



Background
information

**Draft
New Plymouth District Council
(Perpetual Investment
Fund) Bill**



Te Kaunihera-ā-Rohe o Ngāmotu

**New Plymouth
District Council**

This paper provides further information on the background of the Perpetual Investment Fund, and options Council has considered in developing the draft New Plymouth District Council (Perpetual Investment Fund) Bill.

This should be read in conjunction of the “have your say” document at <https://www.npdc.govt.nz/community/have-your-say>

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Part 1: History of the PIF

Purpose

1. The purpose of this part is to provide a brief history of the development of the Perpetual Investment Fund. This includes a brief overview of Council's early investments; Council's shareholding and sale of PowerCo; the management of investments; annual release and balance of investments over time; and the establishment of the PIF Guardians.

PowerCo and the establishment of the PIF

Early investments

2. New Plymouth District Council's early investments included Taranaki Energy Limited, Apex consultants, Hobson Investments, New Plymouth airport (joint-venture with the Crown), four forestry joint-ventures, and Council's own forestry plantations. Council had also inherited staff housing loans and rural housing loans from former authorities at amalgamation.
3. At the November 2000 Council meeting, the Audit Director of Audit New Zealand was minuted as saying "that New Plymouth District Council stands out from other local authorities because of the complexity of its business portfolio, trading enterprises and joint ventures...[and that]...the management and monitoring standards were excellent and a credit to the Council and management".
4. In Council's 2001/2002 Annual Plan and Funding Policy Council stated that "income from each investment will be applied against current expenditure...at the present time the council contemplates maintaining each of its investments at least for the medium term. If they were to be sold, sale proceeds would be subject to the council's direction at that time".

Council's shareholding of PowerCo

5. PowerCo arose from the energy reforms of the 1990s. New Plymouth Energy (the electricity division of Council) merged with Taranaki Electricity (former Taranaki Electric Power Board) to become Taranaki Energy Limited (TEL) in April 1993. In 1995 TEL merged with Whanganui-based PowerCo (the former Wanganui Electric Power Board) to become PowerCo Limited. During the 1990s and early 2000s PowerCo acquired a number of North Island network assets and expanded its investments to Australia.
6. Council held 120.67 million shares or 38.2 per cent of the total number of shares in PowerCo. Council was the largest individual shareholder, with the next largest shareholder having an interest of 11.8 per cent. The shareholding in PowerCo included 62.5 per cent cash and 37.5 per cent in Prime Infrastructure Limited securities (SPARCS). The primary purpose of Council's investment in PowerCo was to generate commercial returns, in the form of dividends so as to minimise Council's rating requirement.

7. In 1996/97 Council transferred ownership of its shareholding in PowerCo to Pukeariki Holdings, an investment company that owned and managed Council's shareholdings in PowerCo. Council held 89 per cent of shares in Pukeariki Holdings, with Infratil owning 11 per cent of shares. Pukeariki Holdings was wound up in the 2000/01 year.

NPEAL

8. The New Plymouth Equity Advisors Limited (NPEAL) was formed in December 2000 as a Local Authority Trading Enterprise (LATE).
9. NPEAL's purpose included the provision of quality and timely advice to Council on its equity and risk based investments in PowerCo, Apex consultants, Hobson investments, New Plymouth joint venture airport, four joint venture forestry ventures, and Council's own forestry plantations. NPEAL contracted other specialist legal and financial advisors to provide the basis for its advice to Council. The company transitioned to a Council Controlled Organisation (CCO) as of 1 July 2003 pursuant to the Local Government Act 2002.
10. The Standard & Poors documentation of 2003 advised that "the above model has worked extremely well and has enabled the Council to deal with the dual responsibilities of proper accountability and effective commercial enquiry / decision-making".

The process of selling PowerCo shares

11. Price Waterhouse Cooper (PWC) on behalf of NPEAL conducted a periodic hold/sell review in 2003 which considered whether PowerCo shares should continue to be held as an investment. The review which also considered general options for investment in a more diversified portfolio, led to NPEAL recommending that Council sells its shares in PowerCo.
12. Council's stated objective for the sale of its shareholding in PowerCo and its subsequent re-investment was to "diversify the Council's investment with a view to reducing its exposure to a single company and industry, while maintaining at least a comparable level of investment income."
13. As of 2003 Council, Taranaki Electricity Trust (TET) and PowerCo Wanganui Trust collectively owned 53.65 per cent of the shares in PowerCo Limited, guaranteeing control of the Company to an acquirer.
14. The sales process was managed by PWC and involved a process of marketing, a confidentiality deed poll, and roadshows to interested parties in Australia and Asia. Expressions of interest were sought, followed by indicative bids. . These were evaluated and a due diligence process was conducted with short listed bidders. The final takeover notice was issued around 16 August 2004.
15. The proceeds of the sale for Council was made up of 62.5 per cent cash (\$162.144 million) and 37.5 per cent in SPARCS (\$97.286 million).

The Perpetual Investment Fund

Establishment

16. Given the pending sale of PowerCo shares, PWC advised on a new investment strategy for Council, recommending a structure comprising of an investment management company, not dissimilar to NPEAL, contracting to Council to monitor and manage investments directly owned by Council.
17. PWC considered that this structure allowed for the investment process to be successfully separated from Council, "making it more difficult for its representatives to dictate investment and income policies". PWC advised that "by having its own investment company, NPDC should be able to manage its investment portfolio at a lower cost than possible through using professional managers".
18. This advice named the company as the Taranaki Investment Management Company (TIML) and advised that TIML should initially have four directors, all of whom are independent of Council. The existing three directors of NPEAL were recommended, however one had identified impending retirement from the board.
19. The main difference noted between NPEAL and TIML was that TIML had an active decision-making responsibility in the wider investment market and an overall investment objective that required above-average performance.
20. PWC recommended this approach as:

"In our view, one way of protecting the funds from future dissipation risk is to create a strong moral obligation to leave the funds untouched. Using the proposed structure, the investment process is successfully separated from the Council, making it more difficult for its representatives to dictate investment and income policies. The use of the Investment Management Company and the ESC [Council's equity subcommittee] to separate the funds from the Council provides a clear demarcation between the Council and the investments".
21. On 2 November 2004 NPEAL resolved to change its name to TIML and an additional director was appointed the following day.
22. TIML was a CCO of Council, with the role of providing investment management services for the PIF and advisory services for Council's other investments.
23. The PIF was established on 9 November 2004 with the sales of Council's PowerCo shareholdings of \$259.425m. The opening funds of the PIF comprised of \$250.25m capital and \$9.175m in interest-bearing debt.
24. The founding principles of TIML included to establish and maintain the PIF as a pure investment owned by Council for the long term benefit of the people of the New Plymouth District; to deliver at least \$19.3 million in annual income to Council; and

to invest and manage the fund on a prudent, commercial, diversified and long term basis that enables the fund to grow in long term value.

25. At its inception, Council put out a press release, with the following quote attributed to the then Chief Executive:

“We’re setting our sights high on this one but when you do the maths it’s definitely an achievable goal.

At present general rates make up around \$45 million per year – some \$20 million from investment income and about \$25 million from ratepayers.

Our advice, and we have some of the best available in the country, is that the Perpetual Rates Reduction Fund is capable of producing gross earnings of 10.65 per cent per year.

On the \$259 million Powerco proceeds, this would achieve a return of more than \$26 million in the first full year of investment – i.e. a \$6 million surplus on our current \$20 million investment income.

This \$6 million would be added to the fund and, assuming we maintained the same levels of return going forward, this surplus would increase year on year.

By 2020 we could have a fund of \$590 million – and this is the point at which, if the council chooses, it would no longer need to ask the ratepayer for the annual \$25 million worth of general rates money.”

TIML Management of the PIF

26. TIML’s initial focus was the investment of cash, and the sale and diversification of SPARC (with this largely completed by mid-2006).
27. In 2007, Council instructed TIML to appoint its own Chief Executive and to separate the structure from Council.
28. The initial release rule for the PIF was set in 2004 by resolution as “to deliver at least \$19.3 million in annual income to the Council”. The LTCCP04-14 and LTCCP06-16 both assumed the release would be \$19.3 million inflation-adjusted per annum. This flat release rule (in real terms) meant Council did not receive any additional release as a result of higher returns, but also did not lower its release in light of lower (or negative) returns.
29. The Global Financial Crisis saw a significant decrease in the value of the PIF’s investments. The fund dropped for \$324m in June 2008 to \$259m by June 2009 – a drop of around 20 per cent. However, the 2009/10 release was still around \$22m, in line with the release of the previous four years.
30. Over the coming years Council adopted lower and lower release rules reflective of the lower value of the PIF and the lower returns being received. In 2008 the release rule for the LTP09-19 was set at 5.6% (with 80% smoothing), which was lowered to 4.0% (with 80% smoothing) for the LTP12-22, and then to 3.3% (with 80% smoothing) for the LTP15-25. Each adjustment was reflective of lower expected

long-term returns, and the continual downward shifts indicate that the previous reduction was insufficient. This potentially may be due to the information available at that time about expected future returns.

31. During this 'rebalancing' period, Council made active decisions to not take quarterly payments from the PIF if it appeared Council would not need them because it was heading towards a surplus at year end.¹ These decisions enabled Council to restore the balance of the PIF earlier than would have otherwise occurred.
32. The reduction in the PIF release had a significant impact on Council's overall financial position. The PIF went from subsidising 30 to 40 per cent of general rates down to 10 to 15 per cent.
33. The initial proposition – that PIF releases would allow Council to no longer charge general rates – is now considered unrealistic.

Tasmanian Dairy Farms

34. TIML purchased 25 farms in Tasmania over a number of years starting in 2008. Initially Tasman Farms was 74.33% owned by Council, and then Tasman Farms then owned 98.13% of the Van Diemen's Land Company. Over time, TIML and Council acquired minor shareholdings (including through restructuring and compulsory acquisition), resulting in full 100% ownership of Tasmanian Land Company Limited and the Van Diemen's Land Company.
35. The ownership of the Farms became controversial within Council. Over a number of years there were various calls by Councillors to divest ownership of the Farms. Combined with the GFC impacts on other investments, the Farms became a large concentration risk for the PIF. The Farms accounted for over 60 per cent of the portfolio for a number of years.
36. The Tasmanian Farms investment was sold by Council in November 2015 for A\$280 million (NZ\$307m), although the transfer was not completed until it received foreign investment approval by the then Australian Treasurer Hon Scott Morrison. The net sale proceeds to the PIF was \$187m.

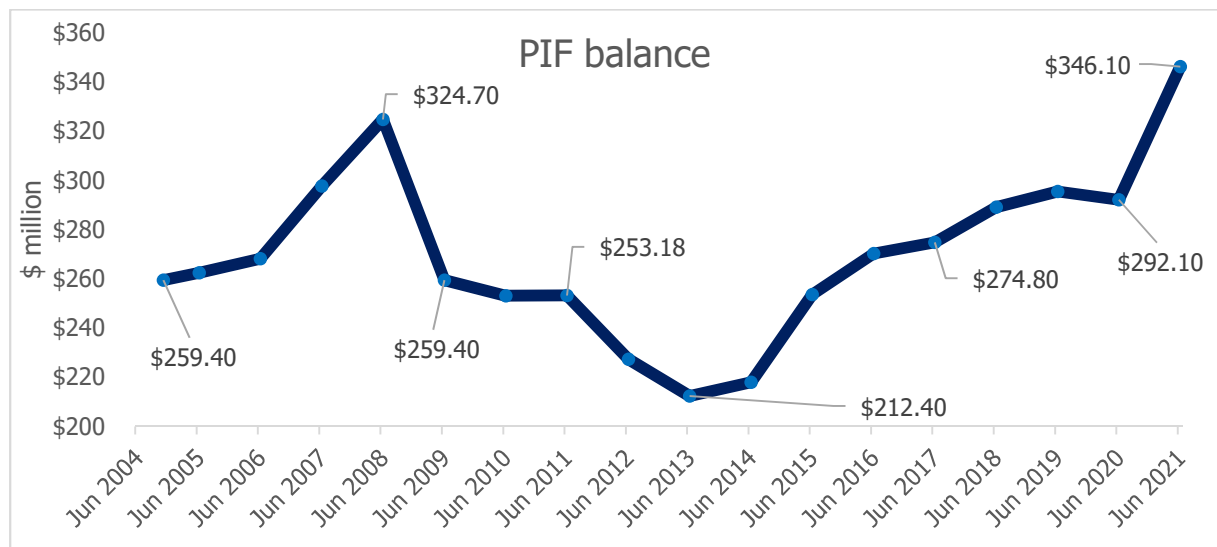
PIF Guardians

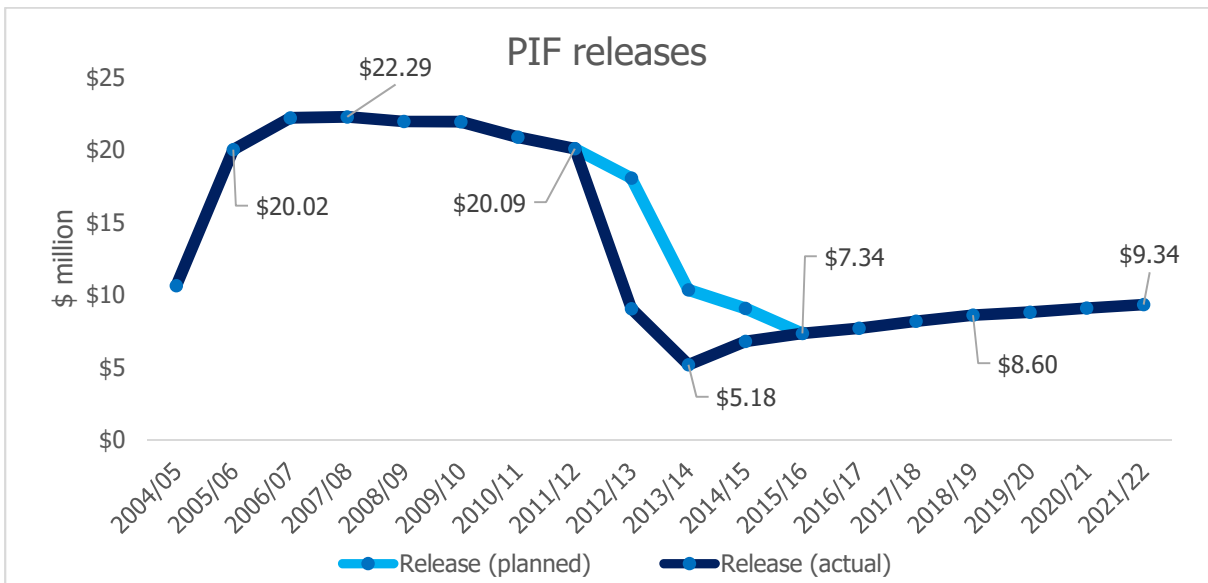
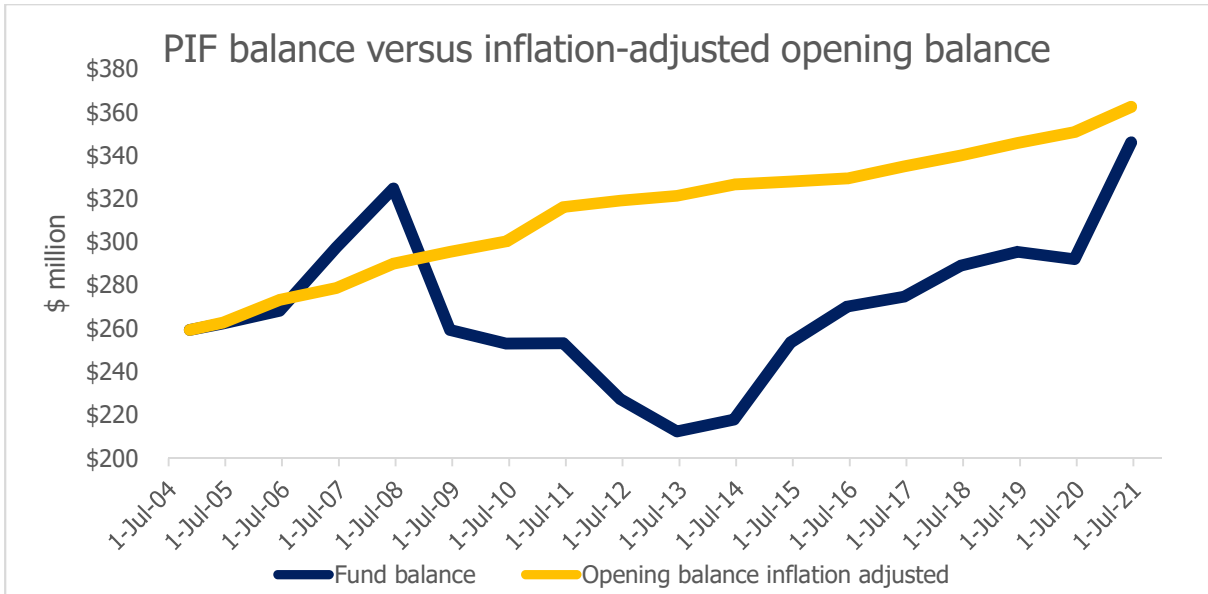
37. With the sale of Tasman farms and the planned rebalancing of the PIF, Council agreed it would be an appropriate time to review the management model for the PIF. In March 2016, Council contracted Cameron Partners to undertake an independent review of the model for managing the PIF, followed by a more detailed "definition of the PIF organisational architecture 'strawman', and design a tender process to procure outsourced services from Investment Consultants and Outsource agents".

¹ In 2012/13 Council did not accept \$9.03m, in 2013/14 Council did not accept \$5.18m, and in 2014/15 Council did not accept \$2.27m.

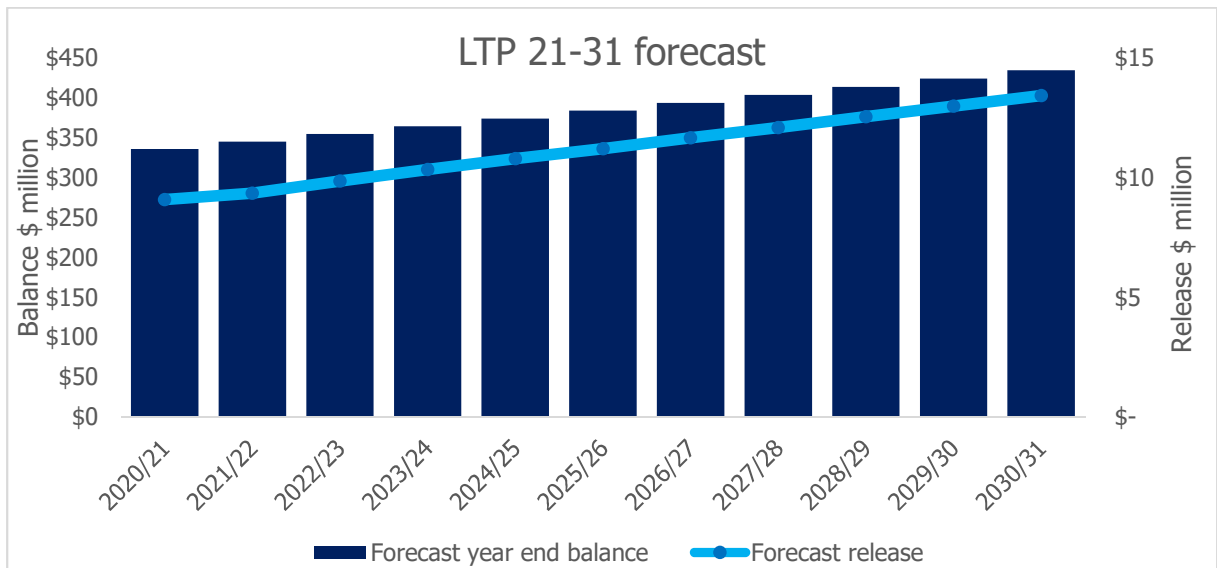
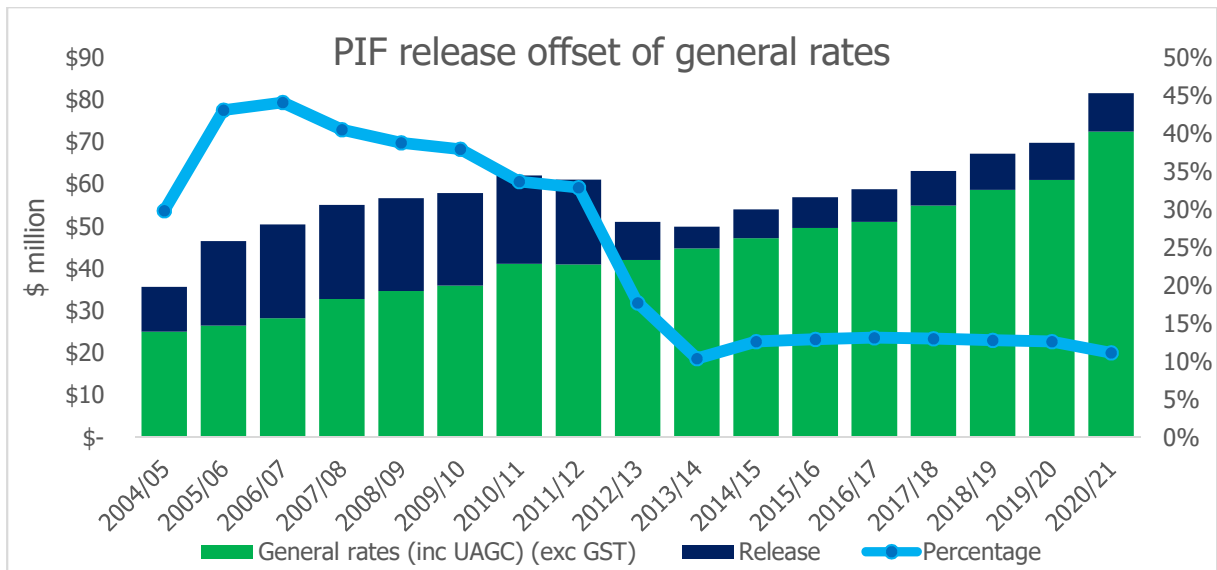
38. With effect from 1 March 2017, Council and TIML terminated the TIML mandate to establish a new structure for the management of the PIF as set out in the PIF Governance Deed. PIF Guardians were appointed as the new directors of TIML, and the name to New Plymouth PIF Guardians Limited was approved.
39. In December 2016 Mercer NZ Limited were engaged as the full outsource agent (FOA) for the PIF. Being responsible for the managing the investments of the PIF; and providing advice to the PIF Guardians regarding the development of the investment strategy and policies and assisting the guardians in their monitoring role.
40. The Governance Deed between Council and the PIF Guardians sets out the responsibilities between Council and the PIF Guardians. The PIF Guardians are responsible for monitoring the FOA and for setting the release rule. The PIF Guardians have twice reviewed the release rule (for the LTP18-28 and LTP21-31), and both times have kept it at 3.3 per cent (with 80 per cent smoothing).
41. Since the change to the PIF Guardian model, the PIF has largely continued to grow. The value of the PIF decreased between 30 June 2019 and 30 June 2020 as a result of financial market impacts from the Covid-19 pandemic and associated lockdowns. However, the PIF value substantially increased the following year reflecting broader financial market trends.

GRAPHS: BALANCE AND RELEASE OF PIF SINCE INCEPTION





42. As part of rebalancing the PIF, in 2012/13 Council did not accept \$9.03m, in 2013/14 Council did not accept \$5.18m, and in 2014/15 Council did not accept \$2.27m. Also note that 2004/05 is a part-year release as the PIF was established in November 2004.



43. The LTP21-31 was completed before the 2020/21 financial year end. The PIF closing balance in the LTP for 2020/21 therefore uses the 31 March 2021 figure, and is approximately \$10m below the actual year end figure.

Part 2: Is legislation the best route to secure the PIF?

Purpose

44. The purpose of this part is to assess whether legislation is the best means to achieving:
- a. Ring-fencing the Perpetual Investment Fund to ensure it is only used to the benefit of the New Plymouth District community (“geo-fencing”)
 - b. Assurances that the Perpetual Investment Fund will be used in a perpetual manner
45. To that end, this paper assesses alternative options for achieving this.

Options and assessment approach

46. This paper assesses the following options:

| Option | Description |
|-----------------------|---|
| 1 Status quo | The New Plymouth PIF Guardians have a Governance Deed with Council (requiring 75 per cent majority of Councillors to amend) that separates out decisions from Council. PIF Guardians provide governance oversight of a third party (presently Mercers) who undertake investment activities. |
| 2 Enhanced status quo | Status quo modified to require a 100 per cent vote of Councillors to amend the Governance Deed, and to amend the <i>Significance and Engagement Policy</i> to list the Perpetual Investment Fund as a Strategic Asset. |
| 3 Trust model | Establish a new trust entity to hold the PIF funds, with trustee obligations to achieve the purposes above, and to provide a release each year to Council. |
| 4 Legislation | An Act of Parliament to govern and guide decision-making to achieve the purpose |

47. It should be noted that both the trust model and the legislation would both be subject to further refinement if pursued.
48. The following criteria are used to assess the options:

| Criteria | Description |
|--------------------------|--|
| Geo-fencing | Does this option achieve the stated goal of ensuring the PIF is only used to the benefit of the New Plymouth District community? |
| Assures perpetual nature | Does this option achieve the stated goal of ensuring the PIF is only used in a perpetual manner? |

| Criteria | Description |
|-------------------------------------|---|
| Credit rating and insurance impacts | Does this option impact on Council's credit rating or insurance approach? |
| Balance sheet | Does this option impact on Council's balance sheet? |
| Implementation | Is the option easy to implement? Will it have costs associated with it? |
| Flexibility | Does this option overly restrict Council in the future in light of changing economic circumstances (such as a different investment market)? |
| Other considerations | Are there any other issues that need to be taken into account for that particular model? |

Assessment

49. The following table provides a high-level assessment of the options against the criteria:

| | Status quo | Enhanced status quo | Trust model | Legislation |
|-------------------------------------|------------|---------------------|-------------|-------------|
| Geo-fencing | | | | |
| Assures perpetual nature | | | | |
| Credit rating and insurance impacts | | | | |
| Balance sheet | | | | |
| Implementation | | | | |
| Flexibility | | | | |
| Other considerations | | | | |

50. As noted above, the trust model and legislation can be further refined. This means some of the issues in this approach could be modified and addressed to mitigate some or all of the negative elements. However, there are fundamental aspects of these approaches that cannot be changed (for instance, a trust model would require the trust to own the PIF).

Status quo

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|--------------------|---|
| Description | The New Plymouth PIF Guardians have a Governance Deed with Council (requiring 75 per cent majority of Councillors to amend) that separates out decisions from Council. PIF Guardians provide governance oversight of a third party (presently Mercers) who undertake investment activities. |
| Geo-fencing | This option does not place any particular constraints on the use of the PIF to the New Plymouth District community. Standard Local |

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| | Government Act provisions apply to Council in regards to the PIF (s12(4)) that mean Council must use the PIF wholly or principally for the benefit of the district. However, any future local government entity (e.g. a Taranaki-wide council) would not have any restrictions on it to only use the PIF to the benefit of New Plymouth District, and its obligations would be to benefit its area. This contrasts to the South Taranaki District Council's Long-Term Investment Fund, which has a local Act of Parliament to ensure it can only be used to the benefit of the South Taranaki District Council regardless of the local government arrangements. |
| Assures perpetual nature | <p>The current approach has been implemented to increase the assurance of the fund being used in a perpetual manner.</p> <p>Decisions on the release rule are set by the PIF Guardians as part of the Statement of Investment Priorities and Objectives (SIPO), not Council. This arrangement for the PIF Guardians to determine the SIPO is set in the Governance Deed. It takes a 75 per cent majority of Councillors present at a Council meeting to amend the Governance Deed. Council requires a 75 per cent majority of Councillors present to amend Standing Orders (cl 27(3), Sch 7, LGA), so it is not legal possible to use a simple majority to subvert this requirement. The Governance Deed is also a legal agreement and requires the PIF Guardians to agree to any amendment to it.</p> <p>However, there is a risk that Council appoints the directors of the Guardians, and can remove directors. This means a Council could seek to subvert the 75 per cent majority, or the PIF Guardians not agreeing to amendments, through the appointment process. Whilst such a move may be difficult and bring with it considerable risk, it is not impossible.</p> |
| Credit rating and insurance impacts | The current approach enables Council to have a very high credit rating and to lower its insurance premiums. This is because Council could use the PIF's capital base if needed following a significant natural disaster instead of taking on debt, or to repay its debt readily if required to do so. As such, Council is in a strong financial position. |
| Balance sheet | The PIF forms part of Council's balance sheet. The PIF offsets debt in terms of overall equity, meaning Council can show has negative or low net debt. |
| Implementation | Status quo so already in place. |
| Flexibility | This approach is relatively flexible. It places a high threshold for change (75 per cent of Councillors present) but at the same time that change can be significant. |
| Other considerations | |

Enhanced status quo

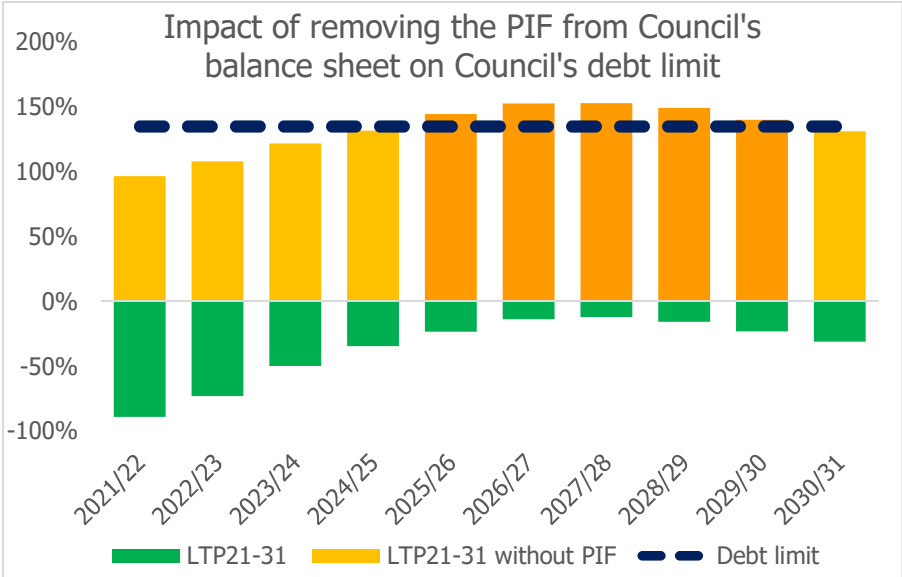
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| Description | This option takes the status quo (as above) and makes two changes to it. |
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| | <p>First, the 75 per cent super majority for Council to approve changes to the Governance Deed would be increased to 100 per cent.</p> <p>Second, the “real capital base” of the PIF would be added to the Strategic Asset list in Council’s Significance and Engagement Policy.</p> |
| Geo-fencing | <p>These enhancements do not provide any additional protections in this regard.</p> |
| Assures perpetual nature | <p>Taking the requirement for changes to the Governance Deed from 75 per cent to 100 per cent (i.e. unanimous) would make it significantly more difficult to change the Governance Deed. This would mean it is significantly harder for Councillors to require a higher release. It would take just one Councillor to oppose the change to prevent it happening.</p> <p>However, Standing Orders only require a 75 per cent majority to change. As this is a legal provision, it may not be possible for Council to impose a higher requirement (this would need legal advice at the time to explore). As such, Council could be subject to challenge by imposing this requirement. It would also mean that a 75 per cent majority could amend Standing Orders to reduce the 100 per cent requirement back to 75 per cent, and then make a change.</p> <p>Adding the real capital value of the PIF to the Strategic Asset list would mean that any decision “to transfer the ownership or control” of the real capital value “to or from” Council would have to be made through an LTP process, including being explicitly provided for in the LTP Consultation Document and LTP itself (s97 LGA). By listing the “real capital base” it would effectively mean that Council would need to use an LTP process to eat into that base. In other words, Council could only take a release larger than a sustainable amount would require community consultation and auditing. This would create a significant barrier to taking more than a sustainable amount.</p> |
| Credit rating and insurance impacts | <p>This approach could have an impact on Council’s credit rating and insurance arrangements as it becomes significantly more difficult to use the PIF’s capital base if required.</p> |
| Balance sheet | <p>The PIF forms part of Council’s balance sheet. The PIF offsets debt in terms of overall equity, meaning Council can show has negative or low net debt.</p> |
| Implementation | <p>In order to embed any changes to require a super-majority, Council must agree to that change by that super-majority. This means that Council would have to unanimously agree to increase the voting requirement to 100 per cent.</p> <p>Amendments to the Significance and Engagement Policy to add the PIF to the list of Strategic Assets will require community consultation.</p> <p>As noted above, there may be legal issues arising from utilising a 100 per cent requirement for voting as it exceeds the Local Government Act’s provisions. This means that this could be challenged.</p> |

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| Flexibility | This approach retains a degree of flexibility. If Council can act unanimously and go through community consultation, then it can make changes as it sees fit. However, this is a very high threshold in a political context. |
| Other considerations | The approach to add the PIF's real capital base to the Strategic Asset list may have inadvertent impacts. In particular, in any year where returns are low, Council would have to take a significantly lower return than it otherwise would under the current model. This is because the return would effectively have to be funded each year out of the interest earned (less inflation). Council could manage this by either changing how it uses the PIF release or by creating smoothing reserves, but it does significantly limit and constrain decision-making. |

Trust model

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| Description | <p>Establish a new trust entity to hold the PIF funds, with trustee obligations to provide a release each year to Council for use within New Plymouth District and to do so in a perpetual manner.</p> <p>The trust would become a CCO. Council would appoint trustees. The number of trustees would be very small, potentially only requiring one or three trustees.</p> <p>The trust would be separate from the PIF Guardians. In effect, the PIF Guardians would continue to provide oversight of the investments, while the new trust would act as the legal owner of the PIF with its obligations being to own the PIF and provide a release to Council to benefit New Plymouth district. The PIF Guardians would become a subsidiary of the new trust.</p> |
| Geo-fencing | The trust arrangement would achieve this requirement. The trust's obligations would mean that it would provide the release each year to Council with an obligation that Council only use it within New Plymouth district. This would constrain any future local authority from using it elsewhere. |
| Assures perpetual nature | The trust arrangement would achieve this requirement. |
| Credit rating and insurance impacts | This would have a more significant impact on Council's credit rating and insurance. This is because Council would have no ability to call upon the funds as needed. The trust arrangement could include ability for Council to request additional funds, but the independence of the trust – and their trustee obligations – would mean Council could not be assured of this. |
| Balance sheet | To implement this approach Council would have to transfer complete control of the PIF to the trust. This would remove the PIF from Council's balance sheet, although the Council Group balance sheet would be unaffected. This would make Council net debt increase significantly, although not the Group balance sheet. |

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| | <p>The below graph takes the Long-Term Plan 2021-2031's net debt to income levels against Council's limit,² and shows the impact of removing the PIF from Council's balance sheet. It shows that Council would be in breach of its net debt to income limits for five of the ten years of the Long-Term Plan (2025/26 to 2029/30 inclusive), whereas with the PIF Council never breaks into having debt larger than financial assets.</p>  <p>The flow-on impact of a trust model would be that Council would need to significantly reduce its forward capital works programme in order to avoid breaching its debt-to-income ratios.</p> <p>At present Standard and Poor's assesses Council on a Group basis for its credit rating. However, there is no assurance that this would continue with this approach given the loss of control over the PIF that this would entail.</p> |
| Implementation | <p>This would require establishment of a trust – and that trust would be a CCO. As such, it would require community consultation under the Local Government Act.</p> <p>This would add to the CCO governance requirements, with new appointments, statements of expectations, statements of intent, quarterly reporting, monitoring etc.</p> |
| Flexibility | <p>Once the trust is established it would become difficult to alter in the future.</p> |
| Other considerations | <p>Local authorities are generally exempt from income tax (section CW39 Income Tax Act 2007). Legal work would need to occur to understand the tax status of any trust set up. It may depend on whether or not the trust can register as a charity (which is unlikely as the trust would not meet the 'heads of charity' test).</p> |

² This is the 'debt affordability' benchmark graph on page 174 of the [Long-Term Plan 2021-2031](#).

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| | This model would also create significant complexity in managing the PIF with two CCOs involved in the process. |
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Legislation

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| Description | This approach would see Council take local Bill to Parliament. The Bill would aim to achieve the stated goals, and potentially other matters. The contents of that Bill is subject to the next paper in this series. |
| Geo-fencing | Legislation can achieve this. The South Taranaki District Council (Egmont Electricity Limited Sale Proceeds) Act 1999 achieves this. |
| Assures perpetual nature | Legislation can achieve this. There are a range of legislative options available in how this can be done, some of which will impact on the criteria below differently. The New Plymouth District Council (Waitara Lands) Act 2018 achieves this for the Waitara Perpetual Community Fund through requiring the release rule to have the objective of maintaining or increasing the real capital value of the fund. |
| Credit rating and insurance impacts | <p>The impact will depend on the contents of the legislation itself.</p> <p>A law that provides absolute certainty of perpetual use (such as hard rules) would likely have an impact on Council's credit rating and insurance approach. A law that provides some degree of flexibility (such as through using principles) would be less likely to impact on Council's credit rating and insurance approach.</p> |
| Balance sheet | The PIF would continue as part of Council's balance sheet. The PIF offsets debt in terms of overall equity, meaning Council can show has negative or low net debt. However, rating agencies may perceive this differently depending on the degree of control available. |
| Implementation | Legislation requires an Act of Parliament. There are significant legal costs associated with this, and the outcome is uncertain. In recent years two local bills have not been enacted (one voted down, one withdrawn presumably to avoid being voted down). The New Plymouth District Council (Waitara Lands) Act was substantially altered by the Māori Affairs Committee and the Committee of the Whole House in order to secure sufficient Parliamentary support for its enactment (noting the amendments were supported by Council). |
| Flexibility | <p>Legislation can provide a flexible approach.</p> <p>However, once legislation is set then it is very difficult to amend in the future. It requires going through the same process and issues as noted in 'implementation' above.</p> |
| Other considerations | Legislation can be used to help achieve other aspects around the PIF. This could include clearing away any legislative fishhooks or provide legislative controls on other aspects of the PIF. |

Council decision

51. Council decided to pursue a local bill.

Part 3: Proposed contents of legislation

Purpose

52. The purpose of this part is to assess what legislative parameters are best to achieve:
 - a. Ring-fencing the Perpetual Investment Fund to ensure it is only used to the benefit of the New Plymouth District community (“geo-fencing”)
 - b. Assurances that the Perpetual Investment Fund will be used in a perpetual manner
53. To that end, this paper assesses alternative options for achieving this.

Options and assessment approach

54. This paper assesses a range of issues and options. Each issue has a different potential set of criteria that apply. Council’s preferred option is noted throughout the paper.

Geo-fencing

55. There are some options around how geo-fencing is done, particularly about whether or not the definition is easily amended or not.
56. In large part, the option to geo-fence is to do it or not to do it.
57. There does not seem to be substantive variation in how to achieve a geo-fencing approach – the two examples of the [New Plymouth District Council \(Waitara Lands\) Act 2018](#) and the [South Taranaki District Council \(Egmont Electricity Limited Sale Proceeds\) Act 1999](#) both have similar constructs that the relevant fund has to be used to the ‘benefit’ of the applicable community. There are differences in drafting (the Waitara Lands Act is for the benefit of the community or a part of it; the South Taranaki Act is primarily for the benefit on the residents and ratepayers), but they amount to minor stylistic differences and have they the same intention and operation. The only change of significance is that the South Taranaki Act is explicit that that fund cannot be applied towards any work outside of the South Taranaki District, whilst this is implied but not specified in the Waitara Lands Act.
58. Council decided that the legislation states that the PIF may only be used for the benefit of the New Plymouth District community.
59. The main issue is whether to provide a fixed definition or to create some degree of flexibility to it.

| Option | Description | Pros | Cons |
|--|---|--|--|
| Status quo | There would be no statutory provision defining the area. If a bill proceeded, it would be difficult (although not impossible) to craft a bill that achieved other outcomes without somehow also including a geofencing approach even if not deliberate. | | This does not achieve the stated aim. It would mean that the PIF could be used in the future outside of New Plymouth district should there be some form of local government amalgamation. |
| Firm definition of area (PREFERRED OPTION) | This would provide a firm requirement that the PIF and its release could only be used within the New Plymouth district. This would be very similar to that of the South Taranaki Act. | This limits any use of the PIF to the current New Plymouth district. The boundaries were defined in 1989 and have not changed since. There has been no proposal to alter the boundaries to the Local Government Commission in those 30+ years, and there does not appear to be any significant push to amend the boundaries. | If there are amendments to the boundaries of New Plymouth district in the future then Council would need to consider whether to take a further local bill to Parliament to align with the changed boundaries. This would require any future Council to undergo rigorous assessment and an independent arbitration. |
| Definition, but amendable as to what constitutes "New Plymouth district" | This would be similar to the first option, but the definition could be amended in the future so long as it is a definition of New Plymouth district. For instance, the Waitara Lands Act provides a definition of "Waitara" but enables an Order-in-Council to expand the area, but it still must clearly be "Waitara" so could not expand to, e.g., New Plymouth. The Waitara Lands Act also requires consultation and for the | This approach would enable the definition of New Plymouth district to be amended if the boundaries of New Plymouth district changed. This would cover situations where the boundaries were shifted (whether an expansion or contraction). | This approach only deals with minor changes to boundaries, but could be subject to attempt to widen the use of it beyond its intended scope. |

| Option | Description | Pros | Cons |
|---------------------------------|---|---|---|
| | Government to independently consider the issue. | | |
| Definition, but fully amendable | This option would create a definition, and enable it to be fully amended. | This is the most flexible for future circumstances. | This undermines the purpose of geo-fencing. It would ultimately be ineffective in providing any controls in the future. |

60. Council's initial decisions are for the bill to define the scope to New Plymouth District and not provide any ability to amend the definition of New Plymouth District. This ensures that any move to alter the area in the future is subject to Parliamentary scrutiny and thus providing a high-degree of assurance of independent decision-making and community consultation (through the select committee process).

Perpetual assurance

61. There are numerous different ways to provide assurance that the PIF will be used in a perpetual manner. There are also clear criteria that can be applied.

| Criteria | Description |
|-----------------------------------|---|
| Assures perpetual nature | Does this approach achieve the stated goal of ensuring the PIF is only used in a perpetual manner? |
| Credit rating and insurance risks | Does this option impact on Council's credit rating or insurance approach? |
| Flexibility | Does this option overly restrict Council in the future in light of changing economic circumstances (such as a different investment market)? |
| Balance sheet | Does this option impact on Council's balance sheet? |
| Implementation | Is the option easy to implement? Will it have costs associated with it? |
| Other considerations | Are there any other issues that need to be taken into account for that particular approach? |

1. Status quo

| Criteria | Assessment |
|-------------|--|
| Description | At present, there are no special legal provisions. The current arrangements do provide a degree of assurance as the New Plymouth PIF Guardians have a Governance Deed with Council (requiring 75 per cent majority of Councillors to amend) that separates out decisions from Council. PIF Guardians provide governance oversight of a third party (presently Mercers) who undertake investment activities. |

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|-----------------------------------|---|
| Assures perpetual nature | The current approach provides a degree of assurance that the PIF will be used in a perpetual manner in that it would require a 75 per cent majority of Councillors present at a meeting to amend the Governance Deed in order to be able to take a more than sustainable amount of funding. |
| Credit rating and insurance risks | This approach has enabled Council to receive the maximum possible credit rating (limited by whatever the Government is at) and to take a flexible approach to insurance. |
| Flexibility | The main limitation on flexibility is the need for a 75 per cent majority of Councillors. |
| Balance sheet | The PIF is part of Council's balance sheet |
| Implementation | Not applicable as this is the status quo. |
| Other considerations | The main protection mechanism – the 75 per cent majority – could be unwound in a single act and then not put back in place due to the way the Governance Deed is amended (e.g. to give Council the decision in the release rule). There is, therefore, a degree of fragility to the system. |

2. Principle-based (PREFERRED OPTION)

| Criteria | Assessment |
|-----------------------------------|--|
| Description | This approach sets out a range of principles that Council must consider in making decisions, with one of these principles being that the PIF is a perpetual fund for the long-term. It would also outline the counter |
| Assures perpetual nature | This is not a strong assurance of perpetuity. Council could consider the principle and discount it. |
| Credit rating and insurance risks | This would have minimal impact as the PIF is still accessible. |
| Flexibility | This approach is highly flexible. Council would have to consider the principles when developing a release rule, but would ultimately be free to make a decision as they see fit. |
| Balance sheet | There would be no impact, the PIF would remain on Council's balance sheet. |
| Implementation | Generally implementation of principle-based approaches are relatively easy, provided that the principle are clear and easy to apply. The PIF Governance Deed may need to be amended upon enactment to reflect this approach. |
| Other considerations | While a principle-based approach, <i>on its own</i> , is not necessarily sufficient to assure the PIF is used perpetually, it can work <i>alongside</i> other options. This would also enable other management principles to be put in place. |

3. Requirement with exemption process

| Criteria | Assessment |
|-----------------------------------|---|
| Description | This approach would see the Council be required to manage the PIF in a manner that is perpetual, but with an exemption process. The process to using an exemption could require a high threshold be met. |
| Assures perpetual nature | This approach generally provides a degree of assurance that the PIF will be used perpetually, but does enable it to not be used in such a manner if the circumstances arise that mean it is appropriate to use the funds. |
| Credit rating and insurance risks | This approach means Council can access the capital of the PIF if needed, so thereby should not have a significant impact on Council's credit rating or insurance approach. |
| Flexibility | This approach would retain flexibility for Council in how to ensure a perpetual approach, and provide a degree of flexibility in case of significant emergency |
| Balance sheet | The PIF would still be retained on Council's balance sheet |
| Implementation | The PIF Governance Deed may need to be amended upon enactment to reflect this approach. |
| Other considerations | Ideally, any legislative exemption process should have clear requirements as to what should be considered before making that exemption. The principle-based approach above would provide a useful set of considerations. |

62. There are several options for the type of requirement:

| Option | Description | Pros | Cons |
|-------------------------|--|---|--|
| Capital floor | A requirement that the capital value of the PIF cannot fall below its current point (inflation-adjusted) | This approach could enable Council to access some additional funds without triggering the exemption process, and thereby could result in a significantly higher threshold for an exemption process. | Markets are fickle and can change significantly. A large decrease in the markets could result in Council being unable to receive a release. Implementation may be difficult as Council would have to keep track of the capital floor each year to compare the PIF's actual balance to. |
| Release rule set by law | The Bill specifies the release rule as a formula. (Formula are used in other laws.) | Very clear approach to setting the release each year. | The release rule has changed over time, reflecting changes to the investment market. This approach risks the release rule being too high, or too low, if there are significant changes to the investment market horizon. It reduces flexibility in how the rule is set. |

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| | | | It is possible to create a more complex formula that takes into account changing expectations in how the financial and investment markets operate. However, this would invariably create an opportunity for manipulation since such expectations are forecasts. |
| Policy requirement | The Bill requires Council to adopt a policy that must have the objective of maintaining or increasing the real capital value over time. The Policy must be followed. This is used in the Waitara Lands Act for the Waitara Perpetual Community Fund. | This approach retains flexibility in how the release rule is set, enabling Council to move with best practice. | There is a risk that Council sets a release rule that does not meet this requirement but it is unchallenged. As such, there needs to be independent assurance that the release rule is intended to meet the stated objective. |
| Release set to return level | The Bill could provide that Council receives the real increase in the PIF value (i.e. increase less inflation) per annum. | Provides Council with immediate benefit from high performance years. | The release would swing substantially, with very high releases in some years and very low in others (even negative). Smoothing reserves may be needed for Council to manage this. If there are negative returns in a year then the PIF balance permanently reduces, or Council has to accept lower returns in future years to rebuild. |
| Legislate separation of PIF release decisions from Council | The Bill requires decisions on the PIF release be made separate of Council with a requirement for it to be perpetual | In effect, this is the status quo as the PIF Guardians determine Statement of Investment Priorities and Objectives (SIPO), which includes the release rule, under the Governance Deed. | Determining who makes these decisions could be a path for influence for Council. Having a statutory exemption process may cause relationship issues between Council and the |

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| | | Council does not approve the SIPO at present. | independent body in its use. |
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4. Requirement with no exemption process

| Criteria | Assessment |
|-----------------------------------|--|
| Description | This approach would see the Council be required to manage the PIF in a manner that is perpetual. |
| Assures perpetual nature | This approach is the strongest at assuring a perpetual nature of all the options. |
| Credit rating and insurance risks | This approach could impact on Council's credit rating and insurance approach as it would mean the PIF is not able to be used in case of significant emergency. |
| Flexibility | This approach could provide some flexibility in how Council sets the release rule, but overall limits flexibility. |
| Balance sheet | The PIF would still be retained on Council's balance sheet |
| Implementation | The PIF Governance Deed may need to be amended upon enactment to reflect this approach. |
| Other considerations | |

63. The options for the type of requirement are the same as option three. There are several options for the exemption process. It should be noted that under all potential approaches there would always be judicial review rights that attach to any decision-making. It is not recommended that the Bill attempt to restrict judicial review rights. The options are:

| Option | Description | Pros | Cons |
|--|---|--|---|
| Council resolution | Council could pass a resolution to receive a higher release | This is the standard LGA threshold. | This can be subject to short-term political imperatives. |
| Council resolution with super-majority | Council could pass a resolution to receive a higher release with the resolution requiring a 75 per cent majority of EMs present to pass | This sets a high threshold (requiring 12 out of 15 members at present). It effectively aligns to current obligations to amend the PIF Governance Deed, which is required to be amended presently so Council can do this. | This can still be subject to short-term political imperatives, but is a higher threshold. |
| Council resolution following specific community consultation | Council could pass a resolution to receive a higher release, but must have consulted the public beforehand | Ensures community is engaged in any decision-making process | Community may not necessarily understand complex financial implications of decisions, making it a tough process (for this reason, |

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| | | | <p>the LGA exempts Councils for having to consult on investment policies). This can further any short-term political imperatives against longer-term thinking.</p> <p>This will slow down any process by potentially one to two months. If it were a true emergency situation then this delay could be detrimental to Council.</p> |
| Council decision through LTP or by way of LTP amendment | Council could pass an LTP, or amend the LTP, to receive a higher release. This would involve standard LTP/LTP amendment processes. | Ensures community is engaged in any decision-making process, whilst also providing for auditing by Audit New Zealand of decision-making. | <p>Community may not necessarily understand complex financial implications of decisions, making it a tough process (for this reason, the LGA exempts Councils for having to consult on investment policies). This can further any short-term political imperatives against longer-term thinking.</p> <p>LTP processes take time, and even an amendment would take at least four months at minimum (and that would require working at an extremely high pace). If it were a true emergency situation then this delay could be significantly detrimental to Council.</p> <p>Audit NZ are ultimately only able to issue an opinion on the LTP/ LTP amendment and not stop decision-making.</p> |
| Central government | Under this option, Council could request to an appropriate part | Provides independent scrutiny of decision-making | This would subject Council decision-making to an outside body and |

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| approval process | of central government (e.g. Minister of Local Government or Local Government Commission) to approve a release above that set by the normal process | | <p>therefore undermines the principles of local democracy.</p> <p>National politics may interfere with the ability of Council to access funds when needed.</p> <p>Central government processes may not prioritise Council's request, particularly in the case of a national emergency situation. This could create delay in an emergency situation that could be significantly detrimental to Council.</p> |
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64. Council's initial decisions are for the bill to include option 2.

Other aspects of current PIF management that could be incorporated into law

| Aspect | Pros of legislating | Cons of legislating | Council decision |
|----------------------------------|--|--|--|
| PIF Guardians | The PIF Guardian model represents best practice, and is a well-founded approach | <p>The model may change from time to time, depending on other aspects (such as statutory powers in relation to CCOs). Legislating a model may limit the ability of Council to use alternative models that may be better suited to managing the PIF if they become available in the future or best-practice evolves.</p> <p>The PIF Guardian model is also relatively complex and difficult to draft accurately</p> | <p>Include an ability for Council to delegate matters to a CCO, Committee or officer as required, but do not specify the current arrangements. Also see below.</p> <p>Include a provision that the Council may institute other measures to achieve the principles of the Bill to ensure that the Governance Deed is not challengeable.</p> |
| Independent financial management | Council has consistently used some form of independent financial management with the PIF, and it is well supported. Providing some assurance in legislation prevents the potential for political decision-making in investments which could result in lower returns. | There are risks about being too detailed about how this should occur as best-practice on how this can occur may change. | Include principles relating to independent financial management and managed on a commercial basis |

| Aspect | Pros of legislating | Cons of legislating | Council decision |
|----------------------------------|---|---|---|
| Council trustee status | Legislating the PIF may create a 'statutory trust' situation. This would mean Council's income tax exemption status would not apply as section CW39(3) of the Income Tax Act 2007 provides that income Council derives as a trustee is subject to income tax. Without clear legislative provision, there is a risk that the PIF becomes subject to income tax and therefore Council's earnings are reduced. | None identified | The Bill should clearly specify that Council is not a trustee of the PIF and holds the funds as a local authority |
| Strategic asset fishhook | Currently the PIF cannot invest in ports or airports in New Zealand without potentially triggering an LTP or LTP amendment because these asset classes are automatically strategic assets. | Exemptions from normal statutory provisions through a local bill are generally unusual. | The Bill should exempt the investment of the PIF from the strategic asset tests of the LGA. |
| Responsible investment standards | Legislating responsible investment standards helps Council to minimise potential reputational risks. They are relatively common, particularly within the public sector. The current SIPO includes a responsible investment policy. | Responsible investments standards are changing over time. They have previously been referred to as "ethical" standards, and more recently as "environmental, social and governance" standards. The current diversified and indexed approach does make it difficult to avoid certain investments. | The Bill should include a principle investments manage the PIF in way to avoid prejudicing Council's reputation. This provides flexibility to address changing standards over time and to reflect the investment approach of the day. Council decided not to require the SIPO to include a responsible investment policy that covers these issues |

| Aspect | Pros of legislating | Cons of legislating | Council decision |
|----------------------|--|--|---|
| General rate subsidy | Legislation could specify that the PIF release is used to offset general rates. This has consistently been Council's approach since establishment of the PIF and previously with the PowerCo dividend. | This limits options for future consideration of the rating system. For instance, some local authorities solely rely on targeted rates and have no general rates. It therefore acts as a constraint on legitimate policy decisions of future Council. | Do not include in legislation, and continue to enable Council to make decisions on how to use the PIF release through the Revenue and Financing Policy. |

Summary of Council decisions for contents of the Bill

| Issue | Recommendation |
|--------------------|---|
| Geo-fencing | Provide that the PIF may only be used for the benefit of the New Plymouth District community, and cannot be used for funding activities outside of New Plymouth District (as per current boundaries) |
| Perpetual nature | Provide the following principles that Council must consider when dealing with the PIF: <ul style="list-style-type: none"> • The PIF should be used in a perpetual manner to benefit both current and future generations • The PIF's capital base may be used in if situations arise that warrant its use |
| Other principles | Provide the following additional principles that Council must consider when dealing with the PIF: <ul style="list-style-type: none"> • The PIF's investments should be independently managed • The PIF's investments should be managed in accordance with a prudent commercial basis • The PIF's investments should be undertaken in a manner that avoids prejudicing Council's reputation |
| Other requirements | Provide the following additional matters: <ul style="list-style-type: none"> • Specify that Council is not a trustee of the PIF • Exempt the investments of the PIF from the strategic asset provisions of the Local Government Act 2002 |