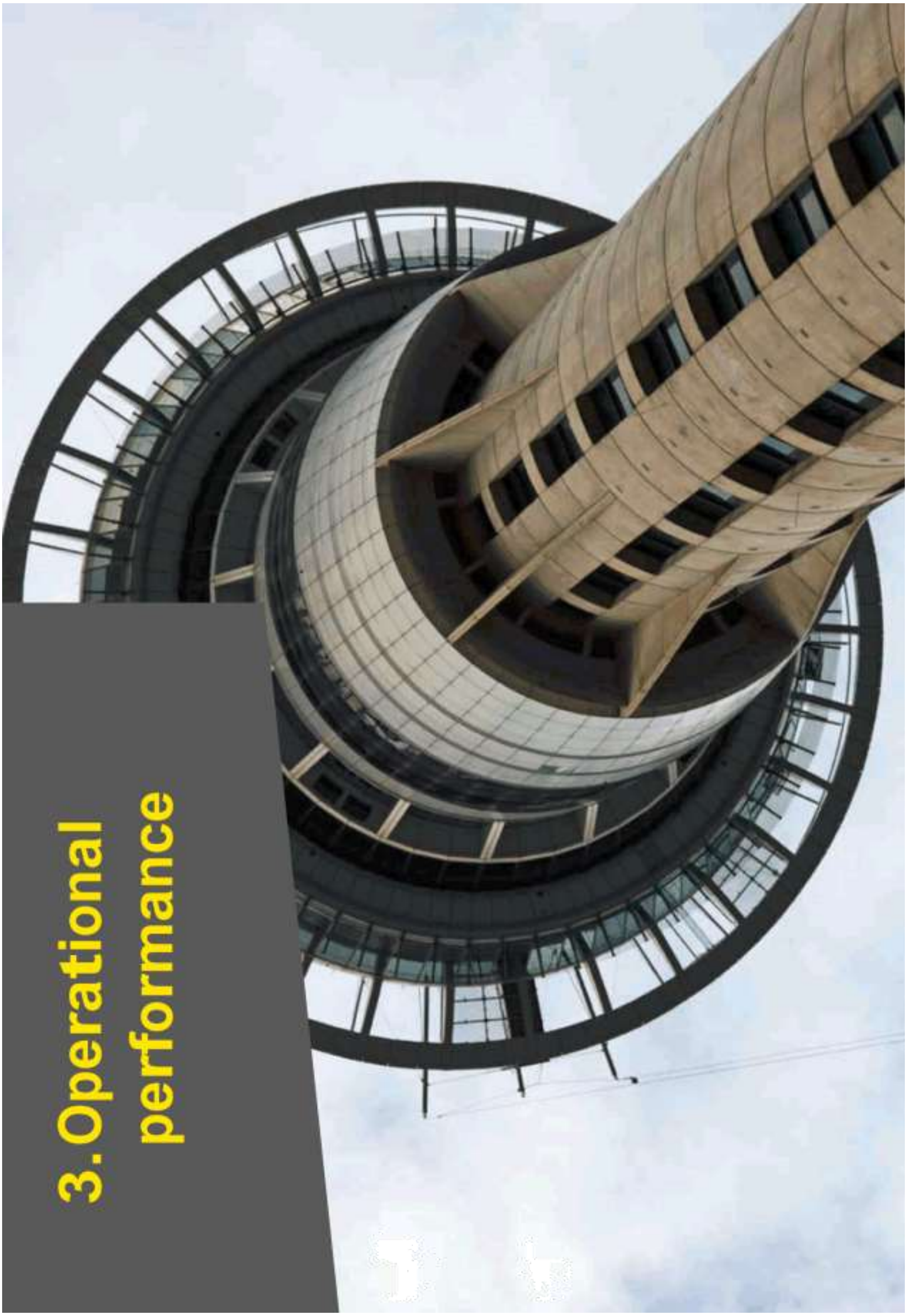
Key assumptions

- Watercare has a new operator – Watercare's forecasted opex and capex and debt are transferred to the private sector;
- Watercare debt will be financed by the new operator, becoming off balance sheet reducing LTP debt;
- Potential efficiency gains, dividends, regulatory costs, have not been accounted for;
- A sale of all 49% of shares in 2017, proceeds used to pay down other existing Council debt;
- Impacts for the 10yr LTP only, we note that benefits grow the longer the debt is off balance sheet;
- Total value of Watercare is based on their water and wastewater services book value assets only base of $8,229m as at FY2015; and
- For simplicity we have used book value. We note the limitations in assuming book value, as the value will depend on a number of factors such as whether a regulator is in place or the dividend payout rules, debt assumptions or governing structure.

Next Steps

If this options is to be pursued, Auckland Council could:

- *Undertake a benchmarking exercise between Watercare and other similar jurisdictions to determine whether operational expenditure and capital expenditure is comparable – bearing in mind the inherent differences between jurisdictions; and*
- *Continue the dialogue with Central Government about issues facing the water sector in New Zealand and the ways that Watercare can support these objectives.*


3. Operational
performance

Overview – Operational performance

Improving the efficiency of existing expenditure reduces the overall requirement for revenue funded from rates. This also protects against value 'leaking' once any funds from asset optimisation are reinvested.

We have undertaken a high-level assessment of core service areas for Auckland Council and the various mechanisms to improve operational performance.

Improving operational performance reduces forecast expenditure – which ultimately means less need to raise debt and/or raise rates.

Improving operational performance also locks in value for Auckland Council – meaning less expenditure is wasted on undesirable activities.

We have highlighted a range of initiatives that would improve operational performance. These options predominantly focus on those operational matters that have a significant capital component to them (that being decisions made around operational improvement can reduce the need for capital expenditure and/or can result in divestment of assets):

- Shared back office functions;
- Network analysis and shared facilities;
- Accommodation strategy;
- Development of land and buildings;
- Pricing review; and
- Fleet review.

Figure 46: Advantages and disadvantages of Operational Improvement

Advantages	Disadvantages
Allocative efficiency By pursuing operational performance improvements, Auckland Council will be achieving allocative efficient outcomes – the services demanded by ratepayers are being supplied at least cost.	*Complexity* Pursuing improvements in operational performance is a complex activity with many cause and effect links. A full investigation of each initiative proposed will have up-front costs – but will result in long-term benefits.
Reduced pressure on debt and rates By improving allocative efficiency Auckland Council will reduce its future expenditure projections. This will result in a reduced requirement to raise debt and raise revenues through rates.	*Loss of asset redundancy* There is an inherent tension between efficiency and resilience (or redundancy). If excess capacity is removed then the ability to respond to shocks is reduced. In many instances this can be managed with internal processes.
Opportunity cost realisation By allocating resources efficiently Auckland Council can make a decision about the provision of new capital expenditure in order to achieve the Auckland Vision of becoming the world's most liveable city.	*Employment impacts* Rationalising service functions will inevitably have an impact on employment. This in part is where savings come from. However, these employees can often be redeployed within the organisation to provide even more value to ratepayers. Due to the current disparate nature of entities within the Auckland Council Group significant effort and time will be required to establish and quantify the "Case for Change".

Option 3a: Shared back office functions

The cost of delivering back office functions is a significant component of forecast expenditure. Centralising 'common' back-office functions across the Auckland Council Group would deliver a lower cost-to-serve

Opportunity Identification: Shared back office functions

Under the current Auckland Council operating model there are multiple de-centralised teams performing 'common' back office functions such as:

- Back office transactional activities – payroll, finance and treasury;
- Professional support services – legal, procurement and human resources (HR); and
- Technology (ICT) – software, technical support, hardware platforms.

Since amalgamation in November 2010 many of these teams have replicated activity and spend in order to establish the required level of capability to deliver these functions across the entire spectrum of Auckland Council entities. This has led to the possibility across Auckland Council of:

- Differing process quality, cost and efficiency levels;
- Replicated capability that is not potentially fully utilised; and
- An inconsistent Return on Investment (ROI) of similar ICT implementations.

While previous work conducted by the State Services Commission in 2007 concludes that although the potential for savings due to shared services in government is limited, a more concerted approach to sharing of services may deliver other benefits and improve value for money over time.

Domestic Case Study – Central Agencies Shared Services

In 2012, the Central Agencies Shared Services (CASS) was established between central agencies to combine resources to deliver sustainable corporate services. Some of the achievements one year after CASS was initiated include:

- Cost savings of over 10% p.a;
- Risk reduction, including key person risk and ability to cope with peaks in demand; and
- Improved capability and resilience of shared services.

Based on the data supplied by Auckland Council we estimate the annual staffing costs of delivering common back office functions i.e. Finance, HR, Communications, ICT, Legal and Property management to be $152m. Based on a saving of 10% per annum the benefit for Auckland Council is projected to be $15.2m annually.

Figure 47: SWOT Analysis

Strengths and Opportunities	Weaknesses and Threats
Operating efficiencies Opportunity to increase the efficiency of existing resources across "common" services that are required to operate Auckland Council. Standardisation of the processes that are used across Auckland Council will drive greater predictability and transparency. Higher ROI on technology investments as a shared services approach will look to rationalise and decommission common ICT components across Auckland Council. *Service provision* Through centralising "common" services, Auckland Council will be able to establish common levels of service and drive ongoing continuous improvement initiatives in areas that offer the highest "value".	*Set-up costs* Due to the current disparate nature of entities within Auckland Council significant effort and time will be required to establish and quantify the "case for change" The implementation of shared services across Auckland Council will be complex and may require significant Executive support *Transition costs* Overseas research highlights the implementation of Shared Services will likely occur over multiple years, putting pressure on existing Auckland Council staff to deliver existing services in parallel to changing how those services will be delivered in the future under a Shared Services Model

Opportunity Identification: Leveraging Auckland Council's size

In addition, we note that significant investments in the establishment of new 'common' local government technology platforms are underway at councils such as Tauranga, Christchurch and Wellington. Currently Watercare supplies bulk water and wastewater services to north Waikato communities. While the development of a National Local Government Shared Services Centre is outside the scope of this report, the Watercare example does provide a working example where other councils could leverage the scale of Auckland Council rather than building or buying local solutions.

In developing this opportunity we acknowledge:

- Auckland Council is currently undertaking a significant technology enabled transformation ('NewCore') that could be used to enable shared services capability for Auckland Council; and
- The implementation complexity that would be required to merge decentralised people, process and technology across the Auckland Council Group.

Assessment of option against criteria

Criteria	Assessment	Considerations
Is the option strategically aligned?	Strategic Medium	<u>Alignment to Council Role</u> In order to operate effectively Auckland Council must provide back office transactional activities, professional support services and ICT. As these are common services across Auckland Council there is an imperative to look at ways where these services can be delivered in the most cost effective manner, while not exposing the Council to unnecessary risk. <u>Customer Service Impact</u> Current customer services levels have to remain as the minimum baseline. <u>Legislative / Regulatory</u> Section 14 of the Local Government Act 2002 states that, in performing its role, a local authority should " ...collaborate and co-operate with other local authorities and bodies as it considers appropriate to promote or achieve its priorities and desired outcomes, and make efficient use of resources." However, it also states that, generally, councils cannot contract out of regulatory responsibilities, so the nature of shared services models needs to be mindful of provisions in the Local Government Act 2002. As part of this option for consideration we are not proposing to contract out regulatory responsibilities. <u>Māori considerations</u> We are aware of the Council's commitment to improve its responsiveness to Māori. Any move towards a Shared Services model would need to be reflected within the Council strategic priorities, work programme and performance measurement in their Statement of Intent.
Ease of implementation	Simple Medium	<u>Ease of implementation</u> and operating risks Experience demonstrates there is no silver bullet to implementing Shared Services successfully; in fact it is often difficult. Many organisations have approached the challenge differently with some seeking to centralise initially and drive process standardisation before addressing technology consolidation. Whilst others have sought to take a 'big bang' approach and initially drive technology reform. Successful Shared Services implementations follow five vital rules of engagement: 1. Benefits to all stakeholders: business cases must be strategic, offer a clear plan and provide incentives for all stakeholders beyond aggregate cost reductions 2. Strong leadership and support: a shared services strategy must have active high–level support and sponsorship from senior executives and politicians. Successful implementations include appropriate consultation and participation, while avoiding the trap of being 'over governed' 3. Align timelines to capacity to implement: implementation strategies must be credible and provide certainty around the benefits they deliver (even if these benefits come in stages, over a number of years for Council)

		4. Strong change management and transition skills: change management and transition requires meticulous execution to prevent cost blowouts, delivery on customer needs and to ensure stakeholder satisfaction. The key to success is a focus on instilling a service and continuous improvement culture 5. Get the governance right: A good governance structure requires a clear delineation of roles and responsibilities between the purchaser and provider of shared services As part of the Next Steps that Council may wish to consider the development of implementation principles to determine prioritised implementation options should be developed.
		Other considerations Should Auckland Council implement Shared Services then provisions must be made for maintaining status quo for the in scope business functions while Council transitions to a future state. This will introduce additional cost and complexity as Council must continue to 'keep the lights on' for all in scope services.
Value	Low - Medium	Market appetite Not directly applicable or disenable market impact.
		Wider Economic Benefits Outside of downstream benefits through co-locating staff and consolidating ICT infrastructure onto a smaller platform over time we do expect there will be significant wider economic benefits.
		Income Impact As noted above we are estimating an annual conservative projected benefit of $15.2m to Auckland Council. This will need to be further qualified as part the proposed Next Steps for Auckland Council.
		Credit rating impact There is likely to be limited impact on the Credit rating due to projected savings through the implementation of Shared Services.

Next Steps:

If this option is to be pursued, Auckland Council could:

- *Undertake a current state performance diagnostic in context of moving to a centralised Shared Services model. This diagnostic would help Auckland Council develop qualified answers in relation to:*
  - *What is the strategic direction for Shared Service?*
  - *What is the functional scope for Shared Service?*
  - *What functions could be or should be retained by individual Council organisation?*
  - *What additional controls and governance will need to be established and where will these sit in relation to Auckland Council and the Governing Bodies?*
  - *Where will we realise efficiencies from our People and respective organisations?*
  - *Where will we realise efficiencies from our technology and processes?*

Option 3b: Network analysis and shared facilities

Undertake a network analysis across all community services to ensure an equitable distribution across Auckland and look to communally locate functionally similar services where possible

Community service provision has been a core feature of local authorities for over a century. However, technological changes (for example, the digitisation of books), changing consumer preferences associated with demographic changes (the growth in numbers of people playing football, basketball and racket sports and the impact this will have on the recreational footprint) and the evolution of ways of delivering services (online compared to over the counter services) may mean that in as little as a decade the cluster of community services traditionally delivered by local authorities may take on a very different shape and, by inference, a different property footprint.

Opportunity Identification: Network analysis

The amalgamation of eight legacy councils created a surfeit of community assets. Auckland Council could be over-servicing communities with community assets which are in turn often under-utilised. Auckland Council has some 282 community facilities across Auckland ranging from 55 libraries to 61 community centres, 132 venues for hire and 49 leisure and aquatic centres. In addition Auckland Council also has several local offices which house Local Area Board staff, 26 regional parks and several hundred open spaces comprising over 40,000 hectares as well as a vast portfolio of other land holdings which do not necessarily fit into easily definable categories.

If we consider the past and likely future growth of the Auckland population, as well as the anticipated shape of the urban environment in years to come, there is likely to be an ongoing mismatch between the network of properties used for the provision of services and the population that those assets serve.

We note that this issue has been foreshadowed somewhat by Auckland Council through:

- The recent adoption of the Community Facilities Network Plan (the Plan).[35] The Plan appears aspirational in that it focusses on providing the right facility in the right place at the right time. The Plan is intent on providing facilities that meet the needs of the community and focusses on the three principals of Provision, People and Programmes.
- In March 2015 the Finance and Performance Committee approved an optimisation program which looked at the recycling of capital from the sale of underlying property for the reinvestment into new or enhanced facilities to better meet the needs of the community.

The Plan, although providing very good analysis of the quality and aspirations of community facilities, could be enhanced with the following additions:

- The Plan focusses on growth and increasing service provision without undertaking a baseline approach that measures 'what is the appropriate level of provision for the current and likely future community?' The Plan also places significant emphasis on maintaining and growing the existing network as opposed to understanding what the right sized network actually looks like given the shape of Auckland's urban framework.
- Benchmarks are established for service provision but not modelled against actual population.
- There is no evidence in the report that community facilities are actually measured in terms of utilisation. Some first person survey work has been undertaken to measure community attitudes to facilities but there is no data on just how well used the network of facilities are.

Ultimately, a full network analysis could emphasise efficiency, cost savings and right sizing of facilities for catchments which cross the boundaries of local area board precincts. It could provide further guidance of what form facilities should take, the principles behind the agglomeration of services, the benchmarks for

[35] http://infocouncil.aucklandcouncil.govt.nz/Open/2015/08/REG_20150806_ATT_5833_EXCLUDED.PDF

provision and ultimately the work that needs to be done to ensure several of the existing facilities are improved in their current state.

- The primary goal of this network analysis would be to ensure an equitable distribution of these services for local areas. This will be achieved by a conscious, systematic, principled based decision about location rather than unchallenged adoption of historic locations. While some localities have access to three libraries within a 2-3 km radius, other localities have none. On the face of it, this does not appear to be an equitable outcome for all Aucklanders.[36]
- A secondary goal would be to rationalise those parts of the network that are deemed surplus to requirements. This would represent both a one-off fiscal benefit to Auckland Council (to pay down debt, reduce rates or accelerate other infrastructure investment) as well as ongoing operational and maintenance cost reductions.[37]

International Case Study – Park Access in New York City

A 2007 NYC report highlighted that New Yorkers had fewer acres of green, public space per person than any other major American city. As part of a wider project called plaNYC, the City committed to ensuring that 85% of New Yorkers live within a 10-minute walk (1/4 mile) of a park by 2030. This is an example of network analysis being used as an effective tool in defining and pursuing outcomes.

There was a 2007 base rate of 74% people living within a 10 minute walk. By 2013 this rate had risen to 76.5%, with some 250,000 more people having improved access due to the project. This improvement was facilitated by opening underutilised spaces as playgrounds, creating and upgrading current parks, and incorporating sustainability throughout the design and maintenance of all public space.

[36] Appendix B provides fuller analysis to support this position.
[37] Raising capital from asset divestments could also precipitate investment in community facilities for new and growing geographic areas of Auckland – or to services geographic locations that are underserved by existing community facilities.

Opportunity Identification: Shared facilities

A concurrent opportunity also exists to jointly provide functionally similar services in the one location. This means that one person will not have to travel to as many geographically disparate locations to perform functionally similar activities. Examples of this could be to house Library services, registration and licensing functions and even non-Council activities like Citizens Advice Bureau in the one location. The use of school facilities, such as halls and parks, could also be considered for multi-use with other community activities to some degree.

The narrowing and co-location of community service delivery facilities reflects a global trend. Projects of this nature typically have a 'one-stop-shop' type vision, improving simplicity for customers and reducing duplication of services for the public entity. As well as more efficient use of assets, this type of reform could be expected to improve the customer service experience for customers of both Auckland Council and central government services. Reducing dispersion of service delivery outlets is in-line with a more customer centric approach.

We have provided some evidence below to help form the 'case for investigation' in Auckland. We pass no judgment over which assets or interests are surplus to requirements or which specific sites should be investigated for investment in community facilities. This exercise would be ideally performed after any network analysis.

International Case Study - Service NSW

This project was a large scale reform of formerly fragmented NSW Government Service Delivery, to a one stop shop delivery model under Service NSW. With budgeted capital expenditure of approximately AU$110m in the period 2013-2015, the project is expected to deliver the following benefits:

- From 400+ government operated shop fronts to 30+ Service NSW 'one top shop' Service Centre Branches across the state;
- From 102+ government call centres to 2-3 dedicated contact centres for government service;
- From 8,000+ information lines and government contact centre phone numbers to one single phone number; and
- From 900+ individual government websites including 52+ transactional websites, to one digital channel.

Figure 48: SWOT Analysis

Strengths and Opportunities	Weaknesses and Threats
Matching consumer preferences Consumer demands change over time. By assessing the services ratepayers require and the location and interrelationship of these with other services, Auckland Council can better provide for its communities. *Reduction of long term costs* Auckland Council could be over-servicing communities with community assets which are in turn often under-utilised. Through the right sizing of this service delivery Auckland Council would no longer need to maintain these assets at the same time as releasing capital for other uses. *Greater operating efficiencies* Right-sizing Auckland Council services would represent an opportunity for both greater efficiency in service delivery as well as a reduced cost, particularly in terms of the property footprint.	*Community risk* Members of the community, including Local Area Boards, view many of Auckland Council's community assets as integral to service delivery regardless of whether they represent efficient use of capital or not. Despite this process offering the opportunity to increase the efficiency of delivery, it is likely that any attempt to shrink the property footprint of these services will be seen as a loss of community capital. *Coordination risk* Coordination across Central and Local government as well as NGOs, although desirable, may create a challenging interface.

Assessment against Criteria

Criteria	Assessment	Considerations
Is the option strategically aligned?	Strategic High	<u>Alignment to Council Role</u> The provision of community services and facilities is crucial part of a local authorities business as usual. Ensuring that this provision is of the right nature, in the right location and to the right service level is fundamental to Auckland Council's role. <u>Customer Service impact</u> Reallocation of surplus community use facilities could dis-benefit existing users. However, co-locating some services and the potential provision of new community facilities in areas where there are not existing services will provide significant benefits. Creating principles around baselines levels of access for community services could also help mitigate this risk. Consolidation of service delivery branches would improve ease of access to Auckland Council services, and international case studies show similar programmes improve overall customer satisfaction. <u>Legislative/ Regulatory</u> There is nothing that we have encountered which would prevent this action although we note that there may be Local Board resistance and significant public consultation would be required. <u>Māori impacts</u> Māori impacts would depend significantly on the assets and interests under consideration.
Ease of implementation	Simple Medium	<u>Ease of implementation</u> The 'right sizing' of community use facilities and the pursuance of a strategy of collocating functionally similar services is a big undertaking and one that will likely face significant local opposition. It will also take time to implement. Consolidation of service delivery facilities would require substantial coordination across existing delivery branches, and potentially some branches outside the organisation (e.g. Central Government). If a principled approach to access distances and population catchments for service provision are adopted, the definition of these access criteria will likely be contentious. <u>Other specific considerations</u> Shared community facilities could result in decreases in staff requirements, due to decreased demand for operating and maintenance staff involved in surplus facilities. This could be partially offset by staff requirements for expansion of existing facilities.

Attachment B

Item 15

Value	Low-Medium	Market Many of the sites of community facilities are prime locations. Should a market solution be chosen as the most appropriate method for delivering value, market interest would likely be high. Wider Economic Benefits Transfer of the surplus facilities to a more efficient use (be that private or public ownership) would improve local economic outcomes, particularly if this acts as a catalyst for wider local development. Costs There would be upfront costs in investigating and assessing community use facilities. This would also take time. Both right sizing and consolidation of service delivery facilities may have reasonably large initial capex costs, but will be expected to reduce operating costs in the longer term. Income/ revenue stream Additional revenue could be derived from reallocation or divestment of surplus community facilities. Credit rating Based on an initial assessment against Moody's rating methodology for Regional and Local Governments, there is likely to be no impact on credit rating due to the amounts involved being immaterial.

Next Steps:

If this option is to be progressed, Auckland Council could:

- *Undertake a network analysis of community assets to ensure an equitable distribution of these services across Auckland. This could contain elements of:*
    - *Comparing the physical location of various Auckland Council facilities across the Auckland region with their catchments and test where these catchments meet prescribed benchmarks;*
    - *Establishing clear utilisation rates for those facilities where utilisation is a clear indicator of value to Auckland Council;*
    - *Undertaking secondary analysis of the catchment overlay with utilisation rates will be able to identify where multiple facilities can be included in one site.*
- *Undertake further work to ascertain what the 'community facility of the future' looks like*
- *Consider a program of rationalisation, agglomeration and 'right sizing' which incorporates all of the principles detailed in the Plan.*
- *Ensure that appropriate consultation and engagement protocols are well thought out, representative and empowering.*

Option 3c: Accommodation strategy

Auckland Council is a large owner of office space in Auckland. By combining and coordinating the accommodation requirement Auckland Council is in a position to reduce costs, improve quality and reduce long term risk associated with these ownership levels

Auckland Council is a very large occupier of office space across Auckland with occupancy across 135 Albert Street, The Strand Takapuna, Manukau City Centre, Henderson Valley, The Bledisloe Building, HSBC House and Watercare in Newmarket totalling more than 97,000 sqm or the equivalent of more than 1 in every 12 sqm of office space in the Auckland CBD. This total does not include the many satellite offices across Auckland as well as the minor office spaces occupied by CCOs. It also does not include depot space such as the train stabling yards and other industrial space occupied by third parties that predominantly service council needs e.g. waste collection or bus marshalling areas).

The location choices of Auckland Council offices are often disparate (Auckland Transport are located in Queen Street and Henderson Valley for example) and are inconsistent in terms of quality. Auckland Council continues to occupy the aging Bledisloe building, for example, whilst Auckland Transport also occupies two floors of the AMP building, an A Grade Building on the waterfront.

Auckland Council has an inconsistent approach to ownership arrangements – Auckland Council occupies several buildings which are Auckland Council owned such as Bledisloe and 135 Albert Street as well as leased properties such as 1-7 The Strand. CCO's for the most part occupy leased properties.

Not only is this portfolio of properties heterogeneous, it is also widespread and inefficient. Even within the tightly developed CBD, several Council organisations which relate very closely to each other are at opposite ends of town meaning organisationally Auckland Council creates inefficiency where people must move between buildings in order to interact.

Auckland Council could consider adopting a single occupier model, delineated within an accommodation strategy, whereby Auckland Council takes control, either through ownership or through a head lease of the properties which Auckland Council and the Group are intending to occupy over the long term.

As the largest occupier in the City, Auckland Council is in a position to reduce costs, improve quality and reduce long term risk. As an indication, a 20% saving in footprint costs, which is likely achievable in 5-10 years, would save as much as $9m in total occupancy costs per annum. This does not include lower allowances for parking and common areas in Council's leased portfolio.

There are several local and international case studies of where disparate Council / Government occupiers have rationalised and streamlined their accommodation requirement. This has had the effect of saving significant costs as well as creating efficiencies within these organisations.

Domestic Case Study – Property Management Centre of Excellence (PMCOE)

This proposed homogenisation of Auckland Council premises is similar to what is being undertaken by PMCOE in Wellington with central governments WAP1 & WAP 2 programs. Various government departments are being moved into homogenous space across the Wellington CBD. The government is anticipating space savings in excess of 85,000 sqm across a 500,000 sqm footprint, or savings of close to 20%.

International Case Study – Various

This strategy of bringing together wide and disparate accommodation footprints at local government level has been rolled out in a number of locations internationally with considerable success. Leading examples include Sheffield City Council (savings of over GBP £2 million per annum), Cambridge City Council (currently implementing), Leicester County Council (saving 20% of annual accommodation costs) and Government of Western Australia (consolidating from 81 buildings into 20 state owned assets).

Figure 49: SWOT Analysis

Strengths and Opportunities	Weaknesses and Threats
Streamline service delivery By having a standardised accommodation footprint, Auckland Council is in a position to standardise many of the other elements of office accommodation. Fit out components such as furniture, IT equipment, floor coverings, internal dividers, wall decorations etc can all be standardised. This has the potential to further increase procurement saving opportunities. *Increased flexibility* The ability of Council to move people around the portfolio is greatly increased across a large accommodation footprint – and where the standard of fit out is homogenous. This allows greater flexibility, especially with project teams. It also introduces the potential for hot desking and generally increasing the efficiency (sqm per person) of the office accommodation. *Replicability* An accommodation strategy has already been delivered by Auckland Council – and this can be extended to include the Group, which currently exercises a number of individual strategies.	*CCO's cannot be 'forced' into a common accommodation model* Given the statutory independence of the various CCO's, Council is not in a position to 'dictate' delivery of a shared accommodation strategy. Council will therefore need buy in from the major players in order to achieve any advancement in this initiative and any outcomes may be difficult to enforce. *Short term cost and disruption* Any initiative that involves major restructuring of office composition will be disruptive and will be delicate to implement operationally. This will involve a lot of upfront cost and resources – but the long term pay-off appears worth the risk. There may also be localised community impacts to consider.

Option Identification:

With such a large footprint, Auckland Council is in a position to leverage a single occupier model whereby Auckland Council takes control, either through ownership or through a head lease of the properties intended to be occupied over the long term. Auckland Council can achieve several key outcomes with this initiative:

- Auckland Council, through its covenant, is in a position to create significant value for private landlords – this should be reflected in lower long term occupancy costs. By adding length / term to Auckland Council's offer, it is in a position to negotiate reduced rents in private accommodation as well as avoid volatility in costs over the long term;
- Auckland Council controls several key sites in and around the CBD. Using its large rent roll, Auckland Council is in a position to trigger private sector development or refurbishment with Auckland Council either owning or leasing premises long term but outsourcing the development risk. This would deliver a built to suit solution in a preferred location;
- By combining Auckland Council's footprint, it is in a position to approach the private sector as a single purchaser. This will likely result in fewer accommodation suppliers; potentially even one supplier of office accommodation. Auckland Council is then in a position to write the terms of any occupancy agreement for benefit using its 'large single customer' clout; and
- By determining what space Auckland Council wants, it can obtain office space which best suits the organisation. This has the potential to result in efficiency gains (less space per person) and potentially the implementation of flexible workspace strategies. Furthermore Auckland Council is in a position to move various departments and CCOs around the portfolio as their needs evolve. This is likely to result in further organisational cost savings.

There are many ways where options could be structured for delivery, including a range of financing options. Refer to the *'New funding tools and finance'* section of this report for discussion on some of these strategies.

Assessment against Criteria

Criteria	Assessment	Considerations
Is the option strategically aligned?	Strategic Medium-High	**Alignment to Council role** This initiative is a fundamental part of Auckland Council ensuring it is fit for purpose. **Customer Service Impact** This initiative would have little if any impact on customer services. **Legislative / Regulatory Barrier** A key roadblock in this process is the independent nature of the CCO's. It is the CCO's which predominantly lease space from the private sector and therefore it is the incorporation of the CCO's into an Auckland Council wide strategy which is likely to generate the highest savings. Stakeholder buy-in is key to this process proceeding however CCO's have a legislated option to opt out of any strategy. **Māori impacts** A number of mana whenua iwi have existing, or are building, strong relationships with Local Boards. Their interests will be strongly aligned to maintaining local services for the benefit of their people who live locally.
Ease of implementation	Simple Low-Medium	**Ease of implementation** This is a long term initiative and needs to be aligned with lease expiries, capital replacement horizons and potentially the property cycle. The procurement of accommodation is part and parcel of the 'normal business ' of Auckland Council and CCO's; the suggestion here is that the process of considering accommodations options is undertaken in a more coordinated and strategic fashion. **Other specific considerations** The outcome of this initiative is likely to see increased efficiency by placing Auckland Council and CCO's closer together physically as well as in better quality accommodation. This is likely to improve Council staff's user experience of their workplace. Increasing lease tenure in leased properties and 'in housing' staff into Council owned assets is likely to reduce future volatility in costs as well as ensuring certainty over tenure reducing operational risk.

Value	Low-Medium	Market impact This initiative is likely to see one of two outcomes: 1) Some occupied space will leave the market. 2) Auckland Council will move office demand from the private sector into Auckland Council owned properties. Both of these are likely to negatively impact private sector property owners. In the long run this is unlikely to stymie the market as historically Auckland CBD sees close to 20,000 sqm of positive absorption per annum meaning any loss of space is likely to be reabsorbed by the market within 12-18 months.
		Wider Economic Benefits Increased concentration of Auckland Council workers will likely increase access to public transport and or the soft infrastructure in the city. There may be localised community business impacts to consider.
		Costs There is likely to be a significant and measurable positive impact on the long term accommodation costs of Council and CCO's. There will be transitional costs, however but these are part of the usual Auckland Council business of managing its accommodation footprint.
		Income Revenue Stream If this strategy results in efficiency gains which generate surplus assets, releasing these will provide a positive impact on revenue.
		Credit Rating Impact Based on an initial assessment against Moody's rating methodology for Regional and Local Governments, there is no impact on credit rating due to the amounts involved being immaterial.

Next Steps:

If this option is pursued, Auckland Council could:

- *Formally assess the 'size of the prize' including a fully and detailed study of the current accommodation requirements of Council and CCOs as well as an understanding of the likely future accommodation requirements;*
- *Undertake a full analysis of lease expiries, ownership intentions and options regarding future development on Auckland Council owned sites;*
- *Have discussions with PMCOE, who have undertaken a similar exercise recently, to understand lessons learnt; and*
- *Develop an implementation plan informed by communication across the various CCO's and Auckland Council staff which are likely to be impacted.*

Option 3d: Development of existing land and buildings

There is significant potential for Auckland Council to realise greater value from existing property assets by enabling greater development

There are a large number of underutilised operational properties held by Auckland Council which are well located and prime for potential development or redevelopment. In many instances these properties have a highest and best use which is well in excess of their current use however these properties are held for operational purposes and as such remain under developed or underutilised over the long term. Examples include land held for car parking in town centres (Bruce Mason Centre), community facilities, libraries and land held for transport purposes.

Many of these land holdings are historic and have seen the urban framework grow around them. The operational use and Auckland Council ownership of these properties have often prevented them from being used in a more intensive fashion.

Opportunity Identification

There is a clear opportunity with many of these assets to increase the development intensity whilst still retaining the public use element of the sites.

There is also a clear potential to partner with the private sector to undertake the development. Auckland Council could maintain Council control through the development process through leasehold or joint venture (JV) ownership structures.

We recognise that it is not possible to identify all of the properties that will be eligible for the above option(s). However, we have provided three examples which should provide the 'case for investigation' of the above concepts.

Figure 50: SWOT analysis

Strengths and Opportunities	Weaknesses and Threats
Higher income generation By developing assets to their full potential, Auckland Council is able to realise higher value from existing assets. Also, by creating an underlying leasehold or JV ownership structure not only is there a release of capital value to Auckland Council through the process, there is also a long term income stream.	*Need for strong governance and a requirement to sell these projects internally* There is sometimes a level of suspicion in partnering with the private sector predicated on the assumption that Auckland Council or the community are being 'taken advantage of' by private developers. This requires both Auckland Council to maintain a strong monitoring program of any project undertaken using Auckland Council land as well as a need to ensure all stakeholder expectations are managed.
Partnering with private capital brings financial discipline Introduction of private sector practices and discipline promotes a rational delivery of the development in line with market best-practice.	*Local area board buy in* Local area boards maintain a sense of ownership over many of the assets in their jurisdiction. If they feel Auckland Council are simply seeking to 'make money' out of a property or are permitting a development which does not, in their opinion, better the community, they will likely oppose any initiative.
Maintenance of service provision as well as meeting other objectives Auckland Council is in a position to influence development outcomes in instances where it owns these sites. Auckland Council can therefore ensure goals such as higher levels of residential intensification, activation of street fronts or increases in the rating base. These outcomes can be achieved alongside Auckland Council service provision objectives associated with the site.	

Attachment B

Item 15

Auckland Council Example – Carpark Development

Auckland Council maintains a number of carparks both under direct ownership as well as through CCO's such as Auckland Transport. These carparks provide for a range of customer groups ranging from weekend sports parking (62 College Road, St Johns), to shoppers shopping in a high street (16 Redmond Street, Three Lamps, Ponsonby) through to commuter parking on the Northern Busway (Albany, Constellation Drive and Akoranga). Several of these carparks are at grade however they are located close to, or on top of, public transport routes in developed urban areas.

The purpose of the parking is clear in almost every case, to provide for the more intensive use of the facilities which they support. Financially however these facilities offer very little if any revenue to Auckland Council.

In many cases these 'at grade' carparks are flat and offer considerable development potential. These carparks offer the opportunity for Auckland Council to partner with the private sector to develop and intensify the sites.

Auckland Council are in a position to deliver one of three potential solutions for these under-developed sites:

- Sell the freehold of these sites with conditions attached and/or covenants on the title / resource consent; which provide for the long term provision of parking on the site to the public. The developer can then proceed to develop the site to a higher density providing these conditions are met;
- Lease these sites on a perpetual leasehold basis to a private developer with conditions in the leasehold document which ensures the long term provision of public parking in the project will continue at Auckland Council's discretion. This will likely result in a similar outcome to a freehold sale however the leasehold title will continue to provide a long term cash flow to Auckland Council; and
- JV with a private developer where Auckland Council puts the land into the development and receives a portion of the profits from the development. The JV agreement and/or the title of the property can be altered to ensure the long term provision of public parking at the site.

This style of development is not uncommon in international environments and has the potential to release the underlying economic value of the sites either in a capital transaction or as a long term income stream. As an indicative example this would see values increase from $55 per sqm in the case of the Constellation Drive Busway Carpark to in excess of $1,500 per sqm in a commercial arrangement with a private developer.

16 Redmond Street has a rating value of $2,480 per sqm or $2.48m, which appears to be about half of the market value. A sale could therefore release the site at close to $5,000 per sqm or in excess of $300,000 per annum under a leasehold arrangement whilst still providing parking to the nearby commercial area.

Auckland Council Example – Auckland Council Golf Courses

Council operates 13 golf courses across the region. The majority of these courses are located in built up residential areas, have a favourable aspect to them and have a limited membership. These facilities provide public open space and add considerable value to the land around them. Golf courses by their nature are undeveloped green space meaning they are often thought to add amenity to the suburb in which they are located.

Many of these properties have a reserve or public open space zoning to them meaning community stakeholders view them in the same light as a park which provides amenity to the wider residential environment. In reality however, many the golf clubs which operate on these land blocks prevent the general public from using the space – therefore providing private benefit, despite being public assets.

Further, because the course operators do not pay market rent equivalent to the highest-value use, the opportunity cost of these sites to Council rate payers equates to many thousands of dollars per golf club member per annum.

The market value of these sites is significantly above the current book / rateable value. Below we list some examples which estimate the value of the upside at between

$600m and $700m[38]:

- Remuera Golf Course: 41.2 ha. Rating value $11m / $26.7 per sqm. Market value $250m - $300m / $675 per sqm;
- Waitamata Golf Course: 28.8 ha. Rating value $12.8m / $44.5 per sqm. Market value $160m - $185m / $600 per sqm; and
- Takapuna Golf Course: 42.9 ha. Rating value $21.1m / $49.2 per sqm. Market value $200 - $230m / $500 per sqm.

If the existing arrangements were reviewed and amended, the identified upside value could be realised. This does not necessarily mean the sale of the entirety of the land occupied by the golf course – decisions will always be scalable.

There is also a number of other potential positive financial outcomes:

- Increased rating revenue –if residential infill is allowed to occur, higher rates revenues will be generated;
- Opportunity for Council to lead the development of master planned communities with a mix of open space, high density development and commercial space;
- Provision of highly accessible greenspace for those new residents living there.

Auckland Council Example – Auckland Libraries

Auckland Council has a vast network of community facilities such as recreation centres, halls and libraries. These facilities provide a valued service to the community and in many instances provide an environment where members of the public can come together to meet and engage with each other. These facilities are often however under developed and are often in their location by way of legacy rather than strategic decision.

As is the case with many of Auckland Council parking facilities, these sites often only occupy one or two stories on sites that offer significant development potential.

Indicative examples include:

- the Epsom Library (a two story property on land identified in the PAUP as mixed use affording up to four stories of mixed use development);
- the Glenfield Library (located on a ridgeline adjacent to a site zoned for high density multi story development); and
- the Howick Community Centre (a public open space comprising of a recreational hall, bridge club and large carpark).

These properties offer opportunities for significant intensification with Auckland Council only requiring either a portion of the site or potential floor area in any future development. Opportunities exist for Auckland Council to partner with the private sector to develop these sites to their permitted intensity whilst providing space for Auckland Council use.

Sites such as the Epsom Library site for example could accommodate the Library use on a first floor with high value street facing retail on the ground floor and several levels of high value residential above. Auckland Council could rent this first floor space from the developer, occupy the space free of charge as a condition of sale or generate leasehold income from the site to subsidise the cost of occupation.

Auckland Council could maintain a leasehold or proportional interest in the property with conditions of use written into the lease and/or freehold title of the property. Such a solution would provide for several of the Council's goals such as: providing intensified residential development and increased public amenity as well as generating either a long term income or capital in the form of a sale.

[38] Please refer to Appendix A for more detail on assumptions of our analysis.

Assessment against Criteria

Criteria	Assessment	Considerations
Is the option strategically aligned?	Strategic Medium-High	Alignment to Council role Development of parking sites around public transport would likely ease long term congestion and encourage the development of high density housing. This is also the case with the comprehensive development of golf courses and existing Auckland Council service sites. There are several other outcomes which could be weaved into intensification outcomes such as better integration of government's community facing services with Auckland Council's community facilities; however this would be dependent on site by site outcomes and likely requires further analysis. Customer Service Impact This initiative would likely lead to better, more modern buildings and facilities for users of Auckland Council services. In many cases libraries or Auckland Council facilities are in older assets which are not ideally suited for their task. This initiative would offer a 'clean slate' opportunity for many of Auckland Council's service offerings in the community. Legislative / Regulatory There may be a need in some cases to change zoning or provisions for reserves / public open spaces, as many of Auckland Council's land holdings have a history which reflects previous or gifted uses or are located on land initially designated a reserve. Māori impacts Consider whether larger iwi, Ngati Whatua o Orakei, would be interested in the commercial opportunity. Some iwi may also be building specific relationships with their local boards around key Auckland Council services, such as libraries, to help deliver te reo Māori courses and other educational programmes.
Ease of implementation	Medium	Ease of implementation The financial and economic argument for this intensification is compelling and not difficult to articulate as it would turn unproductive, undervalued land into productive income generating assets whilst still maintaining Auckland Council's service delivery. However, obtaining buy in from Auckland Council stakeholders and ensuring spaces are right sized for various services, both now and in the future, would likely present a considerable practical challenge and is likely to be the largest road block to implementation however we would anticipate that extensive consultation and communication of the benefit should enable a high degree of success over time. Other specific considerations Many of these assets are viewed by the community as 'community assets'. Any tampering with these assets is likely to generate a negative reaction from Local Area Boards as well as other Auckland Council stakeholders. The potential for political risk is therefore high and would need to be managed.
Value	Medium	Market impact This initiative would likely provide the market with significant opportunities to engage with Auckland Council resulting in a positive financial outcome. There is also unlikely to be significant over supply of sites or property of a particular type, noting the size and depth of the Auckland market.

Wider Economic Benefits

This initiative will enable development of the wider urban framework as well as the intensification of development around commercial hubs.

Costs

Costs are likely to be moderate and in most instances borne by private sector partners. There would be limited costs involved in negotiating each deal with the private sector and formalising documentation as well as potential transaction / agency fees incurred through a public sale process.

Income Revenue Stream

This initiative will generate either:

1) Income from leasehold arrangements put in place in order for the development to proceed.
2) Enhanced asset values in the case that Auckland Council participate in developments in the form of a JV. Auckland Council would place these assets on its balance sheet for long term ownership or potential future sale.

Credit Rating Impact

Based on an initial assessment against Moody's rating methodology for Regional and Local Governments, there is no impact on credit rating due to the amounts involved being immaterial.

Next Steps:

If this option is to be pursued, Auckland Council could collectively:

- *Assess those properties and landholdings that present potential for development uplift; and*
- *Consider this option in concurrence with similar Auckland Council workstreams including the Auckland 30 Year Infrastructure Strategy and any network analysis.*

Option 3e: Pricing review

Optimising the pricing structures for Auckland Council delivered products and services can add additional value and better balance public good requirements

Auckland Council generates revenue from a number of products, services and assets. Currently Auckland Council undertakes an annual pricing review to ensure:

- Auckland Council balances commercial objectives against the need to deliver social outcomes and "core" services to Auckland; and
- Appropriate parity with the private sector in relation to comparative products, services and assets with the view to remaining competitive while offering value back to Auckland.

Although Auckland Council has a repeatable annual pricing review strategy linked to the LTP it is inconsistently applied across the various products and services provided. In addition this process could be further enhanced to take advantage of products and services that are in greater demand due to National and Global market shifts. This enhancement would see prioritised pricing changes taking effect on a more frequent basis and be more aligned projected market demand.

Auckland Council Example – Increase in land use fees for filming in a public place

Auckland Council is currently reporting that in 2013 the screen production industry generated gross revenues of $2.2b in the Auckland region with over 6000 people employed in over 1400 local businesses. Auckland brings in the majority of New Zealand's screen production dollar and has identified film production as a critical sector for growth.

On June 2015 the Auckland Council approved an increase for land use fees for filming in a public place and the Auckland Film Protocol. As part of this change it was noted that Auckland Council had not changed fees for filming in a public place over the four years prior.

We do acknowledge that Auckland Council, in context of achieving a value based approach to pricing, must constantly balance social and community outcomes against the commercial interests of maintaining large assets such as pools and leisure centres.

Auckland Council Example – Under 16 swim for free

In April 2013 Council implemented the "free pools for young people" initiative which is aimed at creating a positive social benefit of providing access to these facilities for all young people and raising swimming abilities.

However commercially, this incentive will need regular review to ensure that the high costs involved with operating these facilities are being covered. Adult fees are not intended to be increased at most pools and with a larger numbers of young people using the pools, the possibility of a decrease in the numbers of regular adult swimmers is likely.

This raises the question of where the income to cover the costs of the facility will come from. Entry charge for supervisors, differing based on the child's age, will assist in recouping some of the costs. Increasing fees for adult swimmers will act as a further deterrent but there is the possibility to provide tiered pricing for privileged services such as adult-only hours or adult-only facilities.

Opportunity Identification: Tiered Service Provision

Auckland Council provides a series of products and services but broadly speaking maintain a one size fits all model of pricing. There is an opportunity to optimise the current pricing structures for products and services by implementing tiered pricing structures for increased levels of service, as exemplified in the commercial sector.

To succeed on producing a tiered pricing structure there needs to be transparency in Auckland Council's offerings. There must be clarity and certainty for the rate payer around the product/service offering and the time frame to expect for each fee level.

Auckland Council Example – Building consents turnaround time

Auckland Council states a building consent will be processed within 20 days although it may take longer if they need more information.

There is an opportunity here to provide a better level of service to the rate payer, especially given the commonality of issuing building consents. The Council's experience could allow for an efficient turn-around time, with regard for regulatory constraints, and enable them to commit to a 20 day deadline inclusive of the time it takes to process additional information. The rate payer's expectation of 20 days should be met. This may require increased levels of back office support however there is the possibility to balance this out by implementing a tiered pricing structure for consents.

For example, long-term planning consents, where the consent is not required for 2+ months, could present an opportunity to offer rate payers a lower fee and reduce the level of back office support required due to the extended timeframe. If this longer term option was commonly used it could balance out the cost of additional back office support for the short term consents. This can be likened to the NZ Passport service, where a higher fee is requested to meet rate payer demand of urgent passport requirements.

Figure 51: SWOT analysis

Strengths and Opportunities	Weaknesses and Threats
Higher income generation	*Potential increase cost-to-serve*
By reviewing pricing in context of market demand cycles Auckland Council could be in a position to generate more revenue in line with market expectations and/or associated value.	Providing a flexible workforce to accommodate tiered service provision may inadvertently introduce additional people into the back office to execute these processes increasing the overall cost-to-serve for Auckland Council.
Increased levels of service to Auckland	*Commercial interests begin to outweigh social outcomes*
By introducing tiered pricing and service levels associated with this then Auckland Council can provide better levels of service aligned to the price point that Auckland is willing to pay for that increase in service level.	As part of the pricing review approach Auckland Council fee increases create a barrier to accessing services and products deemed "core".

Assessment against criteria

We note that Auckland Council already reviews pricing provisions annually. Accordingly, we have not undertaken a separate criteria analysis for the task of rolling out new approaches to reviewing prices – including tiered service provision.

Next Steps:

If this option is to be pursued, Auckland Council could:

- *Assess the current process for establishing pricing models;*
- *Establish and publish a transparent set of pricing principles that outline how Auckland Council will maintain an appropriate balance between commercial interests and social outcomes; and*
- *Establish a forward list of prioritised products and services where pricing should be reviewed and the forward frequency of the reviews based on agreed market demand criteria.*

Attachment B

Item 15

Option 3f: Fleet Review

Efficiently managing Auckland Council's vehicle fleet will reduce operating and maintenance costs while still meeting service requirements. It can also unlock capital to be used to fund other strategic objectives.

Auckland Council Group currently has management of over 1,250 vehicles to support the delivery of the myriad of Auckland Council services. The fleet broadly consists of:

- Small two or four seat hatchback vehicles for general road use;
- Network maintenance trucks which in some instances are on call 24/7, 365 days a year, throughout central Auckland; responding to anything from a burst water main, to a blocked wastewater pipe, to maintenance issues on footpaths and roads;
- A number of 2WD and 4WD utility vehicles for those business units that must visit locations on rough roads, off-road, or on construction sites; and
- Rural fire appliances, as well as two 7.5m launches operated by the Harbourmaster's office.

Globally we are seeing evolving trends that directly influence the management of fleet performance such as:

- Emerging technologies - the use of GPS tracking presents opportunity to reduce vehicle waste (i.e. speed, idle time, routing, maintenance costs) and the adoption of mobile computing platforms allowing real-time access to data in the field;
- Fuel cost mitigation - mitigating efforts include idling and speed reductions, stringent maintenance programs and optimised route planning; and
- Data analytics - the ability to analyse actual vs. expected performance and maintenance statistics, strategic determination of optimal replacement cycle and driver productivity and safety analyses to feed fleet risk profiles.

We believe there is an opportunity to interrogate the full Auckland Council fleet, explicitly including CCO vehicles, to ensure that the service is fit for purpose. In developing this opportunity we acknowledge:

- Watercare has undertaken a fleet review as part of their focus on "Sound Financial Management" in FY2014/15; and
- Auckland Transport has projected a $2m spend to upgrade up to 80 vehicles within its existing fleet in FY2015.

While we acknowledge the diverse requirements for the Auckland Council vehicle fleet we believe that there are apparent synergies across how light and heavy vehicles are:

- Acquired and operated;
- Maintained and repaired; and
- Disposed of at the end of a vehicles "useful life".

Figure 52: SWOT analysis

Strengths and Opportunities	Weaknesses and Threats
Determine optimal capital allocation Opportunity to define the target role for private fleet based on both commercial and operational strategies. Ability to use Group size and scale to optimise how you outsource fleet maintenance and service parts distribution. Additional parking assets can be made available for alternative uses e.g. public parking, through the reduction in the fleet. *Manage purchasing decisions better and manage maintenance* Ability to make lease versus purchase decisions based on robust financial analysis. Opportunity to develop process to retire vehicles based on business plan, budget, maintenance costs, useful life remaining, and salvage value. Could be used as a tool to drive other Auckland Council policy objectives around sustainability such as car-pooling and electric vehicles. Ability to implement constraint based route planning to extend the "useful life" of the fleet while minimising maintenance and fuel costs. *Better employ technological solutions* Ability to use data analytics to better schedule preventative maintenance based on equipment age and forecasted part failures. Opportunity to implement Electric On-Board Recorders (EOBR) for vehicle data collection. *Fleet management* Better fleet scheduling to maximise utilisation of fleet and reduce fleet numbers.	*Heterogeneity of fleet* The diverse geographic nature of Auckland and requirements across Group entities creates challenges in relation to ensuring the "right" vehicle is available in the right location with the appropriate equipment. *Operational challenges* May require a significant change in the operating model across Auckland Council to maintain or improve the management of Council fleet from a centralised location.

The following case study provides a 'case for further investigation' as it demonstrates the current inefficiencies associated with a subset of the Auckland Council fleet. Similar efficiencies could feasibly be envisaged across CCOs and the network optimisation of the entire fleet would provide additional benefits.

Domestic Example – Auckland Council Fleet Review

In September 2015 EY was commissioned by Auckland Council to undertake an independent assessment of fleet utilisation across their light vehicle fleet. This engagement built on earlier analysis conducted by EY in 2013. A summary of findings presented across Auckland Council's (not including CCOs) 698 vehicles assessed are as follows:

- Vehicle average utilisation is still below the benchmark presented in 2013 of 70%;
- Utilisation for vehicles at primary locations (Albert, Bledisloe, Graham, Henderson, Orewa, Takapuna) is below 50%;
- 40% of the Council fleet has utilisation below 30% with Manukau-based vehicles utilised 35% of the time; and
- Approximately 40% of vehicles (236 cars of 618) are stationary at their home base at least 70% of the time.

Assessment against criteria

We note that Auckland Council has already undertaken fleet analysis across Auckland Council. Accordingly, we have not undertaken a separate criteria analysis for the task of rolling this out across Auckland Council including CCOs, but have based our high-level assessment on work previously done.

Next Steps:

If this option is to be pursued, Auckland Council could:

- *Complete a Group diagnostic activity across fleet utilisation data and analysis of private vehicle, taxi and HOP cards;*
- *Clarify and agree individual business unit requirements on the vehicle fleet with the view to identifying the people, processes and technology required to meet these requirements;*
- *Understand where future trends in fleet management is heading and how these can be leveraged across Auckland Council over the next ten years;*
- *Produce a consolidated projection of fleet management costs in context of the projected demand based on the captured business requirements; and*
- *Develop and agree a consolidated fleet management strategy for Auckland Council Group.*

Option 3g: Align CCO and Council Synergies

Achieving potential operating synergies within Auckland Council, (including substantive CCOs and other Auckland Council funded/ related entities) will reduce operating costs and also create the potential for improved revenue streams

Auckland council owns six substantive CCOs as noted on page 54. They were established as part of the amalgamation of the local governments of Auckland with the purpose to operate with a degree of separation from the Council, but to achieve the commercial and non-commercial objectives as outlined in their annual Statement of Intent.

A review of all CCOs was commenced by Auckland Council in 2014, which aimed to identify a number of opportunities to improve the activities, functions, and structures of the CCOs. It should be noted that the review focused on the substantive CCOs. The legacy CCOs and exempt CCOs were not included in this review, including:

- COMET Auckland;
- The Contemporary Art Foundation;
- Te Puru Community Charitable Trust;
- Arts Regional Trust;
- Highbrook Trust;
- Mangere Mountain Education Trust;
- Manukau Beautification Charitable Trust;
- Mt Albert – Community Swimming pool Trust; and
- Safer Papakura Trust.

We note that there are also a number of related organisations that the Auckland Council provides over $50m per annum in financial support directly to or via the Auckland Regional Amenities Funding Board including:

- The Auckland War Memorial Museum;
- Eden Park Trust; and
- The Museum of Transport and Technology.

We note that the operating environment for these entities continues to change, and there may be merit in reviewing their performance against objectives with a view to:

- Establishing new entities;
- Amalgamating governance structures;
- Adding value from greater collaboration of services; and
- Enhancing skills and capabilities.

Figure 53: SWOT analysis

Strengths and Opportunities	Weaknesses and Threats
Enhanced resourcing	Implementation risks
Ensuring that each organisation has the right resources and mandate to deliver on its strategic objectives will improve outcomes for Aucklanders.	There is a degree of implementation and transition risk for any new operating entity – or substantive change in strategic direction.
New value added services	Ongoing resource requirements
Potential to create new services in collaboration with other entities, or realise economies of scale, cost efficiencies or reduce duplication.	There may be associated costs and required time for entities to become more effective before the Auckland Council can realise all benefits.
Clarity on mandate	
Many of these entities have similar mandates – or conversely have different mandates over similar assets. By focussing mandates through organisational change, there should be greater levels of accountability and responsibility.	

Domestic Case study - Panuku Development Auckland

The outcomes of the CCO review lead to a separate review completed by Auckland Council in Nov 2014, recommending that a newly established CCO (Panuku Development Auckland) should be created from the integration of Waterfront Auckland and Auckland Council Property Ltd.

The review provided an opportunity to assess priorities and establish a clearer mandate for the two CCOs. The review also identified a number of expected synergies from the integration. Mainly:

- Bringing together skill sets to focus on existing and new redevelopment locations; and
- Saving of approx. $1.5m p.a. provided for in reduced board requirements alone.[39]

Opportunity Identification:

Our analysis suggests that there are a number of ongoing challenges and opportunities evident in the existing CCO model. For example:

- There is potential overlap and duplication of operational functions between several CCOs. As an example, RFA, ATEED and Auckland Council all have varying degrees of roles in the delivery and marketing of events. Another example is where two separate contracts have been issued for window washing at the Airport on Great Barrier Island – one for the inside windows and one for the outside windows.
- Physical asset ownership is complex and may not always align with the strategic direction of each CCO. For example, RFA owns the Viaduct Events Centre, but operations and maintenance for the wharves sits with PDA. Furthermore, ATEED are charged with bringing events to Auckland, but often choose not to use the Viaduct Events Centre for conference-like events. This misalignment of objectives cannot lead to optimal decision making.
- Complex board relationships. For example, RFA has its own board and makes decisions about funding for entities such as Eden Park Trust, War Memorial Trust and the Auckland Zoo. But each one of these entities also has their own separate boards or trustees that make their own organisational decisions.
- Some CCOs have a myriad of objectives, which must make operational and governance decisions more difficult – with associated costs. For example, RFA is expected to support the not-for-profit (and justifiably so) Auckland Art Gallery, whilst also trying to run a profit generating events management business.

We pass no judgment as to the optimal configuration of all CCOs, but believe that some reallocation of functions or reconfiguration of operational activities could provide benefits to Aucklanders – both in terms of service delivery but also in cost reductions.

By way of an example of improved service delivery, a greater alignment of synergies between CCOs could be a precursor to a collaborative visitor pass to a number of attractions in Auckland targeted at tourists. This can create a new revenue stream by leveraging the number of visitors to different attractions. Further collaboration with AT to include public transport on a pass can also increase value.

It is difficult to place a specific value on the size of this opportunity, but we do note the Waterfront Auckland/ACPL merger identified approximately $1.5m p.a. worth of operational savings alone. A similar exercise across the 'events-based CCOs' could yield similar savings.

[39] http://www.acpl.co.nz/assets/CCO-Review/CCO-Review-Report-27-Nov-2014.pdf

Assessment against Criteria

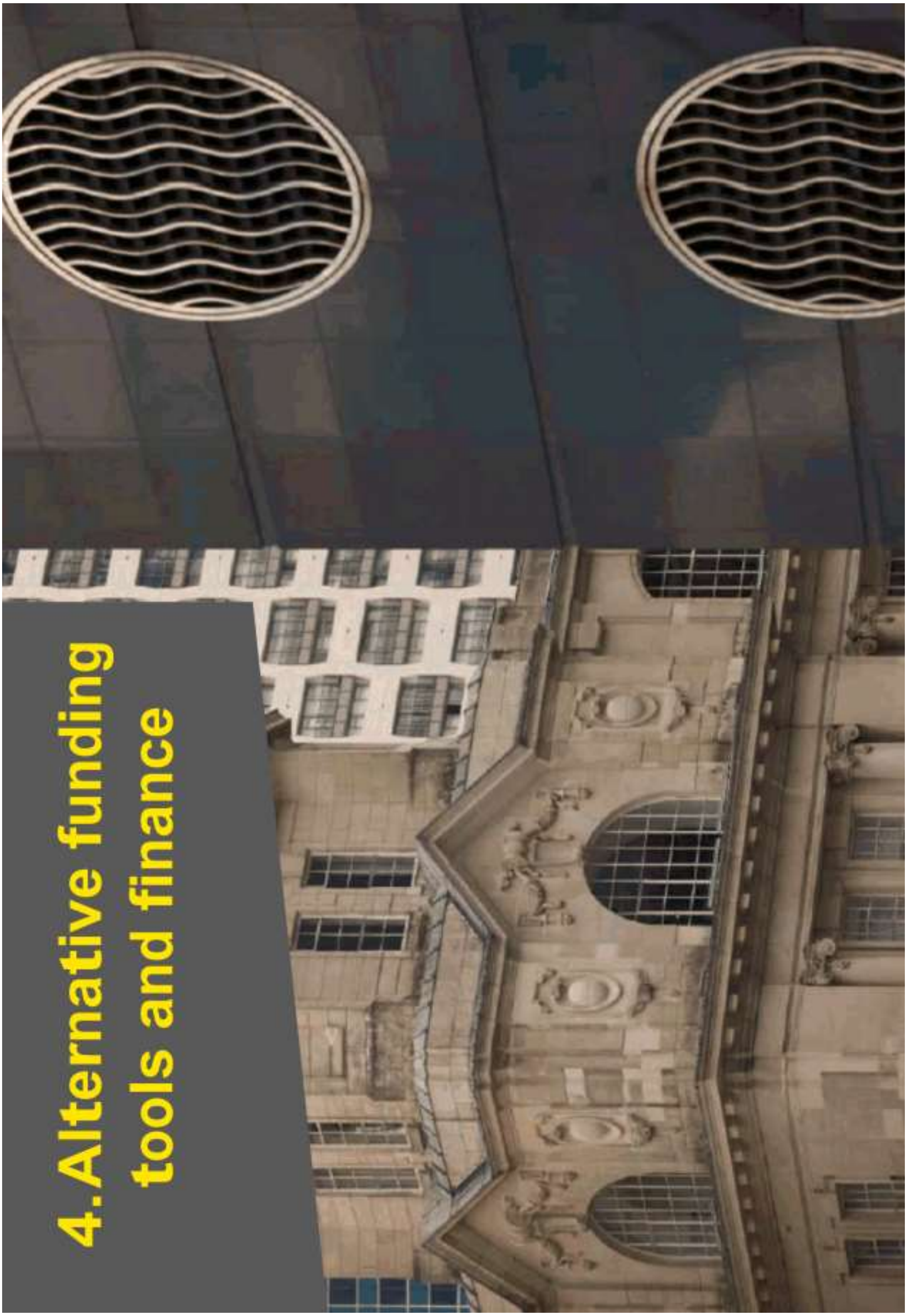
Criteria	Assessment	Considerations
Is the option strategically aligned?	Strategic Medium-High	Alignment to Council role Realising and achieving economies of scale from CCOs fulfill local authorities' purpose to perform activities in the most cost-effective manner for households and businesses. Customer Service Impact Collaboration and amalgamation of services can have the potential to improve customer services and service delivery, and increases of visitors to Auckland's attractions. Legislative / Regulatory Depending on the organisations, there may be limitations to realising all opportunities due to the current legislative requirements and obligations. Legislative amendments may be required for changes to governing arrangements. Māori impacts Māori impacts may be present on a case by case basis. It is dependent on the nature of any organisational changes.
Ease of implementation	Medium	Ease of implementation Depending on the entities and/or the size of activities we expect that the implementation of any suggestion may be complex and will require detailed project planning and a full understanding the current operating and governance structures.

Value	Low-Medium	Market impact No discernable market impact. Wider Economic Benefits As an example, integrated attraction visitor passes can increase attendance rates across a range of activities, impacting on total tourist visitor numbers. Collaboration with Auckland Transport can also further increase the utilisation of public transport. Costs There will be costs associated with implementation but these will be entirely dependent on the level of alignment that is sought. Income Revenue Stream Potential economies of scale and savings from streamlined service provision could reduce operating cost. There is also the potential for new income streams. Credit Rating Impact Based on an initial assessment against Moody's rating methodology for Regional and Local Governments, there is no impact on credit rating due to the amounts involved being immaterial.

Next Steps:

If this option is to be pursued, Auckland Council could:

- *Investigate the amount of value from potential synergies and the potential limitations to access implementation;*
- *Conduct a high level costs vs benefits analysis, current state and future state scenario analysis for various CCO configurations;*
- *Detail an action plan and assemble a capable taskforce for implementation;*
- *Ongoing review of funding for related organisations receiving financial support to ensure they are meeting their performance objectives;*
- *Undertake consultation with stakeholders.*


4. Alternative funding tools and finance

Overview – Alternative funding tools and finance

New and innovative funding and revenue generation methods could relieve revenue creation pressures and rate revenue dependency

We recognise that funding and financing are similar, and often interrelated, concepts, but have defined them as:

- Financing: The capital used to pay for something - for capex this will often include a debt portion. For example a home loan. Ultimately funding must be present to repay finance.
- Funding: The act of raising primary sources of revenue. Examples include development contributions, rates, and dividends.

There are a range of financing and funding tools that Auckland Council could look to implement in order to achieve its fiscal objectives. Some of these tools have been tested with the community and have been debated at length with central government. While the political appetite may not be strong for the legislative introduction of new tools, we do not think they should be taken off the table. In fact, we think that they are an important part of the future funding/financing mix for Auckland and could be further road-tested to help progress the debate.

Legislative restrictions on the introduction of new revenue sources reinforce the existing asymmetric cost and benefit distribution for new infrastructure spend. By and large the immediate costs of growth are felt acutely by local government (due to the large investment required in capital expenditure), yet a lot of the immediate gains from growth fall on central government (GST intake and taxation). Long term gains eventually accrue to local governments (via rates) but there is a timing mismatch between the expenditure and revenue sources.

We have separated our discussion in this section into two main categories We have provided more detailed assessments for those initiatives we think pose the greatest potential for Auckland Council and have provided examples of each option to support the case for further investigation..

Financing initiatives

- Sale and lease back – Property Portfolio Transaction (PPT);
- PPP delivery of self-funding projects – Street lighting PPP; and
- Tax Increment Financing (TIF).

Alternative funding sources:

- Naming rights and corporate sponsorships;
- Advertising on bus stops, buses and trains;
- Review of targeted rates and development contributions;
- Bed taxes, fuel taxes, travel taxes and tolls; and
- Revision of non-rateable land.

Figure 54: Advantages and disadvantages of new finance and funding tools

Advantages	Disadvantages
Additional revenue line New revenue sources can be used to accelerate the progression of desirable projects and assist in improving delivery of core services or reduce other revenue streams such as rates. *Diversified revenue sources* Alternative revenue sources provide a genuine alternative to a regional base rates increase and so can potentially address any revenue volatility concerns.	*Role deviation* Undertaking alternative revenue generating activities may deviate from the core mandate of the Council- pursuit of opportunities could be evaluated on a case-by-case basis. *Skills requirements* Complex deals or activities (for instance TIF deals) will require access to specialist skills to ensure risks and implications are appropriately understood. *No guarantee of success* Important scoping studies may be publically seen as wasteful if they do not lead to results Need for strong governance and a requirement to sell these projects internally within Council.

Individual assessments of the advantages and disadvantages for each funding and financing tool are provided in the remaining section owing to the unique nature of each option.

> "Consider diversifying revenue sources for infrastructure funding, such as sharing in a revenue base linked to local economic activity or taxing the windfall gains that accrue to landowners from rezoning land for urban use" - OECD Survey of New Zealand 2015

Financing Initiatives

Tailored financing initiatives can be used to achieve the dual goals of appropriate risk transfer and timely capital provision. Potentially easing debt burden

Auckland Council has historically procured major capital expenditure projects using traditional procurement approaches centred on construction based models, with elements of risk transfer to the private sector in terms of design and construction but generally with no ongoing obligations in terms of asset maintenance and operation. However, such traditional delivery models have limitations which may not enable the Council to achieve the best value for money and project outcomes in all circumstances. For large, complex or innovative projects, better value and project outcomes may be achieved by utilising non-traditional delivery models.

We have identified a number of such financing initiatives below (4a – 4c). Each financing initiative will have a very narrow scope of instances where they will be appropriate to explore and we have sought to provide an indication of the types of projects that are suitable, where possible.

- Sale and lease back – Property Portfolio Transaction (PPT);
- Self-Funding Public private partnerships – Street Lighting PPP; and
- Tax increment financing (TIFs).

There are a number of advantages from the above options in comparison to traditional delivery methods which can have a positive impact to debt levels and rates including:

- The financial benefit of unlocking capital upfront;
- Allocation of risk to those better suited to manage them;
- Utilise innovation and expertise of the market; and
- Potential cost savings and value capture.

Option 4a: Sale and Lease Back - Property Portfolio Transaction (PPT)

A Property Portfolio Transaction (PPT) involves transferring the ownership of property (and associated risks) from a public entity to a private operator(s), in return for a favourable and flexible rental agreement.

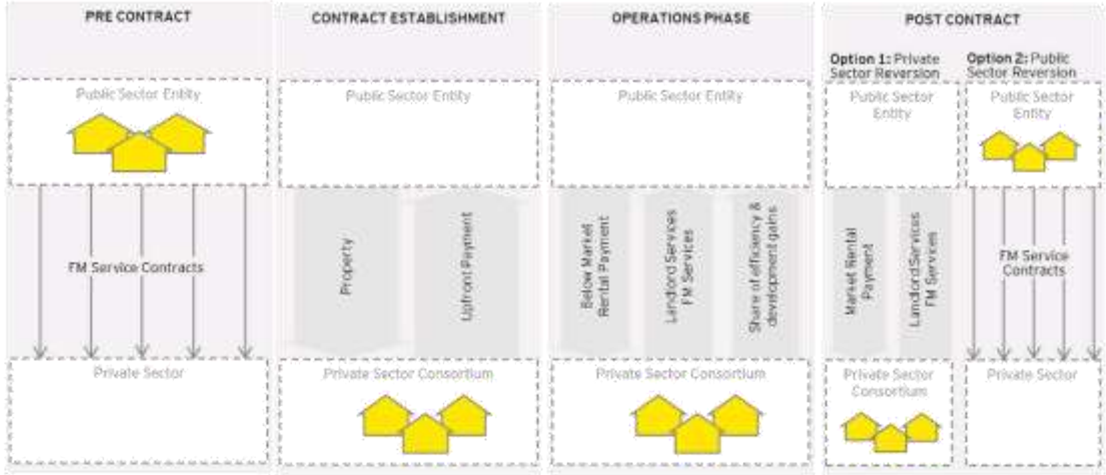
The private operator becomes analogous to a partner for the Council, as they have a joint financial incentive to address surplus asset holdings through improved space utilisation and a decrease in Council occupied footprint. This incentive, along with the contractual flexibility to adapt to realise these outcomes, leads to improvements in efficiency.

Typically the structure is as follows (see Figure 55):

- The private entity pays the Council a lump sum (below market value, possibly zero) in return for the transfer of a portfolio of Council occupied property (sale of freehold buildings and assignment of responsibility for managing leased buildings);
- The private entity will provide serviced property to the Council for approx. 20 years in return for payments below market rate;
- The Council has the flexibility to increase/decrease their rental demand for property within certain bounds, with no penalty; and
- The Council shares benefits including cost savings (utility costs, maintenance costs) and development profits from sale of excess property. At the end of the contract, Council may retain the right to occupy the desired buildings at current market terms; or the property ownership may revert back to the Council.

We note that these general concepts can be flexibly applied, and the form of the project agreement will ultimately be the major determinant of the outcomes and risk transfer achieved through the project. For instance, UK Ministry of Defence's Project MoDEL used an innovative "Prime Plus" contract which was developed to provide the financing for the development of new and refurbished buildings through the expected sale proceeds from released sites. Central to this deal, sales and development risk is transferred to the appropriately incentive private sector, whilst ownership of retained sites remains with Ministry of Defence.

Figure 55: Illustrative structure of PPT



The key benefit of a PPT is the transfer of landlord services (and associated risks) to a specialist provider, whilst maintaining the incentives and flexibility to adopt more efficient practices for using property. The key disadvantages are that the assets and control may be transferred to the private sector at the end of the contract, and the Council would face market rental risk beyond the contract period.

Option identification:

Within Auckland Council's extensive and diverse portfolio of assets, there are a number of portfolios that could be constructed into a form suitable for a PPT. This assessment focuses on the multitude of suburban locations where Council is located. Particularly suburban office locations / Council Service Centres. This is all commercial space and is the only part of the Council portfolio where there is enough scale that this might work. Applying it to the central city office assets might work with single large assets (135 Albert Street for example) however there may not be enough assets within the owned assets in the CBD for serious savings to be made.

PPT type models were delivered in the UK market from the late 90's. Two of the formative, and largest, transactions are detailed below.

International Case Study – Private Sector Resource Initiative for the Management of the Estate (PRIME)

Year:	1998
Public agency:	Department of Social Security
Private party:	Trillium (now Telereal Trillium)
Scale:	700 properties; 1,670,000m²
Upfront payment:	£250 m
Rental value:	£2,000m (PV 1998)
Estimated value:	£600m (PV 1998)

Lessons Learnt:

- PPT type contracts are able to adapt to a changing public sector structure. (In 2001, a restructure brought together the former Employment Services estate into the Department, which transferred to Trillium, under a £1,200m expansion of the PRIME contract.)
- The time and the money spent to get reliable information before the implementation of the deal, reduced contractual incompleteness.

International Case Study – The Strategic Transfer of the Estate to the Private Sector (STEPS)

Year:	2001
Public agency:	Inland Revenue, HM Customs and Excise and the Valuation Office Agency
Private party:	Mapeley Group
Scale:	590 properties; 1,355,000m²
Upfront payment:	£220m
Rental value:	£1,500m (PV 2001)
Estimated value:	£344m (PV 2001)

Lessons Learnt:

- Risk management could be comprehensively addressed including coverage for contractor default, especially in keenly priced deals.
- Mechanisms for penalising poor private sector service levels are crucial.
- Public sector needs to develop and implement a strategy to capitalise on the occupancy flexibility in order to justify the contractual arrangements
- Shared vision of public and private parties will improve outcomes for both.

Assessment against Criteria

The following below sets out EY's view on the strategic importance of the investment against our criteria.

Criteria	Assessment	Considerations
Is the option strategically aligned?	Strategic Medium-High	Alignment to Council Role The current role played by Auckland Council as landlord for back office functions and service facilities in our opinion indirectly meets the purpose of the local government as defined in the Local Government Act 2002. The services provided within the facilities are part of Council's core mandate, and provision of landlord services allows this to occur. However, we note that outsourcing or delegating these services to the private sector is an equally valid method of achieving adequate facilities with potential benefits.
		Customer Service impact The customer impact in a PPT would materialise through any impact on Council officials. Upgrading Council facilities could bring benefit to the Council officials, although some dis-benefit is possible if merging or concentration of facilities is managed poorly.
		Legislative/Regulatory There appears to be no major barriers. Furthermore, s17A of the Local Government Act 2002 now requires that councils regularly review the cost effectiveness of arrangements for providing services.
		Māori impact Mana whenua, either collectively or as part of a consortium, could be interested in participating in a PPT. Aligns favourable with transformational shifts and outcomes sought in the Auckland Plan.
Ease of implementation	Medium	Ease of implementation PPT type contracts are complex and require substantial time and resources to develop effectively. Given a PPT deal would be the first of its kind in the NZ market, the development and execution would likely involve substantial education and upskilling of the directly involved parties and the wider market.
		Other specific considerations Monitoring of the performance of executed PPT deals are a key to success, to ensure service standards are being maintained and appropriate performance regimes can be enforced. However, this is in-line with existing monitoring required under typical contract management.

Value	Medium	Market The relatively small size of the NZ market (compared to the like of the UK) may present a challenge, but we would encourage the deal to be approximately scaled for the larger NZ market players to participate. Success of recent NZ PPP's indicates moderate market interest in long term partnership contracts with the public sector. Wider Economic Benefits Unlocking surplus or underutilised facilities for release to the private sector could provide an opportunity for higher value use – generating positive economic benefits for the Auckland Region. Costs Costs associated with development of a robust PPT contract would be moderate, although this is expected to be compensated by the delivery of long-term savings. Income/ revenue stream Potential to negotiate a substantial capital inflow immediately on contract establishment; however, this will be offset by payment of lease/rental payments for the remainder of the contract. Credit rating Based on initial preliminary assessment utilising Moody's rating methodology for Regional and Local Governments, entering a sale and leaseback transaction will likely result in the following impacts on the credit rating: ► In the event that proceeds from the sale are used to repay its existing short-term debt, no change in credit rating is expected as the decrease in borrowings will largely be balanced by an increase in lease liabilities ► It is considered that, depending on the lease yield and capitalisation rate of the transaction, the amount of borrowings repaid from proceeds could be marginally greater than the lease liability entered into, which would assist to alleviate the existing downward pressure on the credit rating (as noted by Standard & Poor's credit rating report 4/11/14) due to the forecast increase in debt required to fund future projects. Further detailed assessment on a case-by-case basis would be needed to confirm this view.

Figure 56: Advantages and Disadvantages of PPT

Advantages	Disadvantages
▸ Well executed contract negotiation and defined terms of the deed could generate substantial value for money; ▸ Deliver a strong incentive to address surplus asset holdings through improved space utilisation and a decrease in occupied footprint; ▸ Transfers risk of owning and operating property assets to the private sector; ▸ Potential to obtain a sum of capital upfront – which could be used for immediate capital expenditure; ▸ Relieving Council of its property ownership responsibilities could allow greater focus on the delivery of core services; and ▸ PPT type models are easily adapted so can be tailored to meet the specific aspirations of the Council. For instance, there may be potential for this model to be applied to Council buildings, whilst retaining the land as a strategic asset.	▸ Existing flexibility in the NZ lease market may limit the benefits offered in the contract: Sub-leasing is widely accepted in the NZ market and offers a viable alternative to maintaining excess capacity within existing contracts; ▸ Council may have to pay market rental beyond the 20 year period (depending on agreement); ▸ Transfer of public assets to private sector likely to attract political attention; and ▸ A reasonable scale is required to justify the potential complexity of contract development.

Next Steps:

If this option is to be pursued, Auckland Council could

- *Identify the breadth of its office footprint;*
- *Assess whether a PPT is the most efficient method to deliver benefit from its property portfolio relative to other Asset Optimisation options (e.g. status quo, market sale), aligning with their wider strategy;*
- *Bring together property and commercial specialists to interrogate potential assets for a PPT transaction including identification and assessment of the assets; and*
- *If potential transaction exists, define key principles for structuring and delivering the transaction in the NZ market (e.g. assets transferred, outcomes at the end of the transaction).*

Option 4b: Self-Funding PPPs

Public Private Partnerships (PPPs) have been previously explored by the council, and should continue to be considered for suitable projects, transfer of risk is a key benefit.

PPPs offer a number of overarching benefits including (but not limited to):

- Significant risk transfer incentivises the private sector to manage risks effectively- including empirically effective incentives to complete on time and to budget;
- The long term nature of PPP contracts incentivises delivery cost effective whole-of-life solutions;
- Requirements are specified in the form of an output or outcome specification, providing wider opportunity to develop innovative solutions;
- Greater access to private sector experience and expertise; and
- Bundling and scale can lead to new entrants to the market from overseas enhancing value both in the specific project but also through enhancing skills and competition in the region.

While PPP's will typically include private project finance, which minimise the public funding required during the project construction period, in many cases this is repaid by the public agency over the duration of the project through payments spread over the concession period (for example through a unitary charge). Therefore, PPPs should not generally be considered a funding source. However, some projects suitable for PPP delivery can be partially or fully funded through the generation of additional revenue sources or cost savings. There is also increasing trend globally for PPP's to have a significant portion of the debt funded by the benefits of risk transfer through a smaller privately financed tranche.

In this paper we restrict our focus to self-funding PPP's. Self-funding PPPs can assist Auckland Council in delivering immediate outcomes with minimal budget impacts. For example:

- Roading projects: Capex could be provided for the project in return for the future toll revenue of the road (this will unlikely ever be a 100% funding option);
- Street lighting projects: Capex could be provided for the project in return for Council delivering payments to the private sector, offset by savings in their power consumption.

PPP Applicability

Some considerations when determining whether a project is suitable for delivery under a PPP model should include:

- Service specification: The project asset and services must be able to be well specified, measured and delivered to the private sector and unlikely to vary unpredictably over a long time period;
- Project scale: The project must be of suitable scale (in terms of asset and service provision) to sustain the transaction costs of developing, procuring and monitoring a PPP deal;
- Ability to transfer risk: PPP projects endeavour to allocate risk to be party best able to manage them; and typically transfer significant project risk to the private sector;
- Project Complexity: The project must be sufficiently complex to provide opportunity for an innovative solution, and conversely not be so complex that it limits value for money; and
- Value for money: Underlying to every PPP deal should be an efficient use of public resources.

Funding should not be the major motivation for PPP delivery. In some circumstances, the new infrastructure assets may be self-funding, but this is not widely applicable.

Option Identification:

AT is responsible for approx. 108,000 street lights and amenity lights. About 40% are used to service pedestrians (lower wattage) and about 60% are used to service vehicles (higher wattage). Operating and maintenance costs are around $28m per annum; 50% of which is subsidised by the New Zealand Transport Authority (NZTA). Approx. 2.5% per annum increase in load growth is forecast due to Auckland's growth resulting in electricity and maintenance costs of over $0.5m per annum.
There have been large technological advancements in lighting sector, in particular the Light Emitting Diode luminaries (LED) which is shown to have a number of whole of life benefits over the current High Pressure Sodium (HPS) lights. These benefits include:

- Reduction in electricity use (about 50% reduction);
- Reduced replacement and maintenance (1.8x longer life);
- Safer and more effective-(Emitting white light and less surface glare, which is internationally recognised as a safer environment for users at lower electricity use);
- A centralised control system, to manage light levels during low traffic period and the ability to better monitoring of energy use, and of detection of faults. (Emitting white light and less surface glare); and
- Connectivity and data collection.

AT has commenced the procurement of 40,000 of low watt LED. The current procurement model involves AT directly sourcing and contracting out installations of LED. We consider a self-funding PPP could be utilised in the procurement of the LED street lighting as an alternative.

Under a PPP, the parties enter into a long-term output-based contract for complete service delivery. The private sector is responsible for the design, installation and financing of new assets, as well as ongoing asset management, maintenance and operational services. The assets are paid for over the contract period on delivery of the services, rather than an upfront payment. Payment is typically structured to incentivise strong performance, resulting in high quality service outcomes. For street lighting, a PPP would mean a focus on the lighting service to be delivered, rather than the technical specification of the asset. If the lights are functioning and meet the specified service outcomes, the Service Provider will get paid; failure to meet the requirements would result in probable payment deductions. These services specifications could include realisation of energy efficiency and carbon emission and light pollution targets.

Figure 57: Advantages and Disadvantages of PPPs

Advantages	Disadvantages
Private sector expertise and innovation can reduce whole of life cost of the asset and services,	Dependant on the level of detail of specification required, the transaction process can be complex, timely and costly,
Council agrees service standards Provides long term cost certainty for the Council,	Private finance is normally more expensive than public finance,
Long term contract ensure a focus on whole of life approach to assets,	Limited market capacity,
Well specified risk allocation, ensures the correct party are best placed to bear them including design, financing, delivery of asset and technology obsolescence and operating risks,	The perception of loss of control of public assets,
Low complexity of operations of street lights limits interface risk (in comparison to other PPPs),	PPPs are generally long-term and make explicit the cost of change.
Potential for standardised street lighting and management systems,	Multiple stakeholders can be involved creating operating complexity.
The assets are handed back to Council at the end of the concession at a pre agreed condition.	Sufficient project scale means likely bundling required and might require consideration and interaction between multiple procuring entities.

It should be noted that with appropriate mitigants the disadvantages of PPPs can be reduced; for example the cost of establishing a PPP is considerable and should only applied as a procurement method in projects with economies of scale whereby the benefits would outweigh the PPP costs. We see value in a collaborative approach to the PPP. Combining other local councils, or even partnering at a national level will ensure that the costs of the PPP are justified; however consideration should be given to how this will be managed.

Private financing vs public financing only represents one element of the total cost of a project. Projects are subject to stringent value for money assessments and should only progress where the estimated cost of delivering the project as a PPP is lower than the estimated cost of delivering the project by traditional procurement methods.

International Case Study – Birmingham City Council

There are a number of comparable PPPs internationally. The United Kingdom has over 30 street lighting PPPs since 1998 averaging around £45m capital value per project. Birmingham (UK) is the second largest city in the UK with a population of 1.1 million. In 2010 the City Council began a 25 year PPP with Amey UK. The PPP of £2.7b covered a larger highway and maintenance contract.

Part of the PPP covered 95,000 street luminaries to be replaced, with half of these to be replaced in the first 5 year period. As a result of the PPP, savings in energy efficiency and reduction of costs by half (~£2m per year) was realised. This was due to the ability to dim street lights during off-peak periods, and the reduced maintenance costs. The lighting improved visibility and also increased community safety. There also has been a number of street lighting PPPs in Europe.

Next Steps:

If this option is to be pursued, Auckland Council could:

- *Investigate the possibility of amalgamating the road lighting interests with other road controlling authorities (such as other councils and NZTA) to minimise the procurement contracts required;*
- *Preliminary cost and benefit analysis;*
- *Market sounding on potential private partners; and*
- *Project plans including stakeholder consultations.*

Option 4c: Tax Increment Financing

A method in which gains in future tax revenues (or equivalently fee/rate revenues) resulting from a project are pledged to cover the capital costs (typically funded through borrowings).

In reference to the below diagrams (which are indicative only), projects capex will be funded through borrowings, in return for the tax revenue represented by the yellow area. Auckland Council benefits by:

- Being able to capture increased value derived from delivery of a project;
- Being able to work closely with the Private Sector in developing a TIF deal (including design, construction and financing); and
- Gaining a higher tax base following completion of the TIF.

Figure 58: Indicative profile of tax revenue for a TIF project

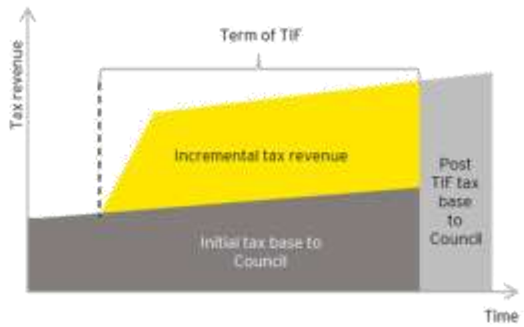
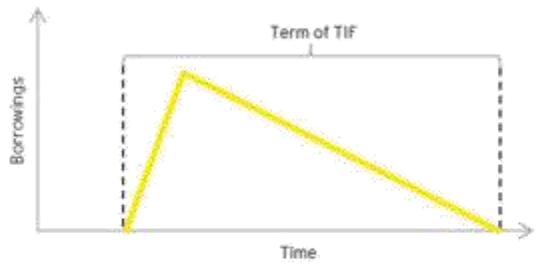


Figure 59: Borrowings over the lifetime of a TIF



The tax revenue stream used to capture the increment tax revenue is variable across models and geographies. There are effectively two popular variation of the TIF model:

- Delivered solely by Local Authority: A model where TIF is used as a financing tool to securitise future income that the local authority will be entitled to as a result of the development. This model is used across a large number of US states; there are thousands of 'TIF districts' created through urban development projects.
- Delivery by Local Authority in coordination with Central Government: A model in which, for the period of TIF, the local authority gets an income flow from central government that represents a portion of the additional tax take by central government as a result of this local investment. This model is more popular in the UK, and a variant of this approach can allow local authorities to benefit from a portion of the incremental tax take to central government on a project by project basis.

Both of these models are relevant to New Zealand, and specifically Auckland Council. Coordination with Central Government introduces more versatile mechanisms for capturing value increase through taxation; however it may introduce an interface issue which will add to the complexity of the delivery.

TIFs could be applied to a range of projects, particularly those which have strong marginal impacts on local land values and/or national tax take- including major transport and urban development projects.

International Case Study – Northern line (London)

In London, plans to develop a 195-hectare area on London's South Bank were being developed, but existing transport infrastructure was insufficient to maximise the redevelopment potential. Extending the Northern Line so it reached the site was seen as one solution, if it could be funded. The Greater London Authority withdrew a loan of up to £1b to develop the project, which would be funded in part through future growth in business rates (as well as planning gains and the community infrastructure levy).[40]

[40] Bilfinger GVA (2015) UK Infrastructure: Unlocking UK Cities and Commercial Property.

International Case Study – Buchanan Quarter (Glasgow)

This project focused on revitalising Buchanan Quarter in Glasgow's city centre, including investment in transport, public realm and cultural infrastructure to catalyse further private development.

A Local Authority TIF scheme seeks to capture additional non-domestic rates (NDR) revenue that would not arise without the delivery of the 'enabling 'infrastructure' that is required to unlock the development, contributing to sustainable economic regeneration.

The Buchanan Quarter TIF scheme will require public investment of £80m, but is expected to encourage over £300m of private sector investment for the city and deliver around 1,500 jobs. The project is expected to begin in late-2015.

Gross incremental tax gain NDR is forecast to be £9.6m, which is reduced to £6.1m accounting for uncollectable revenues and displacement. With Council borrowing costs starting at £5.85m per annum, the project is anticipated to be fully funded by the end of the 25 year TIF period.[41]

Figure 60: Advantages and Disadvantages of TIFs

Advantages	Disadvantages
Value capture mechanism to benefit from some of the additional value delivered to a local region, which may otherwise be captured as private benefit or by Central Government.	Under the current NZ rate system, increase in property value does not guarantee an increase in rate revenue for Council.
	Central Government may be reluctant to agree a "precedent" structure for local authority to benefit from other forms of tax.
Provides mechanism to agree bespoke "by exception" deals with Government to recognise the benefits to the national tax base of investment in Auckland economic infrastructure.	Property value assessments are slow to adjust in NZ (particularly compared to the US), and could make efficient implementation difficult.
	Risk that uplift in tax/rate revenue associated with the project is not realised, and shortfalls would have to be met using other Council funds.
Ability to work alongside the private sector to magnify successful outcomes.	The existing targeted rates system may provide a simpler mechanism of achieving similar outcomes.

Next Steps:

If this option is to be pursued, Auckland Council could:

- *Identify the scope and range of projects that could be applicable to TIFs;*
- *Undertake comparative analysis against alternative models – such as targeted rates – to assess whether TIFs are worth pursuing further; and*
- *Engage with central government – particularly in light of recent work done by the Productivity Commission "Using Land for Housing".*

[41] Glasgow City Council (2010). Buchanan Quarter Business Case V6.

Option 4d: Alternative sources of funding

A range of options exist to improve financial inflows for Auckland Council, with the potential to reduce rates revenue dependency.

Auckland Council has a diverse range of revenue sources outside of the core revenue generators of rates, fees and user charges.

We have only lightly touched on these initiatives in this report and have not provided a full assessment against our criteria because they are so project specific.

We note that there is good coverage of alternative sources of funding contained within the following reports:

- LGNZ: Local Government Funding Review 2015;
- Auckland Council Chief Economist: Housing supply, choice and affordability: Trends, economic drivers, and possible policy interventions (Auckland Council 2015); and
- New Zealand Initiative: In the Zone: Creating a toolbox for Regional Prosperity (2015).

Naming rights and corporate sponsorship

Without loss to the functional use of the assets themselves, Auckland Council (specifically Regional Facilities Auckland) has successfully generated revenue through the sale of naming rights to a number of assets. One of the most recent deals was ANZ Bank's purchase of naming rights of the $32m Viaduct Events Centre in 2014- the exact value of the deal is commercially sensitive although it has been publically cited as being in the 'millions'.

This type of activity could be extended to other assets – including:

- Corporate sponsorship and showcase of art in storage
- Sponsorship of enclosures at the Auckland Zoo
- Naming rights of train stations and other public infrastructure

Corporate sponsorship and showcase of art in storage

Currently 96% of all artwork on the Auckland Council balance sheet sits in storage. The total asset value is $350m and requires a large ongoing maintenance cost (in terms of storage and insurance) yet the public does not get a consistent chance to view these works through the current model. While we understand a 5-10% artwork rotation rate reflects standard practice, we believe corporate sponsorship of art work could help reduce operating costs, provide a one-off revenue boost to the Council and ensure that more art work is seen by the public.

Sponsorship of enclosures at the Auckland Zoo

Auckland Zoo is almost fully self-funded and has valuable relationships with existing commercial sponsors. However, the sponsorship of animals or enclosures could help reduce the need for any rate subsidy for major projects and on-going operation of the zoo.

International Case Study – Dublin Zoo corporate sponsorship

Dublin Zoo has a number of commercial sponsors on-board after running into financial constraints in the mid-2000's.

Their first major agreement was in 2011, when a new enclosure Gorilla Rainforest was sponsored by international tropical produce importer and distributor Fyffes. In 2013, Kellogg's Coco Pops was brought on board as sponsors of the South American House which underwent refurbishment. In 2014, the zoo announced The Natural Confectionery Company was the sponsor of the new Kaziranga Forest Trail.

Although the exact details of these deals are not publically available, Dublin Zoo's annual sponsorship income is estimated at €250,000.[42]

We recommend that the Council undertake a commercial assessment of the current sponsorship agreements at Auckland Zoo and explore the market for further commercial opportunities.

[42] http://www.irishtimes.com/business/media-and-marketing/dublin-zoo-seeks-elephants-sponsor-as-it-awaits-birth-of-three-calves-1.1771374

Naming rights of train stations and other public infrastructure

As well as continuing to seek commercial opportunities to sell naming rights to venues, Auckland Council could seek similar opportunities across non-traditional assets and infrastructure such as bridges, tunnels, and train stations.

International Case Study – Barclays Atlantic Avenue/Pacific Street Subway

In 2009, Barclays Bank paid the Metropolitan Transportation Authority (MTA) USD $4m for 20 years naming rights to the agency's Atlantic Avenue/Pacific Street subway station, one of Brooklyn's busiest.

We recommend that the Council undertake a commercial assessment of their asset base with potential naming rights, followed by a high-level market sounding for commercial interest.

Continuing to advertise on bus stops, buses and train stations

Auckland Transport's network of assets is large and highly visible- meaning it both requires extensive maintenance expenditure, and provides a unique advertising platform. Currently AT reduces opex cost by outsourcing maintenance of the bus stops to Adshell in favour of advertising rights. AT also collects revenue from advertising on the buses.

We recommend that Auckland Council continues to offer advertising opportunities across their asset portfolio, and encourage periodic reviews to determine value for money is being achieved under existing arrangements.

Review of targeted rates and development contributions

Auckland Council currently collects ~$212m p.a. in targeted rates and development contributions.

Continuing to ensure the right level of income is being generated from traditional mechanisms such as *Development Contributions* and *Targeted Rates* (Business Improvement Districts) presents an obvious opportunity for Auckland Council.

We recommend that periodic reviews of these revenue streams are undertaken to ensure that they remain fit for purpose.

Bed Tax

Many international destinations implement a 'bed tax' system (also referred to as a lodging tax or transient tax), where any stay with a commercial accommodation provider incurs a tax (potentially a flat fee, a percentage of room cost, or fee relative to room size). The theory is that that this revenue can be used to fund the city's infrastructure, particularly subsidising those which are heavily used by tourists- overcoming issues of transient visitors who do not provide local authorities with rates or user fees.

International Case Study – Las Vegas Bed Tax

Las Vegas has a 'Bed Tax' of approximately 12-13% on accommodation within the city. Estimated revenue of some USD $200m (2013), of which approx. 35% goes into tourism and the remainder goes into local government, schools and transportation infrastructure. This significant revenue is heavily influenced by the unique tourism profile of the city.

The revenue potential for Auckland Council is moderate. The table below illustrates how a various percentage-based schemes rates translate into revenue for Auckland Council.

Figure 61: Revenue Potential from Bed Tax[43]

Bed Tax Rate	2%	5%	10%
Potential Council Revenue	$10m	$25m	$51m

Legislative barriers exist to implementing such a tax. In 2002 the Government rejected a proposal from the parliamentary select committee on the Local Government (Rating) Act 2002 to allow for such a tax, apparently on the grounds that such a tax was too "industry specific" and might create a threat to the tourist industry. It was also not supported by the Panel of a 2007 Independent Inquiry into Local Government Rates, who noted targeted rates on the business or tourism sector could be used to the same effect.

[43] Revenue is gross of collection costs and assumes no displacement or demand impacts. Derived from national accommodation services spending detailed in the Tourism Satellite Account, and regional guest night estimates in the Accommodation Survey.

We recommend that Council continues to engage with the tourism industry and the wider public to consider strategies for capturing revenue from Auckland's transient population.

Road Tolls

Auckland Council has actively considered tolling options for generating revenue and relieving congestion. Refer to the Auckland Council commissioned report Road Charging Options Study: Scheme Design and Costing (Deloitte, 2013) for further discussion on some of the potential option and implications for Auckland. Although motorway tolls as publically discussed met some challenges from central government, we acknowledge there are a vast variety of forms for such schemes, and encourage Auckland Council to continue to consider schemes of varying scales for further investigation.

International Case Study – Stockholm Congestion Tax

The Stockholm congestion tax scheme, generates estimated public revenue of SEK 540m public revenue net of operational costs, and generating a socioeconomic surplus (assessed through cost benefit analysis) of SEK 683m[44]. Since its implementation in 2006, the zone has also consistently seen a reduction of non-exempt traffic, adjusted for external factors, of 27%. (Exempt vehicles at the time of the study included emergency service vehicles, buses, motorcycles, foreign registered vehicles and electric vehicles).[45].

We recommend that Auckland Council focus on road tolling and associated technology for further investigation and active pursuit. This should include developing a knowledgebase of international case studies, assessing applicability of strategies across Auckland and undertaking on-going discussions with central government.

Revision of non-rateable land

The Local Government (Rating) Act 2002 currently sets out various categories of non-rateable land where Councils can levy targeted rates for water, sewerage and refuse collection on non-rateable land, but cannot levy any other type of rate.

The Local Government Funding Review (2015) identifies the non-rateable land within five main categories:

- conservation, health and education land, including Crown land that is used broadly for conservation and recreational purposes and land owned or used by District Health Boards or not-for-profit educational institutions, from early childhood to schools, to tertiary institutions;
- land used for religious worship and religious education, or for charitable purposes;
- land that is used for transport infrastructure (roads, wharves, railways and airports);
- land used by a local authority for conservation and recreational purpose; and
- Māori land of various types.

The review concludes:

> *"With the possible exception of exemptions on Māori land, LGNZ does not see a coherent, principles-based argument to support statutory rates exemptions. Central government should take responsibility for the full cost of providing conservation, health and education services, rather than requiring a "back-door" contribution from local government. Transport services should pay their way as part of the community. Further, local communities should have the autonomy to decide if they wish to subsidise religious and charitable groups."*
>
> *The Local Government Funding Review (2015)*

We particularly support the view that further investigation is required into the commercial benefit that is being transferred to the private sector in the transport industry, regarding airports and wharves in the Auckland Region. We acknowledge existing legislative barriers to progressing change in this area.

We recommend Auckland Council continue to actively progress investigations into the equity and commercial outcomes resulting from the non-rateable land restrictions and play an active role in leading conversations on this topic.

[44] Eliasson, J., 2009. A cost-benefit analysis of the Stockholm congestion charging system. Transportation Research Part A: Policy and Practice, 43(4), pp.468-480.
[45]Data up to 2012, from Borjesson, M., Eliasson, J., Hugosson, M. B. & Brundell-Freij, K. (2012). The Stockholm congestion charge – 5 years on. Effects, acceptability and lessons learnt. Transport Policy, 20: 1-12. DOI: 10.1016/j.tranpol.2011.11.001.

Regional fuel tax

Adoption of a regional fuel tax would be expected to deliver a relatively stable revenue stream for use in transport spending across the region.

Regional fuel tax has been considered and adopted previously, with mixed views on the overall effectiveness. A regional fuel tax administered at a wholesale level was repealed after three years in the mid-1990s; with reports of petrol wholesalers spreading the cost across the whole country through pricing arrangements, undermining the local impact of the mechanism and disadvantaging small local operators unable to spread the cost. Research suggests Imposition of a regional fuel tax in the current market would be less likely to result in price spreading (Ascari & Berl, 2012).

Legislative barriers exist for this option, as the provision for regional fuel taxes within the Land Transport Management Amendment 2003 was repealed in the Land Transport Management Amendment Act 2013.

Estimates on the potential revenue to Auckland Council are shown in Figure 62 below.

Figure 62: Regional fuel tax revenue potential [46]

Rate (cents/litre)	2	4	6	8	10
Potential Revenue	$32m	$64m	$96m	$128m	$160m

A regional fuel tax also faces a challenge in its long-term sustainability as a major revenue source. As cars become increasingly fuel efficient, and with some forecasters predicting a substantive industry shift toward electric vehicles within the next decade, fuel consumption may limit future revenue streams.

The recent inception of the Auckland Transport Alignment Project will be in a prime position to consider the merits or otherwise of any regional fuel tax.

Negotiate shares of revenue from central government – travel tax

Budget 2015 contained a provision for a border clearance levy, or 'Travel Tax'. The Travel Tax is expected to take effect from 1 January 2016, and will add around $20 to the cost of international travel for every return traveller.

As an international gateway, Auckland could look to start dialogue with central government about whether any proportion of this tax could be ring-fenced for regional expenditure – particularly capital expenditure that improves the attractiveness of Auckland as a gateway to New Zealand. This spirit of partnership should only be pursued if there are genuine synergies that will maximise the tourism spend to Auckland and New Zealand.

[46] Revenue is gross of collection costs and assumes no displacement or demand impacts. Estimates based on annual fuel consumption of 1,600 million litres, from Auckland Transport's Transport Indicators Report June 2015.

Appendices

Appendix A: Data constraints, Assumptions and Bibliography

Data constraints

The analysis undertaken in this report has been largely informed by:

- Interrogation of the Council's finances, policies, plans and publicly available information;
- Face to face interviews with over 25 stakeholders from Auckland Council, and from the wider Auckland Council. This exercise involved over 150 hours of person hours and has significantly contextualised our findings;
- JLL's research and analysis; and
- EY's internal investigations and findings.

We have relied on information provided to us and have deferred to publicly available information where possible. We have not sought to establish the reliability, accuracy or completeness of the publicly available information. No independent valuation of this information has been conducted. Consequently, we give no assurance on such information.

Figures in relation to FY2014 and FY2015 data is sourced from the Auckland Council's draft 2014/2015 annual report, or otherwise stated. Long term plan figures are sourced from the Auckland Council's 10 year budget, long term Plan 2015-2025 for the period 2016-2025, or otherwise stated. Wherever possible, we have used the assumptions consistent with the LTP's assumptions, or otherwise stated. We will take no responsibility for any differences from draft and actuals, forecasts and actuals, or Long term plan forecasting assumptions.

It is recommended that detailed due diligence be undertaken if a commercial path is required.

Assumptions

A range of specific assumptions have been identified in text – where these have been extensive, we have noted these below.

Page	Issue	Assumptions
27; 80; 81	Golf Course Valuations	▶ The estimated market value of these courses assumes a hypothetical residential development. ▶ The 'retail' or finished value of these courses is likely to be significantly higher than the $ per sqm Estimated Market Value given here. Remuera for example is likely to see finished sites range from $1,500-2,000 per sqm, Waitemata $1,200-$1400 per sqm and Northcote $1,000-$1,500 per sqm. ▶ The difference between the 'wholesale value' and 'retail value' reflects an adjustment for yield, site size, development costs, development contributions, infrastructure, sales costs and developers profit. ▶ These large land plots are likely to carry a higher value than a typical green field subdivision due to the developed nature of the surrounds i.e. built up urban frame. They will have more ability to capture demand than green field development on the urban fringe. ▶ Sites such as this will often take as long as 7-10 years, or an entire property cycle to develop and as such reflect high levels of risk. ▶ There are no recorded unconditional transactions of residential land of this size in the Auckland Isthmus. ▶ The market value of these sites likely needs to be tested in more detail. We likely recommend Council seeks to value the entire network as a whole and then seeks a plan to sell these sites down. Market capacity to absorb more than one of these sites at a time needs to be considered in any long term strategy.

Page	Issue	Assumptions

75-83	Auckland Council and Related Accommodation Footprint	- Current occupancy ratios for Council premises are reported to be at 15 sqm per person (Auckland Council Corporate Property Report). In the private sector an acceptable occupancy ratio is closer to 12 sqm per person.
		- There are several ways of improving the level of density within office space ranging from reducing circulation space through to work station design and hot desking techniques. A lot of these gains are achieved through better use of space however often building design is the major impediment to increased efficiency in the long term.
		- This shift from 15 sqm to 12 sqm per person would imply a 20% saving through the more efficient use of space.
		- Council also noted that occupancy was at 87%. This suggests that in a property such as 135 Albert Street there is as much as 2,675 sqm of underutilised space – gross occupancy costs for space of this size in a grade A building in the CBD is likely to be over $1.6m.
		- The above calculation implies a target occupation rate of 95% and a total occupancy cost of $600 per sqm.
		- The occupation of more modern buildings or properties that are more suited to Council's way of working is likely to result in efficiency gains.
		- Several international local government examples have targeted and achieved 20% savings in costs.
		- If we assume Council can shrink their footprint by 20% total space savings using the large properties noted above, are likely to be 19,500 sqm. Using a total occupancy cost of $500 per sqm across this portfolio total savings is likely to amount to $9.75m per annum.
		- We have looked to the largest targets for the purposes of this analysis. There are several other properties which Council occupy not included in here. These include but are not limited to 21 local area board offices, Panuku Development (Pier 21), COMET, The Independent Māori Statutory Board and several other small CCO's. These sites should be included in the analysis also with the potential savings likely to be significant.
		- Using Council / CCO's large footprint to procure an accommodation solution is likely to drive down per sqm accommodation costs as well as defining Council occupancy standards. As such the $550 per sqm gross occupancy cost currently being paid at No 1 Queen Street could be pared back to something around the $450 per sqm mark should the Council purchase:
		    - less impressive premises,
		    - premises closer to 135 Albert Street
		    - refurbished premises that reflect a B Grade rather than an A Grade standard

Throughout the report	Forecast Interest rates and dividends	- Interest rates assumptions are consistent with the long term plan 2015-2025 assumptions; and - Dividends have been sourced from various SOI's then forecasted at the GDP rate sourced from the long Term Plan 2015-2025, or otherwise stated.

Page	Issue	Assumptions	
45 - 50	Recent Port Transactions	Port of Darwin	Port of Darwin was privatised for AUD $506m under 99 year lease 25x EBITDA multiple
		Port Botany and Port Kembla, 2013	Port Botany was privatised for AUD 4.31b and Port Kembla for AUD $0.76b both under 99 year leases 25x EBITDA multiple
		Port of Newcastle, 2014	Port of Newcastle was leased for AUD $1.75b under a 98 year lease 27x EBITDA multiple
		Port of Abbot Point, 2011	Port of Abbot Point was leased under a 99 year lease to Adani Group for $1.8b 28x EBITDA multiple
		Port of Brisbane, 2013	Canadian pension fund CDPQ acquired a 26.67% in the Port of Brisbane for AUD $1.4b 27x EBITDA multiple
		Port of Lyttleton, 2014	Christchurch City holdings acquired a 20% stake in the Port for NZD $82m 2x EBITDA
		Flinders Adelaide Container, 2012	60% stake in Flinders Adelaide Container Terminal AUD was settled for AUD 130m 11.2x EBITDA multiple
		Port of Portland, 2012	Pallaside Port acquired a 50% stake in the Port of Portland for AUD $67m 6x EBITDA multiple
		Port of Geelong, 2012	35% stake in Port of Geelong was settled for AUD $24.9m 5x EBITDA multiple
		DP World Australia, 2010	A 75% stake was settled for AUD $1.5b 19x EBITDA multiple
		Jiangsu Lianyungang Port Co, 2015	5% stake in the company was settled for CNY ¥441m 46x EBITDA multiple
		Integrax Bhd, 2015	78% stake was settled for MYR RM761m 13x EBITDA multiple
		PT. Pelayaran Nasional Bina Buana Raya Tbk, 2014	39% stake was settled for IDR 194,972million 7x EBITDA multiple
		EMS Seven Seas ASA, 2014	82% stake was settled for NOK 112m 12x EBITDA multiple
		Muelles de Penco S.A., 2014	7% stake was settled for CLP 1.1b 3.9x EBITDA multiple

Source: S&P Capital IQ and publically sourced information.

Item 15

Attachment B

Grouping of activities

Below is our assessment and categorisation of LTP activities and their description for analysis in this report.

Auckland Council Group

Corporate/Governance	
Regional governance	Running elections, providing support to the mayoral office, councillors, CCOs and elected members
Local governance	Provide support to 21 local boards such as strategic advice, preparation of local board plans, developing local board agreement and community engagement
Organisational support	Operational functioning of the council and the council's internal services managed by organisational support

Planning Development and Regulation	
Regional planning	Regional planning such as the Auckland Plan, Unitary Plan, Infrastructure Strategy and area spatial plans produced by Regional planning
Local planning & development	Develop local business precincts and town centres
Regulation	Regulation includes a range of function such as resource and building consents, environmental health, animal control, street trading and licensing

Environmental, social and community	
Solid waste and environmental services	Manage kerbside domestic refuse, recycling, hazardous and inorganic waste, public litterbins and loose litter
Stormwater management	Manage the stormwater system and network to minimise the risks of flooding
Local environmental management	Habitat restoration, species management, native planting, water quality improvements delivered by local environmental management
Regional community services	Deliver regional library activities, regional events (etc Movies and Music in Parks), regional festivals (etc Waitangi Day events)
Local community services	Deliver local library services, local art and culture programmes, local events (etc Christmas events)
Regional parks, sport and recreation	Manage regional parks, Auckland Botanic Gardens, cemeteries, memorial areas
Local parks, sport and recreation	Manage local parks and open space and local recreation activities such as swimming pools and leisure centres

Council Controlled Organisations

ACIL	Investment	Investment holdings in POAL, AIAL and Auckland Film Studios Limited managed
AT	Public transport and travel demand	Public transport (bus, rail, ferry) delivered by AT
	Roads and footpaths	Roads, footpaths, cycling and safety delivered by AT
	Parking and enforcement	On-street/off-street parking and enforcements managed by AT
Watercare	Wastewater treatment and disposal	Waste water services delivered by Watercare
	Water supply	Water supply services delivered by Watercare
PDA	Property development	Town centre revitalisation and property management delivered by Panuku Development Auckland
	Waterfront development	Wynyard Quarter development delivered by Panuku Development Auckland
ATEED	Economic growth	Major events, tourism and business
RFA	Regional facilities	Regional facilities such as Zoo, Art Gallery, Mt Smart, QBE stadium, Viaduct Events Centre, Civic Theatre, Bruce Mason managed by Regional Facilities Auckland

Auckland Council
Alternative Sources of Financing

EY 115

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Publications

We have leveraged EY and Jones Lang LaSalle knowledge and resources across a number of elements of this engagement. We have supplemented this investigation with the following reports:

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We also received a range of specific and discrete data requests from Auckland Council which is too numerous to note here.

Legislation and Regulation

We have investigated, or remained cognisant of the following pieces of legislation and regulation.

- Land Transport Management Amendment Act 2013
- Local Government Act 2002
- Local Government (Auckland Council) Act 2009
- Local Government (Financial Reporting and Prudence) Regulations 2014
- Local Government (Rating) Act 2002
- Public Works Act 1981
- Resource Management Act 1991
- The Hauraki Gulf Marine Park Act 2000The Port Companies Act 1988
- Waikato-Tainui Raupatu Claims (Waikato River) Settlement Act 2010

Appendix B: Community Facilities – Background research[47]

The following map(s) and tables provide elementary locational data on the distribution of the Auckland Region's library network. The network has been divided into North, South, Central and West. The four mobile library services (that travel throughout the region) are not shown.

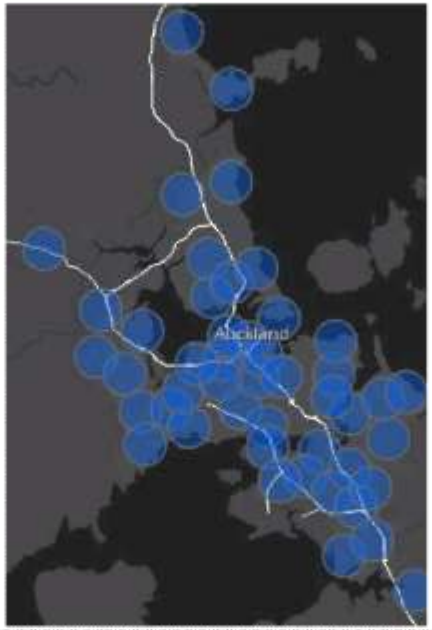
Map 1: Library distribution

Map 2: Population distribution (2013)

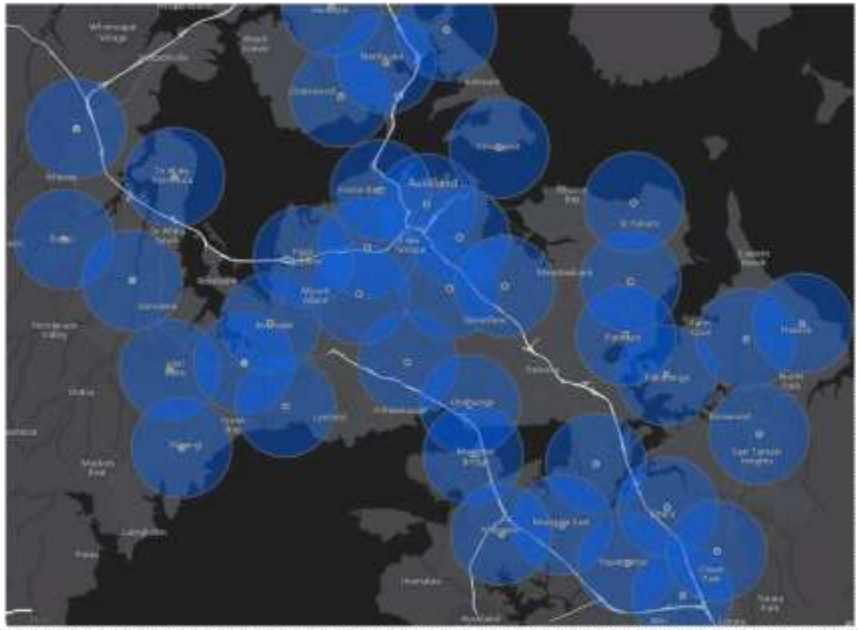
[47] Analysis has been provided by JLL Research and Consulting.

The following map(s) provides a two km radius around each library location, thus providing an illustration of the networks coverage.

Map 3: Two Kilometre Radius of Auckland Regions' Library Network



Map 4: Two Kilometre Radius of Auckland Regions' Library Network

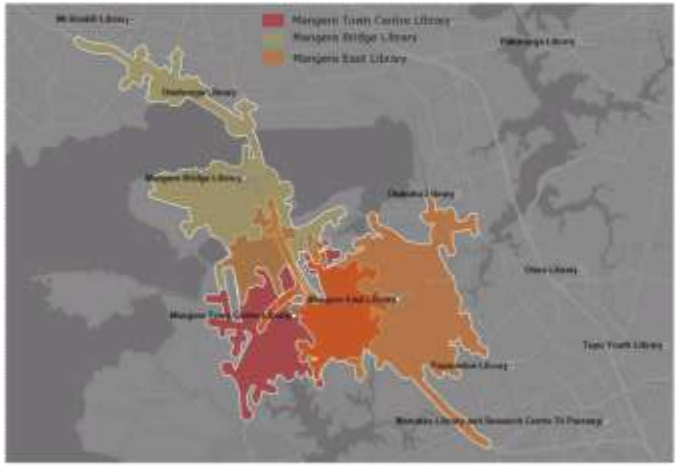


Map 5: Five Minute Drive Time Network Coverage

Map 6: Preliminary Catchment Areas – 5min Drive Time

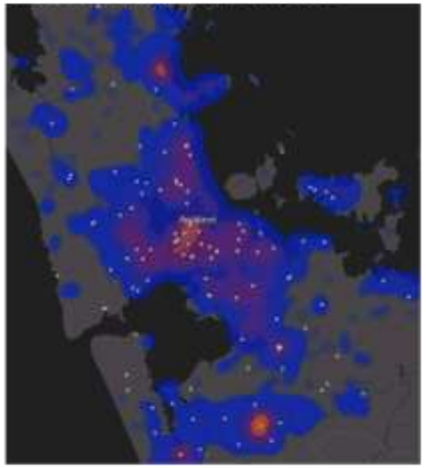
It is clear from maps 4 and 6 that a large number of the Auckland Region libraries share over lapping areas when a two km radius or five minute drive time area is applied across the network. Map 7 highlights an example of this.

Map 7: Overlapping Five Minute Catchment Areas – Mangere Example



Map 8: Community Hall Distribution

Map 9: Population Distribution 2013



Maps 8 and 9 provide elementary locational data on the distribution of the Auckland Region's 136 Community Hall network.

The following maps provide a two km radius around each Community Hall location, thus providing an illustration of the networks coverage.

Map 10: Two Kilometre Radius of Auckland Regions' Community Hall Network

Map 11: Two Kilometre Radius of Auckland Regions' Community Hall Network

The following maps show the walk time and drive time coverage around community halls.

Map 12: 15 Walk Time Network Coverage

Map 13: 5 Minute Drive Time Coverage

Appendix C: Acknowledgements

This project has been informed by over 25 interviews with over 35 stakeholders from across Auckland Council. We acknowledge the time and energy donated by these people in the development of this report. Despite this contribution, the views expressed in this report remain ours and in accordance with our Disclaimer.

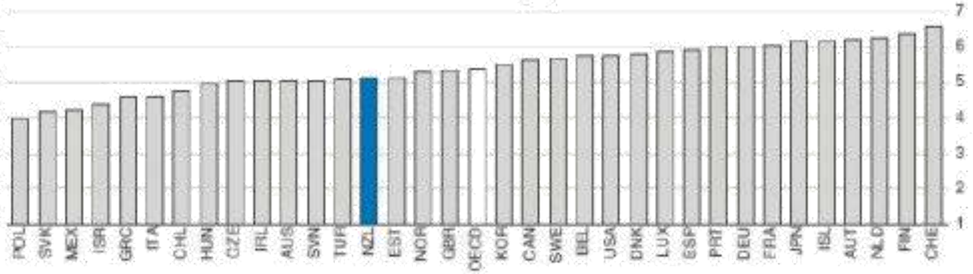
We were unable to meet with Auckland Energy Consumer as part of this review.

Appendix D: OECD Infrastructure Survey

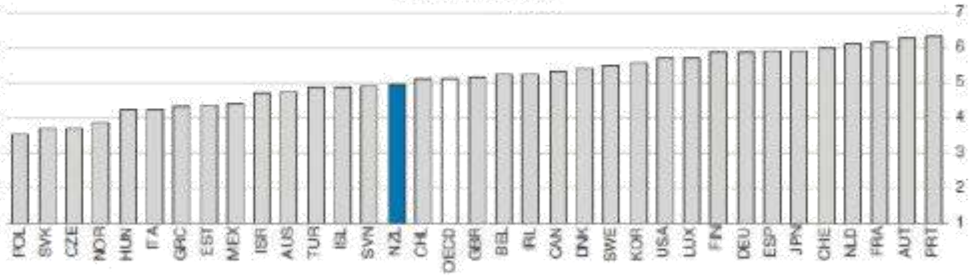
The Organisation for Economic Cooperation and Development (OECD) occasionally reviews the economic performance of member countries. In May 2015, New Zealand's most up-to-date *Economic Survey* was released.[48] A notable conclusion was that New Zealand needed to "Removing bottlenecks to sustain the economic expansion". Housing and transport investment were cited as key infrastructure bottlenecks.

The following charts reflect this finding as they show the perceived quality of New Zealand's infrastructure is lower than the OECD average.[49]

A. Perceived quality of overall infrastructure
Score from 1 to 7 (best)



B. Perceived quality of road infrastructure
Score from 1 to 7 (best)



[48] This report can be accessed through the following link http://www.oecd.org/eco/surveys/New-Zealand-2015-overview.pdf
[49] This information was ultimately sourced from the World Economic Forum (2014) "The Global Competitiveness Report".

Appendix E: Glossary of terms

Term	Definition
AC	Auckland Council
ACIL	Auckland Council Investments Limited
ACPL	Auckland Council Property Limited
AECT	Auckland Energy Consumer Trust
AIAL	Auckland International Airport Limited
AMETI	Auckland Manukau Eastern Transport Initiatives
ATEED	Auckland Tourism, Events and Economic Development
AT	Auckland Transport
BBC	Better business case
CAPEX	Capital Expenditure
CASS	Central Agency Shared Services
CBD	Central Business District
CRL	City Rail Link
CaPA	Communications and Public Affairs
CAGR	Compound average growth rate
CCO	Council Controlled Organisation
CCTO	Council Controlled Trading Organisation
DPA	Development Property Auckland
DFAP	Diversified Financial Assets Portfolio
EBIT	Earnings Before Interest and Tax
EBITDA	Earnings Before Interest, Tax, Depreciation, and Amortisation
EOBR	Electronic On-Board Recorders
EY	Ernst and Young
GFC	Global Financial Crisis
GST	Goods and Services Tax
GDP	Gross Domestic Product
HPS	High Pressure Sodium
HR	Human Resources
IMSB	Independent Māori Statutory Board
ICT	Information and Communication Technology
IAF	Infrastructure Acceleration fund
JV	Joint Venture
LTMA	Land Transport Management Act 2003

LED	Light Emitting Diode
LGA	Local Government Act 2002
LGFA	Local Government Funding Agency
LGNZ	Local Government New Zealand
LTP	Long term Plan
MTA	Metropolitan Transportation Authority
NIP	National Infrastructure Plan
NPV	Net Present Value
NSW	New South Wales
NZD	New Zealand Dollar
NZX	New Zealand Exchange
NZTA	New Zealand Transport Agency
NDR	Non- domestic Rates
NSC	Northcote Shopping Centre
Opex	Operating Expenditure
OECD	Organisation for Economic Co-operation and Development
PDA	Panuku Development Auckland
p.a	per annum
POAL	Ports of Auckland Limited
PV	Present Value
PRIME	Private Sector Resources Initiative for the Management of the Estate
PMCOE	Property Management Centre of Excellence
PPT	Property Portfolio Transaction
PPE	Property, plant and equipment
PPPs	Public Private Partnerships
RFA	Regional Facilities Auckland
RAB	Regulatory Asset Base
ROI	Return on Investment
RFR	Rights of First Refusal
Sqm	Square meter
SOI	Statement of Intent
STEPS	Strategic Transfer of the Estate to the Private Sector
SWOT	Strengths, Weaknesses, Opportunities and Threats
SACL	Sydney Airport Corporation Limited
TIF	Tax increment financing
Ofwat	Water Services Regulation Authority
WACC	Weighted Average Cost of Capital

Appendix F: Additional Options for consideration

We summarise those opportunities which did not make our shortlist under the following three categories:

- Out of scope: Those options which fall outside of the scope of this engagement.
- Lack of information: That issue where we heard and identified potential opportunities, but we did not have a full suite of information was not available to make suggestions over next steps or undertake detailed analysis. Further analysis might reveal potential worth exploring.
- Existing work stream: Those issues where we heard and identified potential opportunities, but we note that Auckland Council is addressing these through current initiatives.

Out of Scope	Lack of Information	Existing Workstream
Structural reform to the Council: The structure of Local Government may not be conducive to perfectly efficient decisions from an economic or financial perspective. However, Local Government has to balance a range of interests that are a lot wider than purely economic and financial. We have not investigated this any further.	Renegotiating existing property leases: We have not explicitly investigated discrete leases with a view to renegotiate them. We have taken a more holistic view of Auckland Councils property portfolio and pricing strategies, suggested a number of solutions which are broader than this one.	Procurement: Procurement will be vital to Council improving its operational performance. Positive strides are already being made – estimated that $180m has been saved for Auckland Council. We have not delved deeper into this topic.
Council being a 'lead' developer: If the Council wanted to be truly 'commercial', it could create a fund to purchase land alongside transport corridors and 'lead investment'; it could then capture the value uplift and sell the property for a capital gain. We note this issue was canvassed as part of the recent Auckland Council Chief Economist report: Housing supply, choice and affordability: Trends, economic drivers, and possible policy interventions (Auckland Council 2015).	Stormwater: Information was not readily available so we can't do a full assessment. Further investigation into this activity might reveal potential opportunities worth exploring in more detail. We do note however that: - There appear to be a range of theoretical synergies between the Stormwater division, AT and Watercare. We understand that there is already some alignment of operations (including the timing of various civil works) but these synergies could potentially be improved. - Stormwater team currently has a staff of 50-100 people	Social Housing: Auckland Council has a diverse role in social housing. From an asset management perspective, it owns approx. 1,500 rental units and 157 owner-occupied units across Auckland valued at $149m. Auckland Council is currently partnering with the private sector and the not for profit sector in the redevelopment of the Wilsher Village in West Auckland which will cost an around $34m. We support these efforts for greater partnership.
Legislative amendments to shorten the process to divest land: Concerns were raised about having to go through cumbersome processes to divest assets (Public Works Act in particular). Any amendments to the Public Work's Act is outside of the scope of this engagement.	Seismic impact and contingencies: We have not investigated whether there are any solutions to reduce the contingency budget for seismic strengthening or for contingencies like Leaky homes.	Risk management: Auckland Council has a Treasury function's approach to risk management is broadly in line with best practice.
	Wider public transport procurement: Auckland Council could insource various public transport capex (busses and ferry) as well as the operations of these assets. We did not receive any information to support this notion. A fuller investigation should be undertaken before formal judgment is passed.	

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