NAPIER CITY COUNCIL
Te Kaunihera o Ahuriri

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PROSPEROUS NAPIER COMMITTEE

Open Agenda

Meeting Date:	Tuesday 26 July 2022
Time:	Following the Napier People & Places Committee
Venue:	Ocean Suite East Pier 50 Nelson Quay Napier
	Livestreamed via Council's Facebook site

Committee Members	**Chair:** Councillor Taylor **Members:** Mayor Wise, Deputy Mayor Brosnan, Councillors Boag, Browne, Chrystal, Crown, Mawson, McGrath, Price, Simpson, Tapine and Wright
Officer Responsible	Deputy Chief Executive / Executive Director Corporate Services
Administration	Governance Team
	Next Prosperous Napier Committee Meeting

ORDER OF BUSINESS

Karakia

Apologies

Councillor Browne, Councillor Boag and Councillor Chrystal

Conflicts of interest

Public forum

Nil

Announcements by the Mayor

Announcements by the Chairperson including notification of minor matters not on the agenda

Note: re minor matters only - refer LGOIMA s46A(7A) and Standing Orders s9.13

A meeting may discuss an item that is not on the agenda only if it is a minor matter relating to the general business of the meeting and the Chairperson explains at the beginning of the public part of the meeting that the item will be discussed. However, the meeting may not make a resolution, decision or recommendation about the item, except to refer it to a subsequent meeting for further discussion.

Announcements by the management

Confirmation of minutes

Agenda items

Minor matters not on the agenda – discussion (if any)

AGENDA ITEMS

1. INVESTMENT PROPERTY PORTFOLIO REVIEW

Type of Report:	Operational
Legal Reference:	N/A
Document ID:	1477991
Reporting Officer/s & Unit:	Bryan Faulknor, Manager Property

1.1 Purpose of Report

To update the Committee on the performance of the Napier City Council's Investment Property Portfolio (Leasehold Land) and provide a recommendation on whether to continue to allow freeholding.

Officer's Recommendation

The Prosperous Napier Committee:

a. **Resolve** to receive the report prepared by PricewaterhouseCoopers *(Doc Id 1478676)* reviewing the Napier City Council's Investment Property Portfolio.

b. **Resolve** that Council continue to allow the freeholding of non-strategic land on a case by case basis in accordance with the Investment Property Portfolio Policy.

c. **Noting** that Council's amended Investment Policy has now been completed and suitable alternative investment opportunities have been identified for Council's consideration.

1.2 Background Summary

The Investment Property Portfolio consists of 61 remaining leases.

These are perpetually renewable ground leases. Council owns the land and the lessees own the improvements. The properties are predominantly located in the Onekawa Industrial area, Pandora Industrial area, and Ahuriri.

The sites in the portfolio are typically commercial and industrial in nature; however, there is also some high-density residential property as a result of changing land use over time and new apartment developments occurring on former commercial/industrial land.

1.3 Issues

Following public consultation as part of the Long Term Plan 2018-2028, Council resolved to allow freeholding of non-strategic land on a case- by- case basis.

An Investment Property Portfolio Policy was adopted in 2018 which sets out the terms and conditions on which Council may sell the land. Amongst the conditions is the requirement for Officers to make a recommendation to Audit and Risk who make a recommendation to Prosperous Napier who in turn report to Council.

The ground rents fund the net cost of the Inner Harbour and the maintenance of certain foreshore reserves.

Since the adoption of the policy, 10 properties have been freeholded. Further freeholding was put on hold pending identification of suitable new replacement investments.

A separate report from Council's Investment and Funding Manager is being presented to the Committee outlining reinvestment issues.

1.4 Significance and Engagement

During the pre-election period, Council business must continue however Council should also carefully consider the impact policy decisions or significant changes would have on the incoming Council.

1.5 Implications

Financial

Council engaged PricewaterhouseCoopers (PwC) to review the portfolio and in particular its performance in terms of historical and forecast returns. The report is attached and highlights:

- Value at 30.6.21 - $73.68 million, with revaluations 30 June 22 expected to indicate $97.8m.
- Annual ground rents - $2.02 million.
- Rental yield of 2.74% at 30 June 2021, however rental yields fluctuate depending on growth in land values e.g. between 2014 and 2016 yields were in excess of 5%.
- Total returns being both rent and capital growth has been attractive by any measure, over the short and long term, and has typically materially outperformed, by way of example the NZX50 index and the NZ 10yr Gov't Bond Yield.
- Portfolio is a desirable low risk passive investment requiring limited ongoing management.
- Represents an intergenerational 'store' of wealth where relatively low cash returns are traded off against strong capital growth and low risk.
- Conversely, the portfolio is not diversified by asset type or geography.

Table: Historical returns

Analysed period	Leasehold Portfolio - Total Return (IRR)	NZX50 Index*	NZ 10Yr Govt. Bond Yield**
5 years (Jun 21 - Jun 17)	32.0%	12.9%	2.3%
10 years (Jun 21 - Jun 12)	14.3%	13.9%	5.0%
15 years (Jun 21 - Jun 07)	8.0%	8.8%	5.9%
20 years (Jun 21 - Jun 02)	18.8%	9.8%	6.8%

**Compound annual growth over the analysed period*

***Bond yield is the yield to maturity at the start of the analysed period*

Year	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
Total Annual Rental (m)	$0.43	$0.83	$0.99	$1.07	$1.23	$1.34	$1.37	$1.46	$1.53	$1.54	$1.54	$1.80	$1.89	$1.97	$2.02
Total Valuation Amount (m)	$37.70	$41.88	$31.69	$30.69	$31.23	$31.63	$28.49	$28.76	$29.38	$29.79	$31.55	$36.59	$49.67	$52.61	$73.68
Rental Yield*	**1.13%**	1.99%	3.11%	3.47%	3.94%	4.24%	4.79%	5.07%	**5.20%**	5.17%	4.89%	4.91%	3.81%	3.75%	2.74%
Annual Capital Return %	3.00%	11.09%	**-24.34%**	-3.13%	1.76%	1.29%	-9.93%	0.93%	2.16%	1.40%	5.93%	15.95%	35.75%	5.93%	**40.05%**
Total Return (annualised)**	4.16%	13.30%	**-21.99%**	0.23%	5.76%	5.58%	-5.62%	6.05%	7.47%	6.64%	11.11%	21.64%	40.92%	9.90%	**43.89%**

** Annual income yield (relative to the value in the respective year)*

***Sum of capital growth and net income over a single period expressed as a %, with income reinvested*

Table: Potential Forecast Returns

Year	2021	2022	2023	2024	2025	2026	2027	2028	2029	2030	2031	2032
Lessor's interest (m)	$73.68	$97.79	$102.68	$107.82	$113.21	$118.87	$124.81	$131.05	$137.60	$144.48	$151.71	$159.29
Total Annual Rental (m)	$2.02	$2.27	$2.59	$2.62	$2.73	$2.90	$2.97	$3.69	$4.11	$4.24	$4.45	$4.86
Rental Yield*	2.74%	2.32%	2.52%	2.43%	2.41%	2.44%	2.38%	2.81%	2.99%	2.94%	2.94%	3.05%
Total Return (annualised)**	43.89%	35.80%	7.65%	7.55%	7.53%	7.56%	7.50%	7.95%	8.14%	8.08%	8.08%	8.20%

** Annual income yield (relative to the value in the respective year)*

***Sum of capital growth and net income over a single period expressed as a %, with income reinvested*

Effect of leasehold tenure on investment in Napier

A negative market sentiment towards leasehold assets is present in the local market.

Many lessees display a negative sentiment towards leasehold property and are of the view that ground rent obligations affect their investment decisions.

Leasehold tenure (the lessee's interest) is generally perceived as an unattractive ownership option that can result in under-investment in leasehold land. The leasehold land tenure is in perpetuity however, Council receives the benefit of the capital gain in land values as opposed to the lessees.

PwC state that there is no observable difference in the extent of investment and quality of improvements between the leasehold and freehold assets and note that previous analysis undertaken did not provide any conclusive evidence that leasehold tenure was having a material adverse impact on investment levels in Napier industrial/commercial land. PwC however are of the view that this will likely change in the near future as improvements age (and require progressive and, in some cases, considerable capital expenditure) and ground leases undergo reviews and the significant increases in land values and therefore ground rent increases crystallise.

Social & Policy

N/A

Risk

N/A

1.6 Options

The options available to Council are as follows:

a. To accept the Officer's Recommendation to receive the PwC report, to continue to allow the freeholding of non-strategic land on a case by case basis in accordance with the Investment Property Portfolio Policy. Noting that an amended Investment Policy has now been completed and suitable alternative investment opportunities have been identified for Council's consideration.

b. To receive the report but continue to put a hold on further freeholding until further considerations are made.

1.7 Development of Preferred Option

After being presented with the PwC report the Audit and Risk Committee resolved on 29 June 2022 as follows:

COMMITTEE RESOLUTION Mayor Wise / Councillor Simpson

The Audit and Risk Committee:

a) **Receive** the report prepared by PwC reviewing the Napier City Council's Investment Property Portfolio *(Doc Id 1473267)*

b) **Recommend** to Council that it continue to allow the freeholding on non-strategic land on a case by case basis in accordance with the Investment Property Portfolio Policy.

c) **Noting** that the Investment Policy has now been completed and suitable alternative investment opportunities have been identified for Council's consideration.

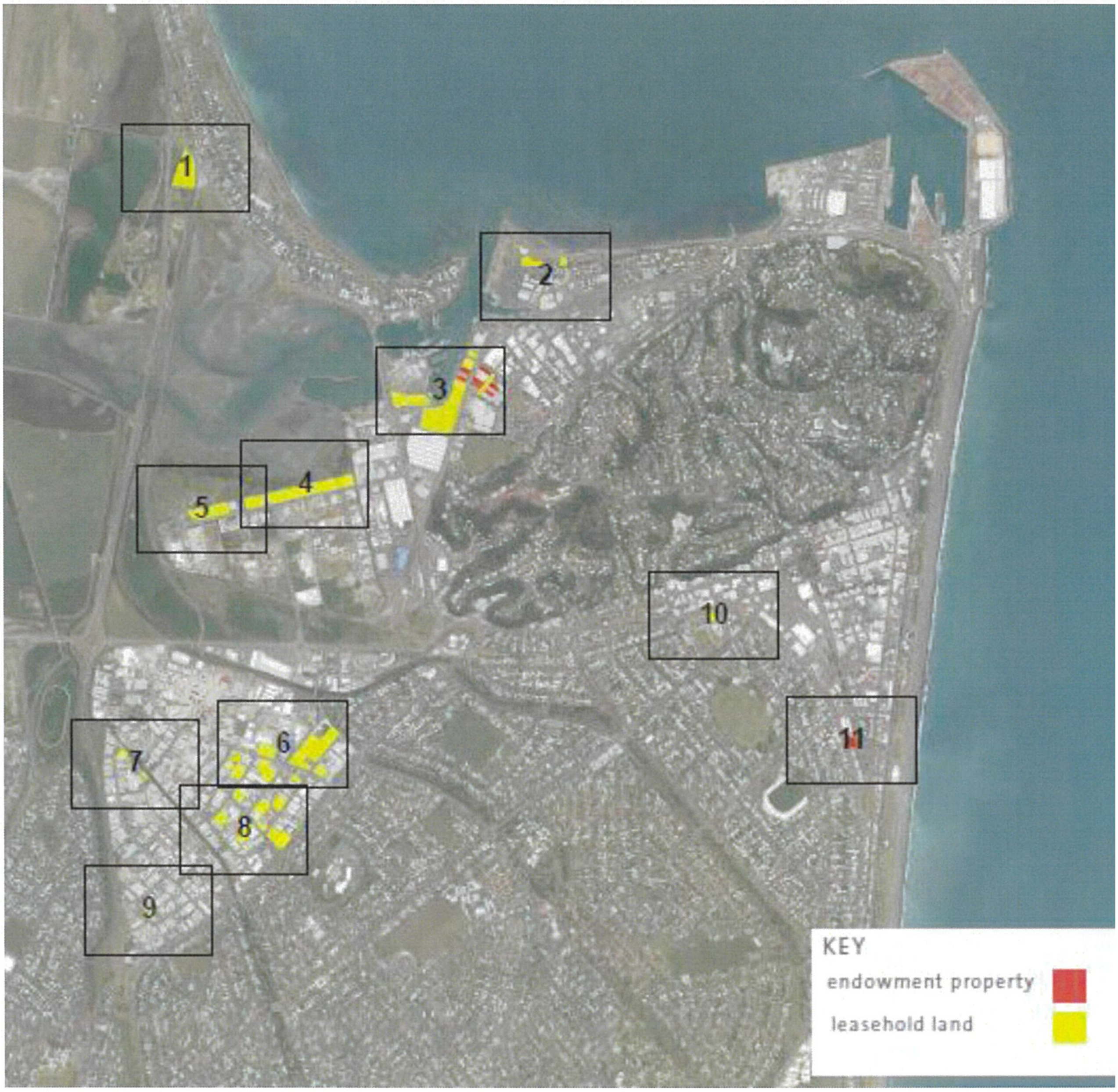
Carried

Based on the above recommendation from the Audit and Risk Committee option a. is the preferred option.

1.8 Attachments

1 Leasehold Land location map (Doc Id 1478675) ⇩

2 PwC review of the Investment Property Portfolio (Doc Id 1478676) ⇩



Leasehold land location.

Area 1 -Westshore Motor Camp
Area 2 -Hardinge Road
Area 3 -West Quay and Ahuriri
Areas 4 & 5 -Thames Street
Areas 6, 7, 8 & 9 -Onekawa Industrial Area
Area 10 -Owen Street
Area11 -Wellesley Road

DRAFT

Napier City Council

Leasehold investment portfolio review

May 2022

pwc

Napier City Council
Private Bag 6010
Napier, 4142

via email: garry.hrustinsky@napier.govt.nz; bryanf@napier.govt.nz

23 May 2022

Re: Napier City Council's Leasehold Investment Portfolio Review

This is a draft report. The comments in this draft report are subject to amendment or withdrawal: our definitive findings and conclusions will be those set out in the final report.

Dear Garry and Bryan,

Napier City Council (NCC) has a lessor's interest portfolio which comprises 61 perpetually renewable leases (excluding the residential leasehold portfolio) which are predominantly located in the Napier suburbs of Onekawa, Ahuriri and Pandora. NCC is reviewing its capital structure and nature of its investments and is seeking to understand the characteristics of the Leasehold Portfolio.

In accordance with your instructions as confirmed in our engagement letter dated 24 February 2022 (the Contract), we are pleased to provide you with our report, which includes:

- review and analysis of the historical asset values and long term portfolio returns (capital and income), including our view on potential forecast returns, and the volatility of the returns;
- a summary of the legal nature of the portfolio (including lease structures and review profiles);
- commentary on market sentiment / market impact on leasehold tenure and investment in land and buildings/businesses that might be associated with the tenure; and
- commentary in relation to the issues and opportunities associated with freeholding of the Leasehold Portfolio.

This report is strictly confidential. You may not make copies of this report available to other persons except as described in the Contract, and subject to the conditions described therein. We will not accept any duty of care (whether in contract, tort (including negligence) or otherwise) to any person other than you, except under the arrangements described in the Contract.

Yours sincerely,

John Schellekens
Partner

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Important notice

This report is issued pursuant to the terms and conditions set out in our engagement letter, dated 24 February 2022, and the Terms of Business referenced thereto.

This Report is addressed to you, NCC, and should not be reproduced or supplied to any other party without first obtaining our (PwC) written consent. We accept no responsibility for any reliance that may be placed on our Report should it be used for any purpose other than that set out below and in any event we will accept no liability to any party other than you in respect of the contents.

This Report does not constitute formal valuation advice and can not be used as such; our report does not comply with the minimum valuation reporting requirements referenced in local and international valuation standards.

This Report is strictly confidential and (save to the extent required by applicable law and/or regulation) must not be released to any third party without our express written consent which is at our sole discretion.

To the fullest extent permitted by law, PwC accepts no duty of care to any third party in connection with the provision of this Report and/or any related information or explanation (together, the “Information”). Accordingly, regardless of the form of action, whether in contract, tort (including without limitation, negligence) or otherwise, and to the extent permitted by applicable law, PwC accepts no liability of any kind to any third party and disclaims all responsibility for the consequences of any third party acting or refraining to act in reliance on the Information.

This Report has been prepared solely for the purposes stated herein and should not be relied upon for any other purpose. We accept no liability to any party should it be used for any purpose other than that for which it was prepared. This Report is strictly confidential and (save to the extent required by applicable law and/or regulation) must not be released to any third party without our express written consent which is at our sole discretion.

We have not independently verified the accuracy of any information provided to us and on which we have relied. Accordingly, we express no opinion on the reliability, accuracy, or completeness of the information provided to us and upon which we have relied and accept no responsibility for any errors which that information may contain.

The statements and opinions expressed in this report are based on information available as at the date of the report. We reserve the right (but will be under no obligation) to review our analysis and if we consider it necessary, to revise our opinion in the light of any information existing at the date of this Report which becomes known to us after that date.

The statements and opinions expressed herein have been made in good faith, and on the basis that all information relied upon is true and accurate in all material respects, and not misleading by reason of omission or otherwise.

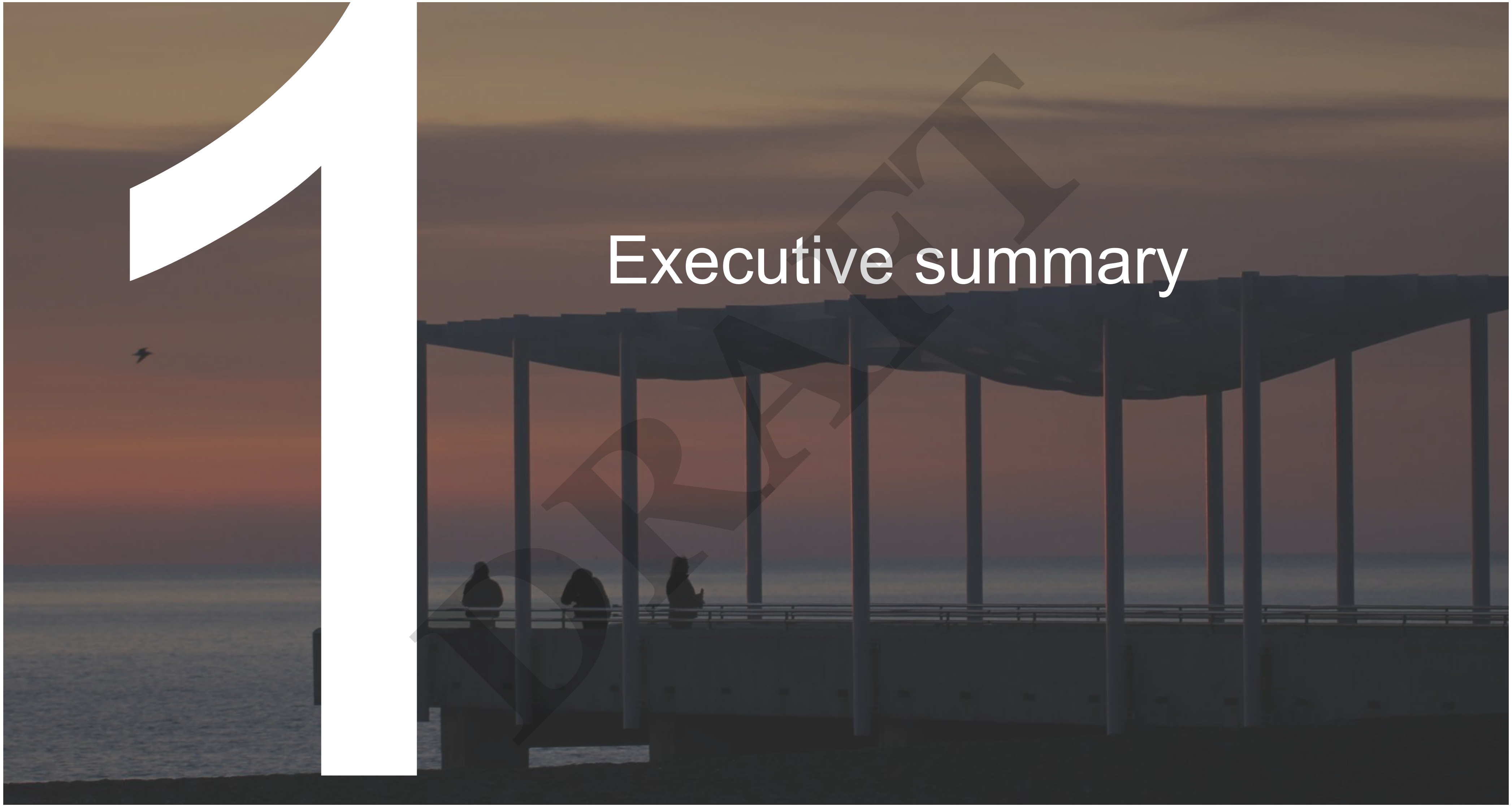
In addition, the following should be noted:

- Certain numbers included in tables throughout this document have been rounded and therefore do not add exactly.
- Unless otherwise stated all amounts are stated in New Zealand dollars and are inclusive of GST.
- Our analysis and commentary is indicative in nature. We reiterate that this report does not constitute a formal valuation advice and can not be used as such.

At the date of issuing this report, the COVID-19 pandemic continues to evolve and while many parts of the world, including New Zealand, are to a large extent moving on from the initial pandemic impacts, Omicron (and other variants) continue to linger and impact government policy and wider activity. What has become clear at this juncture is that the effects have been and continue to be sector specific, with tourism, retail and in some instances development assets the most impacted. In contrast, residential and industrial property has shown strong resilience to the crisis.

Contents

1 Executive summary



1.0 Executive Summary

Introduction and background

NCC owns a lessor's Interest portfolio (Leasehold Portfolio) which comprises 61 perpetually renewable leases (most follow 21 yearly review cycles) which are predominantly located in Onekawa, Ahuriri and Pandora, in Napier.

NCC is seeking to understand the characteristics of the Leasehold Portfolio (including lease structure composition and historical & forecast returns) as a part of its capital structure review. In addition, NCC wish to understand if the leasehold tenure is having a negative impact on investment decisions and inhibits new development in the area. We also comment on the issues and opportunities associated with freeholding of the Leasehold Portfolio (which is already occurring on a case by case basis for 'non-strategic' assets).

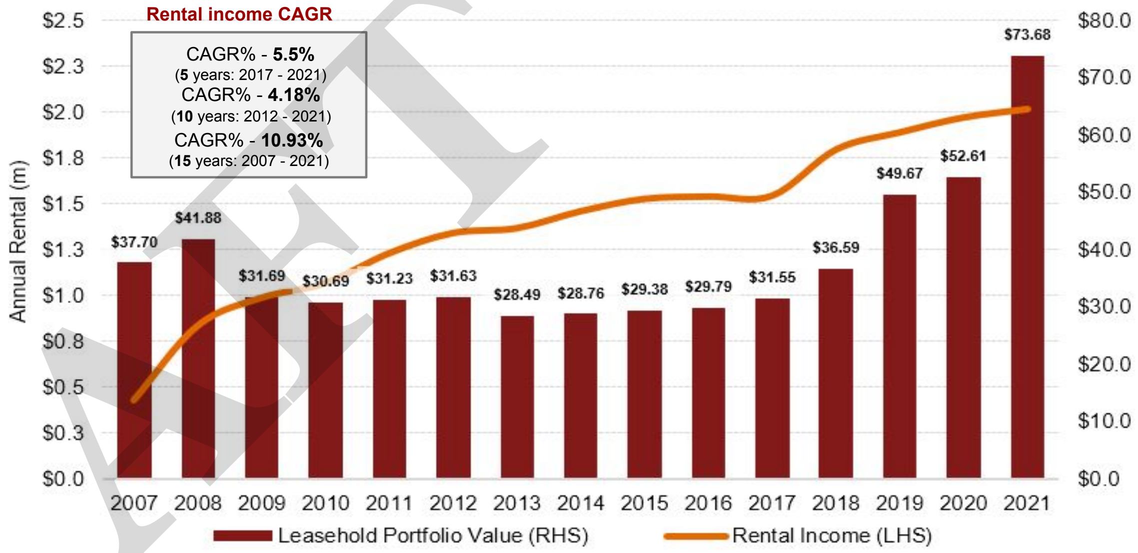
As at 30 June 2021, the Leasehold Portfolio was is valued at **$73.68m** and is generating an annual income of **$2.02m** (reflecting a rental yield of **2.74%**).

Historical values and returns

Overall, the value of the Leasehold Portfolio grew substantially over the past five years after a period of stagnation post the Global Financial Crisis(GFC) events. The commercial / industrial land market in Napier experienced a period of rapid land value growth post 2017 significantly boosted investment activity. The growth in underlying land values is almost directly correlated to growth in lessor's interests.

Rental return for the portfolio generally remained low (between 1.13% to 5.20%) and declined progressively (relative to value) as the value of NCC's Leasehold Portfolio improved. The compounding average growth rate (CAGR) in rent has varied over time, but been consistently solid.

Chart: Historical passing rental and the value of the Leasehold Portfolio



Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	
Total Annual Rental (m)	$1.34	$1.37	$1.46	$1.53	$1.54	$1.54	$1.80	$1.89	$1.97	$
Total Valuation Amount (m)	$31.63	$28.49	$28.76	$29.38	$29.79	$31.55	$36.59	$49.67	$52.61	$7
Rental Yield*	4.24%	4.79%	5.07%	5.20%	5.17%	4.89%	4.91%	3.81%	3.75%	2
Annual Capital Return %	1.29%	-9.93%	0.93%	2.16%	1.40%	5.93%	15.95%	35.75%	5.93%	40
Total Return (annualised)**	5.58%	-5.62%	6.05%	7.47%	6.64%	11.11%	21.64%	40.92%	9.90%	43

** Annual income yield (relative to the value in the respective year)*

***Sum of capital growth and net income over a single period expressed as a %, with income reinvested*

By virtue of the predominantly 21 year review cycles, rent reviews are 'lumpy' and therefore rental and total returns may vary considerable at any one time when analysis is undertaken across shorter investment horizons.

1.0 Executive Summary (cont.)

Total returns, being rental return and capital growth and as measured by internal rate of return (IRR) and summarised in the adjacent table, has been attractive by any measure, over the short and long term, and has typically materially outperformed, by way of example, the NZX50 index.

Table: Historical returns

Analysed period	Leasehold Portfolio - Total Return (IRR)	NZX50 Index*	NZ 10Yr Govt. Bond Yield**
5 years (Jun 21 - Jun 17)	32.0%	12.9%	2.3%
10 years (Jun 21 - Jun 12)	14.3%	13.9%	5.0%
15 years (Jun 21 - Jun 07)	8.0%	8.8%	5.9%
20 years (Jun 21 - Jun 02)	18.8%	9.8%	6.8%

**Compound annual growth over the analysed period*

***Bond yield is the yield to maturity at the start of the analysed period*

Impact of leasehold tenure on Napier's industrial sector

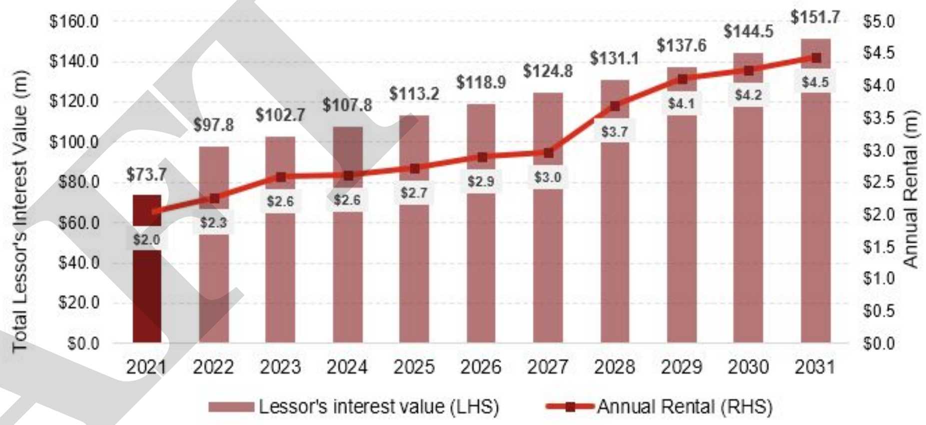
Leasehold tenure (the lessee's interest) is generally an unattractive ownership option that can result in under-investment in leasehold land.

There is no observable difference in the extent of investment and quality of improvements between the leasehold and freehold assets and we note that previous analysis undertaken by CBRE in 2016 did not provide any conclusive evidence that leasehold tenure was having a material adverse impact on investment levels in Napier industrial / commercial land. This, in our view, will likely change in the near future as improvements age (and require progressive and, in some cases, considerable capital expenditure) and ground leases undergo reviews and the significant increases in land values and therefore ground rent crystallise.

Forecast returns

To assist you with framing a view on future performance of the Leasehold potential capital and income growth profiles based on some key assumptions and our discussions with (and the information provided by) your Valuer.

Chart: Leasehold Portfolio performance forecast (high level, indicative analysis only)



Overall, based on the assumptions modelled (which are highly indicative only), the portfolio has the potential to continue experiencing capital appreciation with the rental levels increasing over time as more ground rental reviews take place. The rental yield, however, is projected to remain comparatively low (relative to value), generally below **3.0%** in any given year.

We have also undertaken a sensitivity analysis to test the impact the underlying growth in land values might have on the value of the portfolio and income yields. Assuming that growth in the first year crystallises being largely the known growth in the market since the June 2021 valuation, the analysis indicates that:

- if land values continue to appreciate at a level close to an average rate of **5%** per annum, the Leasehold Portfolio value might further appreciate by circa **55% (CAGR 6.96%)** over the next 10 years;
- if land value growth is subdued at say **2.5%** per annum the increase in value might be in the region of **25% (CAGR 5.78%)**.
- under a high scenario, if the land value growth averages say circa **7.5%** per

2 Leasehold Portfolio Overview & Historical Returns

2.0 Leasehold Portfolio Overview & Historical Returns

2.1 Introduction and background

NCC owns a Lessor's interest portfolio of 61 perpetually renewable leases which are predominantly located in the Napier suburbs of Onekawa, Ahuriri and Pandora. The cash flow generated from this investment is used to offset the cost associated with the maintenance and upkeep of the Napier inner harbour and foreshore reserves.

For the sake of clarity, the value of the NCC's Lessor's Interests has been determined broadly in line with the underlying freehold values and not using the traditional Lessor's Interest model whereby the sum of future cash flows is considered. This is the approach undertaken by your Valuer as the traditional way of calculating Lessor's Interest results in a value in excess of the freehold land value.

NCC's Leasehold Portfolio is extensive. We completed a roadside inspection of the majority of the properties with you on 14 March 2021.

The sites in the portfolio are typically commercial and industrial in nature, albeit we understand that there is also some high density residential property as a result of changing land use over time and new apartment developments occurring on former commercial / industrial land. For clarity, NCC has a residential leasehold portfolio which does not form part of the Leasehold Portfolio referenced in this report. Also, as per your instructions, our analysis includes endowment land but excludes recently freeholded properties as well as vacant (40 - 52 Thames Street) and improved (13 Husheer Place) properties.

The Leasehold Portfolio was valued by TelferYoung at **$73.68m** plus GST (if any) as at 30 June 2021. The total passing rental of **$2.02m** per annum reflected a passing rental yield of **2.74%** (as at June 2021).

Overall, the Leasehold Portfolio experienced exceptionally strong capital growth between 2017 and 2021 growing from $31.55m to $73.68m (reflecting a **134%** increase over a five year period). This increase was primarily fuelled by a strong level of industrial / commercial land value appreciation in Napier, and particularly post mid 2020 after the immediate impact of COVID-19 (which was experienced across many land markets nationwide).

2.2 Portfolio overview

The Leasehold Portfolio includes properties that are geographically located in the following Napier suburbs Ahuriri (Seafront), Pandora, Onekawa and other

Map: Geographical location of the properties included in the Leasehold Portfolio

2.0 Leasehold Portfolio Overview & Historical Returns (cont.)

The following table details the breakdown of the portfolio value by location:

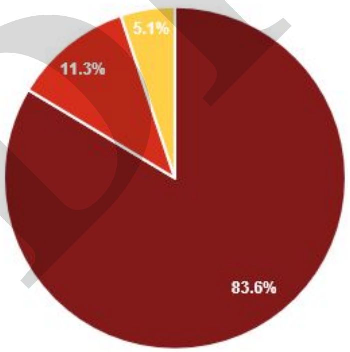
Table: Portfolio value by location (as per 30 June 2021 registered valuation)

Location	No. of leases	Lessor's interest ($m)	% of total	Rental ($m pa)	Income yield %
Seafront	11	$40.95	55.6%	$1.12	2.73%
Ahuriri Other	5	$4.03	5.5%	$0.09	2.23%
Pandora	16	$11.64	15.8%	$0.35	2.97%
Onekawa	27	$15.27	20.7%	$0.41	2.67%
Other	2	$1.79	2.4%	$0.05	3.04%
Total	**61**	**$73.68**	**100.0%**	**$2.02**	**2.74%**

The majority of portfolio value (as at 30 June 2021) lies with the Seafront assets (**55.6%** of portfolio value) followed by assets located in Onekawa (**20.7%**) and Pandora (**15.8%**).

The ground leases are perpetually renewable in nature with the vast majority (**80%+**) of the leases (by total value) following a **21** year review cycle, **11.3%** of the portfolio has seven yearly reviews with **5.1%** having five yearly reviews. The fact that a large portion of the portfolio has 21 yearly reviews and therefore long periods between reviews reflects the total passing yield currently achieved (relative to the valuation) of **2.74%**.

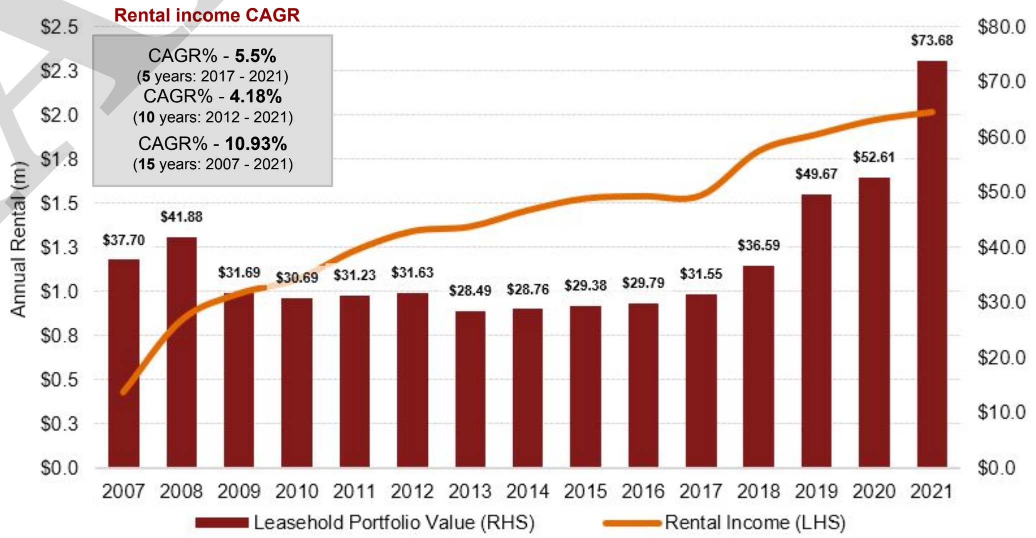
Chart: Review frequency (by value)



The absence of more frequent ground rental reviews coupled with the strong growth in the underlying land values results in the ground rental income constantly 'lagging' relative to what would be considered market attractive returns. Historically, continuous appreciation in land values led to income returns progressively declining (relative to the capital value) post years where there are a high volume of reviews.

Despite the low income returns, the Leasehold Portfolio has experienced strong capital value growth, particularly since 2017 (as depicted in the chart below).

Chart: Historical passing rental and the value of the Leasehold Portfolio

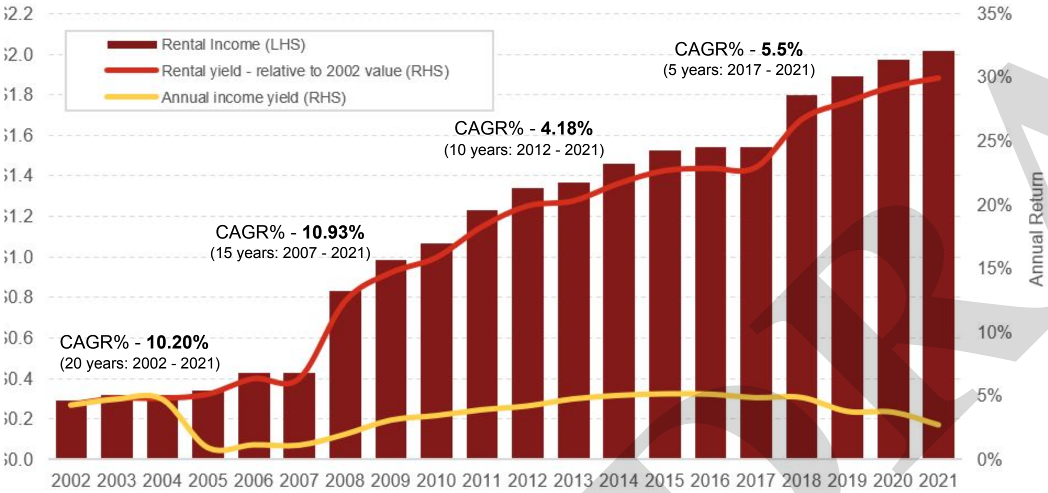


2.0 Leasehold Portfolio Overview & Historical Returns (cont.)

2.3 Historical returns

Historical returns dating from 2002 (and reflecting a 20 year investment timeframe) are depicted below:

Chart: Portfolio's rental income and rental yields (2002 - 2021)



The rental yield (red line) reflects the actual cash return achieved and is calcul as a function of annual rental income in the respective year relative to the 2002 portfolio value. The annual income yield (yellow line) is calculated by dividing e year's income by that year's value. We summarise the key findings as follows:

- Annual income returns experienced fluctuation and more recently started tc progressively decline post 2017 as land valued grew significantly. As at 202 the annual income yield was **2.74%** (by way of comparison, between 2014 2016 rental yields were in excess of 5.0%). The annual income yields decli due to the rapid increase in capital values in recent years (as shown in the graph on the previous page). Meanwhile, rental levels continue to 'lag' behi underlying land values and Lessor's interest value.
- We note that whilst rental yields have declined, the rental income generate from the Leasehold Portfolio progressively increased from 2002 (yields declined as a percentage of value but the actual rental roll did not reduce).
- Passing yield (re-based to the 2002 value) is strong at **c.30%**. This metric h limited, if any, relevance to evaluating portfolio performance but it is of gene interest. It is primarily driven by the increase in rental levels as a result of strong growth in land values (measure of a 2002 reference point).

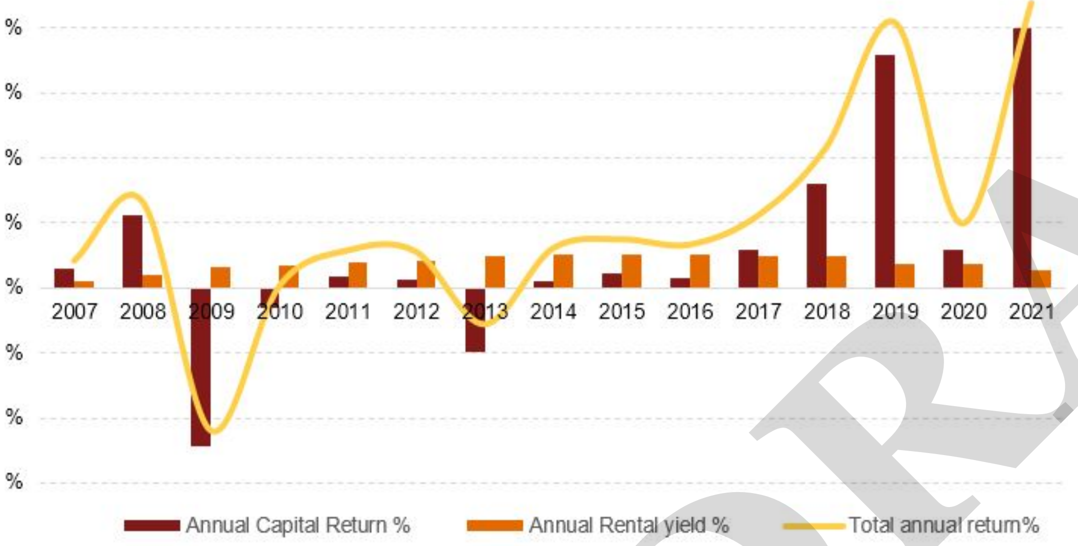
	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
l Annual Rental (m)	$0.43	$0.83	$0.99	$1.07	$1.23	$1.34	$1.37	$1.46	$1.53	$1.54	$1.54	$1.80	$1.89	$1.97	$2.02
l Valuation Amount (m)	$37.70	$41.88	$31.69	$30.69	$31.23	$31.63	$28.49	$28.76	$29.38	$29.79	$31.55	$36.59	$49.67	$52.61	$73.68
al Yield*	1.13%	1.99%	3.11%	3.47%	3.94%	4.24%	4.79%	5.07%	5.20%	5.17%	4.89%	4.91%	3.81%	3.75%	2.74%

nual income yield (relative to the value in the respective year)

2.0 Leasehold Portfolio Overview & Historical Returns

The Portfolio's capital and income returns experienced considerable volatility over the past 15 years, as depicted on the chart below:

Chart: Capital, income and total returns



The Leasehold Portfolio experienced a substantial (**24%**) drop in capital value in 2009 as a result of the GFC. Post 2009, annual capital returns stayed mostly subdued for the period between 2010 and 2017. From 2017, portfolio value starte to appreciate (which was driven by the growth in the underlying land values) with considerable year-on-year uplifts experienced in 2018, 2019 and more recently ir 2021.

Annual income returns since 2007 ranged between **1.13%** to **5.20%**, peaking in 2015 and gradually declining since as capital growth intensified. We reiterate tha income returns reflect the 21 year review cycle and, depending on the level of growth in land values over the medium term, income returns will likely continue tc remain low.

The total annual return also experienced fluctuations following the year on year changes in the total portfolio value. Year 2009 saw a sharp decline of **-21.99%** wi total returns peaking in 2019 and 2021 at **40.92%** and **43.89%** respectively (in lig of the considerable land value uplifts).

	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
Annual Rental (m)	$0.43	$0.83	$0.99	$1.07	$1.23	$1.34	$1.37	$1.46	$1.53	$1.54	$1.54	$1.80	$1.89	$1.97	$2.02
Valuation Amount (m)	$37.70	$41.88	$31.69	$30.69	$31.23	$31.63	$28.49	$28.76	$29.38	$29.79	$31.55	$36.59	$49.67	$52.61	$73.68
al Yield*	**1.13%**	1.99%	3.11%	3.47%	3.94%	4.24%	4.79%	5.07%	**5.20%**	5.17%	4.89%	4.91%	3.81%	3.75%	2.74%
al Capital Return %	3.00%	11.09%	**-24.34%**	-3.13%	1.76%	1.29%	-9.93%	0.93%	2.16%	1.40%	5.93%	15.95%	35.75%	5.93%	**40.05%**
Return (annualised)**	4.16%	13.30%	**-21.99%**	0.23%	5.76%	5.58%	-5.62%	6.05%	7.47%	6.64%	11.11%	21.64%	40.92%	9.90%	**43.89%**

2.0 Leasehold Portfolio Overview & Historical Returns (cont.)

Relative to other investment alternatives, the Leasehold Portfolio has outperformed Government bonds in each of the analysed periods. The portfolio also outperformed NZX50 over the short term and the long term (5 and 20 years) whilst generating generally comparable returns over the 10 year and 15 year timeframes.

Table: Historical returns

Analysed period	Leasehold Portfolio - Total Return (IRR)	NZX50 Index*	NZ 10Yr Govt. Bond Yield**
5 years (Jun 21 - Jun 17)	32.0%	12.9%	2.3%
10 years (Jun 21 - Jun 12)	14.3%	13.9%	5.0%
15 years (Jun 21 - Jun 07)	8.0%	8.8%	5.9%
20 years (Jun 21 - Jun 02)	18.8%	9.8%	6.8%

**Compound annual growth over the analysed period*

***Bond yield is the yield to maturity at the start of the analysed period*

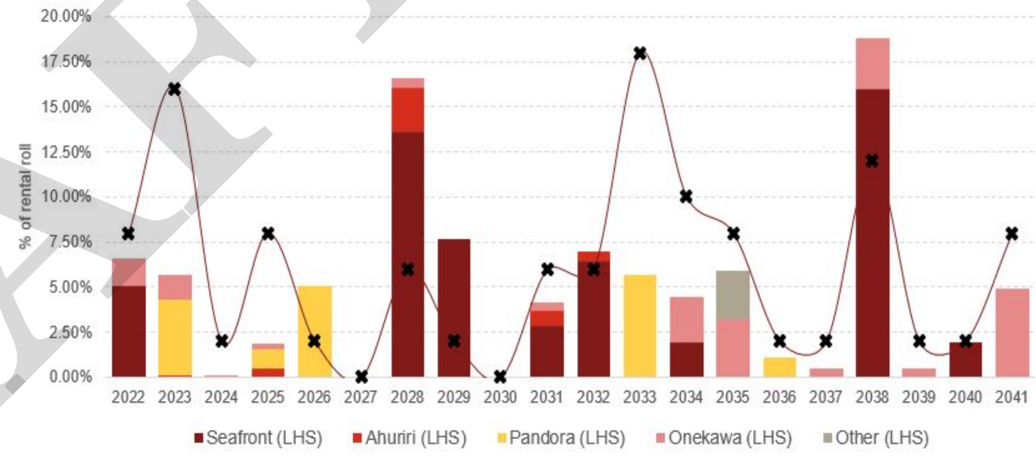
The IRR over the five year period presents as a clear outlier in the above analysis. The IRR of **32%** is due to the portfolio value more than doubling in the past five years and the rental generated increasing by circa **31%** over the same period.

2.4 Future ground rent reviews profile

The upcoming ground rental reviews will directly influence the level of income generated from the Leasehold Portfolio as more reviews occur reflecting higher ground rental payments. The review structure within the portfolio are in part prescribed at fixed ground rental percentages (fixed rental percentage multiplied by land value) and in part set to market.

A breakdown of the rental expiries by location (measured against the June 2021 rental levels) is shown on the right hand side (RHS) in the chart below, and the proportion of rental roll (by count) subject to review on the left hand side (LHS):

Chart: Rent review profile (as % of rental roll as at June 2021)



- Over the next five years **19.30%** of the portfolio (by rental roll) is due for ground rental review (18 leases);
- **47.67%** of the portfolio (by rental roll) is due for a review in the next 10 years (25 leases); and
- **71.81%** having reviews over the next 15 years (47 leases).
- The majority of the ‘high value’ Seafront leases have reviews in **2028**, **2029**, **2032** and **2038**.

2.0 Leasehold Portfolio Overview & Historical Returns (cont.)

2.5 Leasehold portfolio considerations

From a risk perspective, the Leasehold Portfolio is low risk. It is generating a stable income stream (that would be hard to replicate) whilst having essentially no reversionary risk as in the event of Lessee default the entire asset reverts to NCC.

Lessor's interests are passive assets relative to the more conventional property investments requiring limited ongoing management (however ground rental reviews can be contentious). Conversely, the Leasehold Portfolio is not diversified (by asset type or geography, with most sites located in neighbouring suburbs) exposing it to the specific fluctuations in the land development market in Napier. As an asset class, Lessor's Interests are substantially a 'capital gains play' or intergeneration 'store' of wealth where relatively low cash returns are traded off against strong capital growth and low relative default risk.

As previously detailed, the portfolio experienced considerable capital growth in recent years which was primarily driven by the scarcity of available industrial land in Napier and robust demand for industrial / commercial zoned land. Based on our discussion with your valuer (Mike Penrose of Telfer Young, 'Valuer'), these factors will likely continue to underpin the portfolio's value going forward. We have been advised that very limited land is available for sale within the precincts where the Leasehold Portfolio properties are located and that these locations are generally tightly held (with only a handful of properties transacting annually). As a result, the market view is that there is still 'room' for further appreciation in land values.

While the future outlook for the portfolio is generally optimistic at present, there are certain economic 'headwinds' such as the rapidly rising cost of capital (as interest rates increase) and ongoing supply chain challenges (i.e. rising construction costs and labour / material shortages) that might ultimately have an adverse impact on the land development market. However, as the demand for industrial / commercial land in Napier is underpinned by scarcity of land rather than availability of capital, the impact of these 'headwinds' on pricing might be somewhat subdued.

With almost half of the portfolio (measured against the 2021 rental roll) due for a ground rental review over the next 10 years, more lessee defaults might be expected as ground rentals could become unaffordable to some sitting lessees.

However, even if lessee's defaults do occur, NCC will re-take possession of the land (on a freehold interest basis) and the improvements, noting that in most (but not all) case, the improvements will represent added value.

2.6 Napier industrial market overview

The Napier industrial market has enjoyed a period of strong growth on the back of strong economic conditions and primary sector activity in Hastings District and a global focus on industrial assets. The demand for most industrial assets is strong and largely generated from investors, owner occupiers and developers. Industrial rents are trending upward for most accommodation that is of sound quality and reasonably located, with underlying land values having placed pressure on yard/ground rents. Dated premises that have reduced utility or are situated in secondary locations remain flat or under pressure, or indeed are trending toward redevelopment opportunities.

Napier City's industrial land supply is under pressure, with development becoming scarce. This has resulted in industrial land experiencing significant upward pressure that is unlikely to subside until such time as new land supply is introduced by way of rezoning.

Freehold A, B and C grade improved industrial investment assets are tending to provide the following returns:

- A-grade industrial assets that are occupied by quality tenants under on good lease terms are now attracting yields between **4.50%** and **6.00%**.
- B-grade assets with lesser quality tenants are attracting yields between **6.00%** and **7.00%**.

2.0 Leasehold Portfolio Overview & Historical Returns (cont.)

- C-grade assets that are dated, situated in inferior locations, or subject to inferior lease terms are attracting yields of **7.00%** or greater.

The gap between vacant and leased yields is tight, with reduced interest rate costs and greater risk appetite having translated into firmer yields across the board (albeit this could change as interest rates rise).

In summary, Napier City is an established and somewhat constrained industrial location and tends to generate demand from local investors, owner occupiers and port related activities. In recent years Napier has experienced an increase in investment from non local / institutional parties as a result of its attractive yields relative to other cities or districts.

2.7 Legal nature of the portfolio

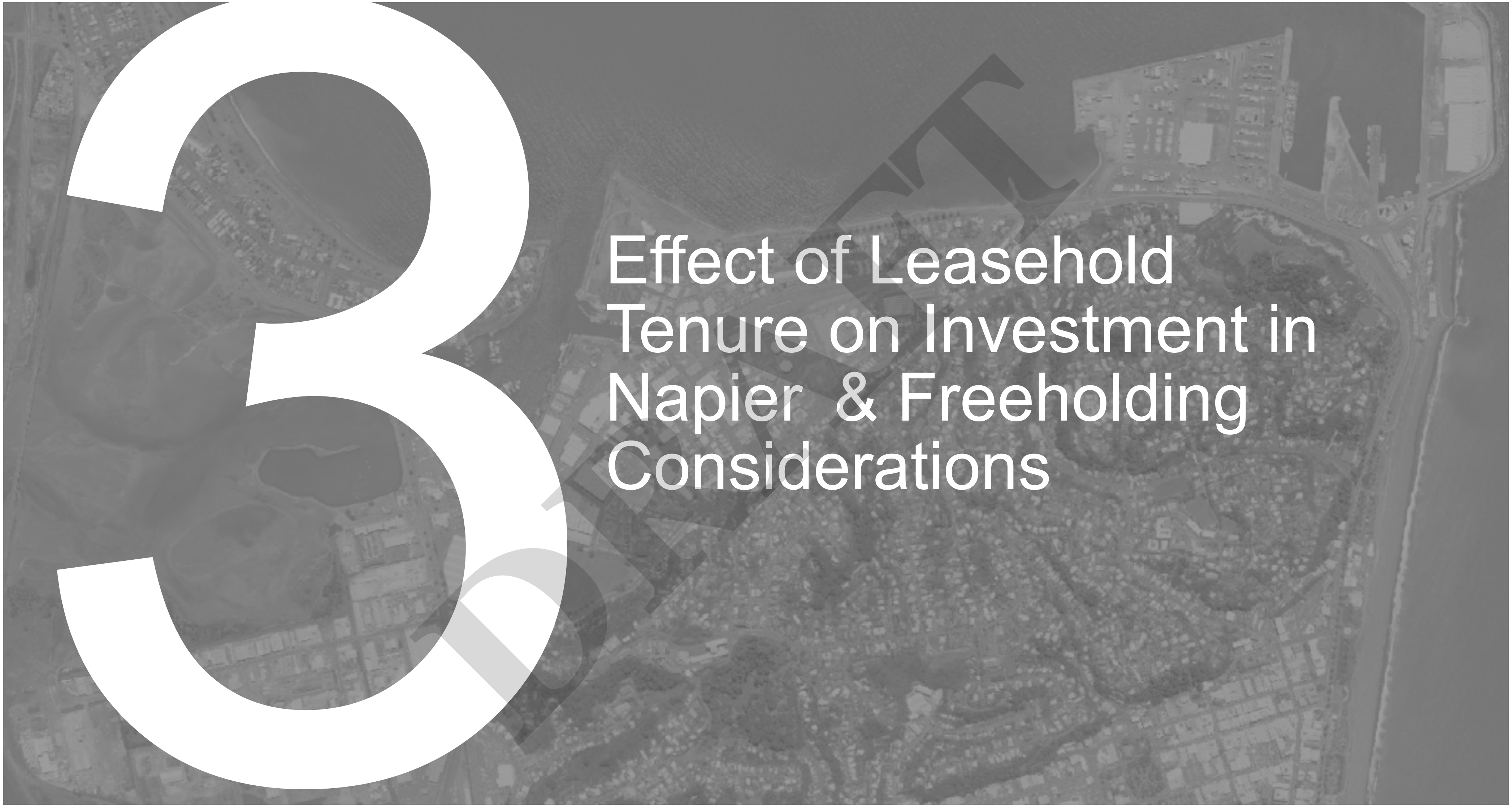
We have been provided with a sample of leases that are representative of the portfolio's legal composition. As discussed previously, the leases are perpetually renewable with the majority of the leases (by value) being subject to a 21 year rent review cycle. A summary detailing the key lease terms for each of the lease types is provided **overleaf**.

We make the following observations based on our review of the leases provided:

- Whilst the sample of leases provided generally include market-linked rent reviews, a considerable portion of the portfolio is subject to a prescribed ground rental percentage on review (being set at 5% of the freehold land value).
- The leases do not appear to incorporate ratchet clauses, meaning that the rental could decrease from the current levels.
- All leases (within the sample provided) include maintenance clauses whereby the Lessee shall keep and maintain the improvements in good repair order and condition.
- In the event of the lease being cancelled, improvements revert to the Lessor free from compensation.

2.0 Leasehold Portfolio Overview & Historical Returns (cont.)

Sample lease type	1	2	3	4
Term	**20 year**	**21 years**	**21 years**	**21 years**
Rent payment frequency	Quarterly	Half yearly	Half yearly	Half yearly
Rent review frequency	5 yearly	7 yearly	21 yearly	21 yearly
Rent review structure	Market (fair annual rental)	Market (fair annual rental)	5.0% of the freehold land value	Market (fair annual rental)
Ratchet clause	Nil	Nil	Nil	Nil
Renewal terms	20 years	21 years	21 years	21 years
Renewal structure	Perpetually renewable	Perpetually renewable	Perpetually renewable	Perpetually renewable
Operating expenses	Net	Net	Net	Net
Permitted activities	Development and operation of a motel together with closely related business activities such as a restaurant and bar.	Not mentioned	Not mentioned	Not mentioned
Maintenance obligations	The lessee shall keep and maintain all buildings, fences, gates, drains and other improvements in good repair order and condition. During the initial seven years of the lease, the lessee shall paint, clean and refurbish the exterior of the premises. During every subsequent seven years the lessee shall paint / clean and generally refurbish the exterior of the premises. Upon expiry or sooner, the lessee shall deliver the buildings, fences, gates, drains and other improvements with fair wear and tear, damage or destruction by fire alone excepted.	The lessee shall keep and maintain all buildings, fences, gates, drains and other improvements in good repair order and condition.	The lessee shall keep and maintain all buildings, fences, gates, drains and other improvements in good repair order and condition. Upon expiry of sooner, the lessee shall deliver the buildings, fences, gates, drains and other improvements with fair wear and tear, damage or destruction by fire alone excepted.	The lessee shall keep and maintain all buildings, fences, gates, drains and other improvements in good repair order and condition. Upon expiry of sooner, the lessee shall deliver the buildings, fences, gates, drains and other improvements with fair wear and tear, damage or destruction by fire alone excepted.
Improvements on expiry	Should the lessee choose not to renew, and the lease be sold, lessee improvements will be sold to new lessee at the lower of valuation or lessee's nomination. Should the lease be cancelled, all improvements, other than those removed by the lessee shall revert to the lessor free from compensation / payment.	Per lease type 1	Per lease type 1	Per lease type 1
Lessee's right to assign/sublet	Not without the lessor's consent which cannot be unreasonably withheld.	Per lease type 1	Per lease type 1	Per lease type 1



3 Effect of Leasehold Tenure on Investment in Napier & Freeholding Considerations

3.0 Effect of leasehold tenure on investment in Napier

3.1 Local market sentiment to leasehold tenure

A negative market sentiment towards leasehold assets is present in the local (and national) market although the period of buoyancy over the past two years has somewhat softened this negative view.

We are also aware that CBRE stated within their Investment Property Portfolio Review report (March 2016), that the lessees that they have met with all displayed negative sentiment towards leasehold property and stated that ground rental obligations affect their investment decisions (albeit noting that they met a small sample of lessees only that were specifically selected due to their strong views).

Anecdotally, we are aware of a recent instance where post a recent ground rental review (subject to a seven yearly review cycle), the ground rental more than doubled and was no longer affordable to the sitting lessee. The lessee made an attempt to sell the Lessee's interest (which was not successful) and then to freehold the site (also unsuccessfully).

Arguably, these instances will likely become more common as circa **50%** of the investment portfolio (by rental roll) will have a ground rental review over the course of the next 10 years and they will be having material ground rent increases. With most leases following a **21** year review cycle, the majority of the rentals currently payable have been established based on significantly dated land values and this will accentuate the adverse impact on lessees of ground rent on review.

3.2 Impact of leasehold tenure on investment decisions

We did not observe a noticeable difference in quality between the leasehold and freehold assets during our inspection in the locations where Leasehold Portfolio properties are located.

This would indicate that the leasehold tenure is not currently having an "obvious" impact on the reinvestment decisions (at least in building improvements), but this observation is likely more a factor of the established nature of Napier's industrial precincts with relatively limited new development (except in specific pockets). CBRE also noted in their report that many properties had been redeveloped or modernised immediately prior to the GFC in the late 2000's (although any investment since the GFC was likely to be minimal).

Photo: 68 Thames Street, Pandora

Photo: 54 Thames Street, Pandora

In addition, CBRE's analysis into the potential impact that the leasehold tenure has on reinvestment decisions in Napier did not provide conclusive results:

- The residual analysis (feasibility analysis solving for affordable land value) undertaken resulted in negative land values under the leasehold scenarios, albeit it was noted that development on freehold land was also challenging as economic rents required for a feasible development were also well below market levels.

3.0 Effect of leasehold tenure on investment in Napier (cont.)

- Analysis of capital value relative to land value (whereby improvements value is expressed as a percentage of capital value based on rating valuations) indicated a slight discount for NCC owned leasehold assets relative to freehold assets, albeit this could be due to a number of properties included in the Leasehold Portfolio being undercapitalised. Overall, there was no material observable difference relative to the freehold sites.
- Analysis of the general age of properties similarly did not produce a conclusive result as, proportionally, properties in the Leasehold Portfolio did not appear to have older onsite improvements relative to the freehold properties in the same locations.

However, in our view the following factors will have an impact on reinvestment decisions going forward:

- The majority of improvements developed on NCC land were built between 1960's to 1980's, meaning that they will either be requiring progressive capital upgrades or have reached a stage where (tenure aside) highest and best use is likely to be for redevelopment.
- Where a ground rental review is also approaching (and a considerable increase in ground rental is anticipated), lessees would be more likely to defer any capital upgrades and / or redevelopment until the ground rental is known/settled.
- In the event the ground rental payments reach unaffordable levels for lessees, lessee default / abandonment is likely, in which case the value/treatment of the improvements will be determined in line with the provisions of the lease and ultimately may result in Lessee's interest reverting to the lessor (NCC) under default provisions.

Overall, whilst to this point leasehold tenure does not appear to have had an observable impact on investment decisions. We expect that the impact of leasehold tenure will become more apparent as upcoming ground rentals are reviewed and the significant increase in underlying value flows through to rental increases.

3.3 Freeholding overview

Disposal of non-strategic assets can ultimately assist with redevelopment / revitalisation of industrial and commercial land in Napier and facilitate private investment into locations currently dominated by leasehold land. The proceeds received from freeholding could be diverted to other, investments with different attributes and provide a level of diversification and balance between income vs capital returns.

At present, the investment portfolio generates low income returns but highly attractive capital returns; capital returns cannot, however be realised until sale of a Lessor's Interest. Also, as land values appreciate, the freehold land that is currently underutilised or underdeveloped will likely attract new development activity that might not otherwise occur on leasehold land

In June 2018, NCC passed a resolution allowing freeholding of 'non-strategic' land. At present, freeholding is undertaken at NCC's full and sole discretion (as per the Investment Property Portfolio Policy document, and is not "a right" to encumbent lessees); under the resolution, the Lessor's Interest can only be sold to the registered lessee. This process is completed on a 'case by case' basis and there is no right of appeal or arbitration. The market value for the property is determined by a registered valuation which provides individual values for the following interests:

3.0 Freeholding considerations

- Freehold land value;
- Lessor's interest value;
- Lessee's interest value;
- Vacant possession value (assuming freehold tenure);
- Marriage value (if any) (which is an arbitrage opportunity that arises from merging Lessor's and Lessee's interests relative to the unencumbered freehold interest value).

The **greater** of the freehold land value or the aggregate of the Lessor's interest value and marriage value is then being used as the market value of the land.

We are aware of a number of freeholdings completed by NCC that have occurred over 2020 and 2021, these are summarised as follows:

Address	Sale Date	Sale Price	Land Area	Rate
9B,9D,9E Riddell St	Mar 21	$652,000	1,879 sqm	$347 psm
29 Austin Street	Jan 21	$350,000	1,004 sqm	$349 psm
34 Austin Street	Nov 20	$450,000	1,224 sqm	$368 psm
31 Cadbury Road	Aug 21	$285,000	766 sqm	$372 psm
30 Austin Street	Nov 20	$540,000	1,532 sqm	$352 psm
25 Cadbury Road	Dec 20	$345,000	1,072 sqm	$322 psm
19 Carnegie Road	Dec 20	$295,000	867 sqm	$340 psm
32 Austin Street	Nov 20	$330,000	938 sqm	$352 psm

Overall, the sale prices achieved upon freeholding were (as expected) in line with the freehold land values in Onekawa (at the time of sale).

In addition, we summarise in the table below a more detailed analysis pertaining to freeholdings occurred that over the past 12-24 months in Napier (NCC freeholdings are highlighted in grey):

Address	Sale Date	Land area	Lessor's interest	Rate $psm	Yield	IRR	%FHLV
97 Austin Street	Feb 19	46,640	$8,220,000	$176	1.05%	3.53%	117%
34 Austin Street	Nov 20	1,224	$450,000	$368	5.98%	7.42%	105%
32 Austin Street	Nov 20	938	$330,000	$352	5.00%	5.99%	100%
30 Austin Street	Nov 20	1,533	$540,000	$352	5.00%	5.99%	100%
96 Austin Street	Nov 20	29,645	$6,200,000	$216	-	-	100%
25 Cadbury Road	Dec 20	1,072	$345,000	$322	5.01%	5.83%	100%
29 Austin Street	Dec 20	1,004	$350,000	$349	5.00%	6.19%	100%
70 Taradale Road	Jan 21	4,067	$1,740,000	$428	-	-	101%

Source: TelferYoung Valuations

This analysis also reflects that freeholding is undertaken at or slightly above freehold land values. Importantly, all of the NCC freeholdings appear to have been undertaken post a recent ground rental review as initial yields are in line with the prescribed ground rental percentage (of 5.0%).

3.0 Freeholding considerations (cont.)

3.4 Freeholding considerations

We summarise pros and cons of the freeholding strategy of Leasehold Portfolio as follows:

Pros

- Leasehold tenure is generally an unattractive ownership option that results in under-investment in leasehold land and in many cases has proven to be not viable for the Lessee's interest owner over a long-term. This is particularly evident in instances where the ground rental is not reviewed frequently (i.e. follows a 21 year review cycle) or where the land value growth is considerable, resulting in unaffordable ground rental payments upon review. Freeholding addresses this challenge.
- Freeholding helps facilitate private investment into the areas dominated by leasehold land (stimulating development in these locations).
- In its current composition, the Leasehold Portfolio lacks diversification (both geographical and asset class) and is highly exposed to fluctuations in underlying land values. Freeholding facilitates diversification of the portfolio and could be viewed as establishing a more market attractive balance between income and capital returns.
- Lessor's interests (generally having low frequency of rent reviews) as an investment class are a substantially a "capital growth play"; the full extent of capital gains can only be realised on sale.
- Freeholding of 'strategic' sites is currently not contemplated in the NCC Investment Policy. NCC's objective is to hold 'strategic' assets until their strategic value can be realised. Once a plan for an area is shaped, NCC may dispose of its lessor's interest (or partner with the incumbent lessee) on the condition that the desired public benefits are achieved from the future use of the land. As such, NCC will not be disposing of the strategic sites until the appropriate time; this is a logical approach.

Cons

- Inherently, the Leasehold Portfolio is low risk. Lessor's interests are a highly sought after investment class due to their passive nature and stable cash flow characteristics with low default risk. They represent substantially a 'growth' play and a safe 'store' of intergenerational wealth.
- We understand that the proceeds from freeholding are required to be reinvested into a suitable alternative investment (creating reinvestment risk) so that NCC can continue to fund maintenance of the Napier's inner harbour and foreshore reserves. The steady and low risk cash flow generated from the Leasehold Portfolio would be hard to replicate albeit investing in assets with slightly higher risk and higher relative cash returns may represent value for money (albeit such a strategy would need to be carefully considered). Other investment classes are generally more volatile, management intensive or higher risk compared to the Lessor's interest assets.
- The returns generated from the Investment portfolio have outperformed NZX50 and Government Bond Yield returns.

3.0 Freeholding considerations (cont.)

- Timing of freeholding. It is likely that lessees would be more inclined to pursue freeholding after (or shortly prior to) a ground rental review (whereby owning land may become a more viable option relative to paying higher ground rental). As such, sale proceeds from freeholding will likely be 'bumpy' which may complicate investment decisions.
- The 'high value' sites are predominantly located within the Seafront precinct which is a strategic area and freeholding is unlikely to occur until the 'strategic value' of the land can be unlocked. As such, freeholding will likely be limited to smaller sites that have lower value (<$1.0m).
- There is sound demand and limited supply of industrial / commercial land in Napier which led to considerable appreciation in land values, particularly over the past five years. Land scarcity is likely to continue driving total return from portfolio into the future.

4 Forecast Returns Analysis

4.0 Potential forecast returns analysis

4.1 Overview

To assist you with framing a view on future performance of the Leasehold Portfolio, we liaised with your Valuer who is familiar with the investment and locational characteristics of the portfolio. We summarise the key findings from our discussion as follows:

- As previously discussed, Napier City's industrial land supply is under pressure, with new development land becoming scarce. Industrial land experienced significant upward pressure that is unlikely to subside until such time as new land supply is introduced by way of rezoning.
- Recent re-sales of industrial / commercial land indicate very strong value uplifts ranging from 28% to 100%+ over the past 12-24 months period. This suggests a further value uplift in the portfolio valuation since the last financial reporting date (being 30 June 2021).
- The strong land value growth experienced over the past years may well have reached a cyclical peak as at the date of this report, however, the local market is driven by scarcity rather than availability of capital, which may underpin future value appreciation (at least for a period).
- Historical, long term, land value growth rates of 1% to 3% that were widely adopted by Valuers in the past for forecasting purposes are no longer believed to be appropriate in the local market context (particularly considering the level of growth experienced in the past five years). Your Valuer is of the opinion that land value growth rates of between 5% to 10% per annum would be more appropriate for indicative, high level forecasting purposes (considering a 10 year investment horizon). We are not convinced this is appropriate to where we are in the market cycle.

4.2 Approach to forecasting returns

Forecasting future performance of any property asset is a highly hypothetical exercise as market conditions that exist at present may change swiftly and unexpectedly. In fact, the property market nationwide is starting to show signs of softening. By way of example, during the GFC the portfolio value experienced a considerable decline that took over 10 years to recover to pre-GFC levels.

Future economic (and asset) performance is impossible to predict with any degree of accuracy. As such, our analysis is indicative and high level only and should be considered in this context. We reiterate that at present there is a high level of market volatility that might have an adverse impact on the Napier property market (and ultimately translate to decline in the underlying industrial land values, being the key determinant of the value of NCC's Leasehold Portfolio).

To frame our view on potential future returns we have considered the following:

- First, to estimate the value of the Leasehold Portfolio as at May 2022 we have indexed the registered valuations of the Lessor's Interests (prepared as at 30 June 2021) for the respective locations. The indexation was informed by the percentage inflation ranges provided by your Valuer. By its nature, these ranges are highly indicative only (and we have been advised to treat them with caution). For the sake of clarity, the value derived using this analysis may be considerably different to the registered valuation for the 2022 financial year that you will procure shortly where valuations are performed at an individual property level. The advised ranges are summarised in the table overleaf.

4.0 Potential forecast returns analysis (cont.)

Table: Indicative land value inflation in various precincts since 30 June 2021

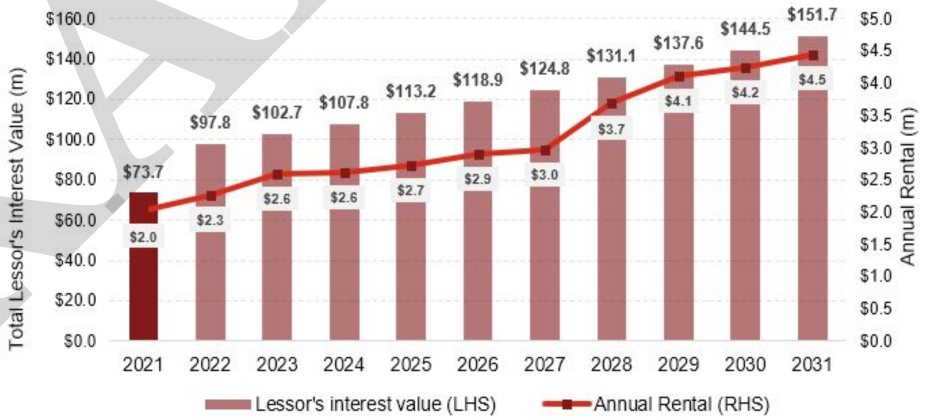
Precinct	Low	High	Adopt
Seafront	20%	30%	**20%**
Ahuriri	40%	100%	**40%**
Pandora	60%	80%	**60%**
Onekawa	45%	65%	**45%**
Other	25%	60%	**25%**

To be pragmatic, we have adopted the lower end of the aforementioned ranges in our analysis.

- Second, we adopted a **long term** land value growth rate of **5%** per annum from year 2023 onwards (again, this is at the lower end of the indicative long term land value growth range indicated by your Valuer).
- To forecast future **rental levels** we have, at a high level, modelled current passing rentals (until the respective review dates for the individual leases) as well as estimated future ground rentals that would be payable post the review date based on the land value growth assumptions made above (and having regard to the prescribed ground rental structure in place). This high level analysis has limitations:
- First, the ground rental increases resulting from the upcoming reviews may become unaffordable for many tenants (reviews over the next 10 years indicate an average ground rent increase of **3.67** times the current passing rental payable). This could lead to lessees defaulting, which will reduce the total rental roll, albeit will allow NCC to essentially have the freehold interest in the land. Our analysis does not account for any potential lessee's defaults.
- Second, where the ground rental structure is not prescribed (and is to be determined based on fair market levels), we have adopted ground rental percentages as assessed in the June 2021 valuations.

The chart below depicts the high level, forecasted, performance of the investment portfolio over a 10 year investment horizon (subject to the assumptions and limitations outlined above):

Chart: Leasehold portfolio performance forecast (high level, indicative analysis only)



Year	2021	2022	2023	2024	2025	2026	2027	2028	2029	2030	
Lessor's interest (m)	$73.68	$97.79	$102.68	$107.82	$113.21	$118.87	$124.81	$131.05	$137.60	$144.48	$
Total Annual Rental (m)	$2.02	$2.27	$2.59	$2.62	$2.73	$2.90	$2.97	$3.69	$4.11	$4.24	
Rental Yield*	2.74%	2.32%	2.52%	2.43%	2.41%	2.44%	2.38%	2.81%	2.99%	2.94%	
Total Return (annualised)**	43.89%	35.80%	7.65%	7.55%	7.53%	7.56%	7.50%	7.95%	8.14%	8.08%	

4.0 Potential forecast returns analysis (cont.)

We note that the significant increase from 2021 to 2022 reflects a 'catch up' on the significant improvement in the industrial market between NCC's latest valuation (June 2021) and the date of this report.

The portfolio has the potential to continue experiencing capital appreciation with the rental levels increasing over time as more ground rental reviews take place. The rental yield, however, is projected to remain low (relative to value), generally below **3.0%** in any given year, which substantially reflects the review structure of the portfolio, dominated by 21 year reviews.

Notwithstanding, the 'actual' (absolute) rental roll is increasing progressively over time. Whilst the rental returns are lower relative to the conventional property assets which attract rental yields in the region of 4.5% to 6.0% for A grade industrial assets, the characteristics of the lessor's interest portfolio (secure cash flow, passive investment nature and low risk profile) would be hard to replicate.

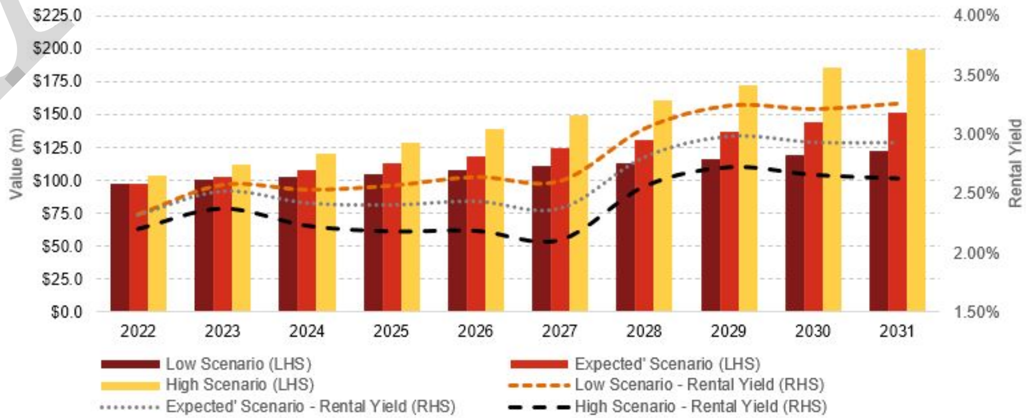
We reiterate that this analysis is indicative and high level only and may not eventuate. The value of the portfolio may decrease (as it has in the past) in response to the changes in economic conditions.

4.3 Sensitivity analysis

Further to the above, we undertook sensitivity analysis relative to the key variables adopted (which in this case is the indexation metrics (to estimate 2022 value) and long term value growth rate). We modelled the following scenarios:

- **Low Scenario:** Base case & 2.5% long term growth - to estimate the 2022 value we have adopted the lower end of the advised land value movement range (as detailed on the previous page, ranging from 20% to 60%); for the long term land value growth rate (post 2022) we used 2.5% per annum (which is more conservativerelative to the expected 5% to 10% range).
- **'Expected' Scenario:** Base case - for the 2022 value we have adopted the lower end of the advised land value movement range and for the long term land value growth (post 2022) we used 5%.
- **High Scenario:** 2022 Average & 7.5% long term growth - this is an optimistic scenario, the midpoint of the advised land movement range was adopted to estimate the 2022 value with the long term land value growth rate modelled at 7.5% from year 2023 onwards.

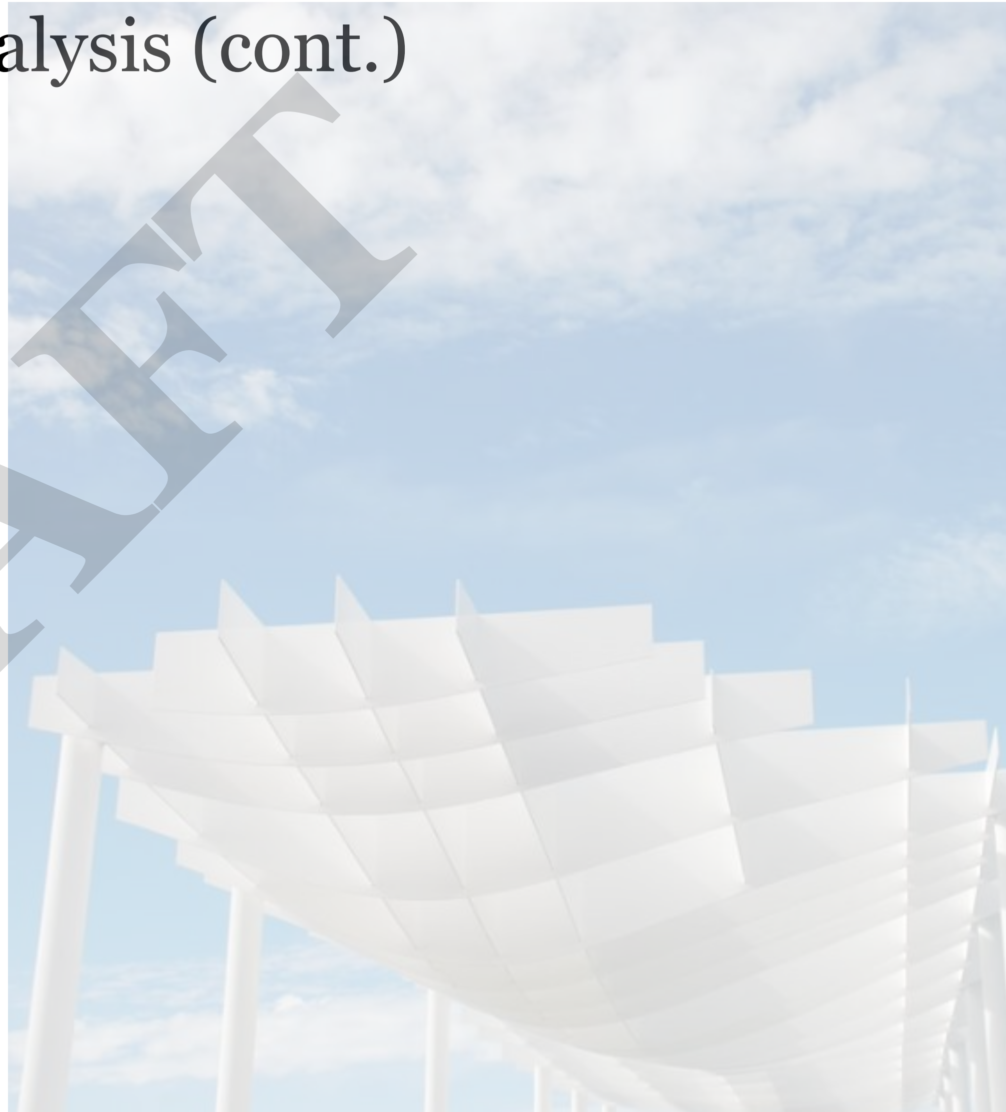
Chart: Sensitivity of the forecasted performance of the investment portfolio to changes in the land growth rates



4.0 Potential forecast returns analysis (cont.)

This analysis, assuming that growth in the first year crystallises the known growth in the market since the June 2021 valuation, indicates that:

- if land values continue to appreciate at a level close to an average rate of **5%** per annum, the Leasehold Portfolio value might further appreciate by circa **55%** (**CAGR 6.96%**) over the next 10 years;
- if land value growth is subdued at say **2.5%** per annum the increase in value might be in the region of **25%** (**CAGR 5.78%**).
- under a high scenario, if the land value growth averages say circa **7.5%** per annum the Leasehold Portfolio value might increase by **92%** (**CAGR 8.63%**).

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2. INVESTMENT POLICY REVIEW

Type of Report:	Operational
Legal Reference:	Local Government Act 2002
Document ID:	1477103
Reporting Officer/s & Unit:	Garry Hrustinsky, Investment and Funding Manager

2.1 Purpose of Report

The purpose of this report is to highlight and explain key proposed changes to the Investment Policy and to introduce the draft Statement of Investment Policies and Objectives (SIPO).

Officer's Recommendation

The Prosperous Napier Committee:

a. **Approve** the amended Investment Policy as presented (Doc Id 1471211)

b. **Approve (in principle)** a draft copy of the Statement of Investment Policies and Objectives (Doc Id 1471214)

c. **Note** that agreement on risk appetite for the Statement of Investment Policies and Objectives (the allocation to income and growth assets) and a portfolio distribution policy must be established by Council prior to adoption of the Statement of Investment Policies and Objectives.

2.2 Background Summary

Napier City Council owns various properties in Napier which Council classifies as Napier City Council's Investment Property Portfolio. This land, held in the portfolio, is leased to various individuals and entities. All land held in the portfolio was originally commercial and industrial land. Council holds and manages these properties on behalf of the Napier community for the benefit of both current and future generations. The Napier community enjoys the benefit of these properties through a reduction in general rates to the extent of income received.

On the 18 September 2018 Council adopted (within the Investment Property Portfolio Policy (Leasehold)) a divestment and investment policy for the sale proceeds be established and approved by Council resolution prior to the release of any leasehold land.

As part of that piece of work, changes to the Investment Policy have been drafted to receive and manage funds from the sale of any leasehold land through the inclusion of a Statement of Investment Policies and Objectives (SIPO).

Further, in a November 2019 report produced by the New Zealand Productivity Commission (*Local government funding and financing*) signalled a general shift in approach for local authority investment activity across a number of areas including capital investments. Innovation, diversity and flexibility within a prudent framework are encouraged to assist local authorities in meeting an increasing financial burden.

Additional changes are recommended within the Investment Policy to allow greater flexibility in how Council invests within the existing framework. To that end, portions of the policy have been rearranged and expanded to improve clarity, terminology updated or corrected, and investment limits softened to reflect a more contemporary and prudent approach.

Summary of Key Changes

- The purpose for holding strategic investments has been expanded to include cultural benefits and providing specific examples of strategic investments.
- A distinction has been established in the policy between the risk appetites for different asset classes rather than being risk averse for all asset classes.
- A more logical flow was introduced to the policy that creates a clear introduction, detail of what Council can invest in, and a subset of rules for each of those investments.
- Particularly for Treasury Investments, definitions have been included and investment limits have been replaced with investment guides to prevent adverse investment events occurring where Council is required to prioritise investment limits over cash flow and funding needs.
- The introduction of a separate Statement of Investment Policies and Objectives (SIPO) to manage funds received from the sale of leasehold property. This was done to keep the Investment Policy simple (the proposed SIPO is over 20 pages long), and to allow different investment rules to exist.

2.3 Issues

The current version of the Investment Policy does not allow for leasehold sale proceeds to be quarantined and managed differently from other Council assets. This has given rise to the need to introduce a SIPO that is referenced within the Investment Policy.

Investment rules within the policy reflect outdated terminology and are relatively inflexible. Adherence to the current policy may be detrimental Council assets – particularly in highly volatile or irregular economic environments.

Should a revised Investment Policy be adopted, additional work will need to completed on the Statement of Investment Policies and Objectives (SIIPO) (draft attached to this report) to ensure that it is appropriate for Council’s needs. This work will include consultation with industry specialists on the agreed investment strategy.

2.4 Significance and Engagement

During the pre-election period, Council business must continue however Council should also carefully consider the impact policy decisions or significant changes would have on the incoming Council.

The Investment Policy impacts on several hundred million dollars of Council assets.

Due to the specialised nature of investing, Council does not need to publicly consult on the Investment Policy (*refer to S.102 (1), (2), (4) and (5) of the Local Government Act 2002*).

The policy was workshopped by Council prior to presentation.

A final draft of the SIPO will need to be presented to Council for adoption.

2.5 Implications

Financial

Council has over $60m of leasehold property, with approximately $3m of sale proceeds that requires reinvestment. There is no requirement to sell property, but an appropriate vehicle needs to be available for current proceeds and any future proceeds.

Social & Policy

Policy amendments have been prompted from changes to the Investment Property Portfolio Policy (Leasehold) and direction from the Audit and Risk Committee for officers to proceed with a review of Council's investment strategy.

Risk

Without an amendment to the Investment Policy, Council is currently in breach of its obligations under the Investment Property Portfolio Policy (Leasehold) as some leasehold property has been sold without an investment policy in place to receive the proceeds.

Provisions within the current Investment Policy are not fit for purpose with regards to leasehold sale proceeds.

Much of the framework within the current policy was developed at a time of greater economic stability. Adherence to policy provisions is having a detrimental impact on treasury investments.

2.6 Options

The options available to Committee are as follows:

a. Approve the recommended changes to the Investment Policy and approve (in principle) the Statement of Investment Policies and Objectives.
b. Approve the recommended changes to the Investment Policy and approve (in principle) the Statement of Investment Policies and Objectives subject to further amendments (in addition to, or in place of, those recommended).
c. Reject recommended changes to the Investment Policy and the introduction of the Statement of Investment Policies and Objectives.

2.7 Development of Preferred Option

The preferred option has been developed with reference to current best practice, consideration of policies from other local authorities and in response to wider economic conditions.

2.8 Attachments

1 Investment Property Portfolio Policy (Leasehold) (Doc Id 1471213) ⇩
2 Investment Policy (current) (Doc Id 1471212) ⇩
3 Investment Policy (proposed) (Doc Id 1471211) ⇩
4 SIPO (draft) (Doc Id 1471214) ⇩

INVESTMENT PROPERTY PORTFOLIO POLICY (LEASEHOLD)

NAPIER CITY COUNCIL
Te Kaunihera o Ahuriri

Investment Property Portfolio Policy (Leasehold)

Adopted by	Napier City Council on 18 September 2018
Relevant Legislation	Local Government Act 2002, Hawke's Bay Endowment Land Empowering Act 2002, Napier Borough Endowments Act 1876
NCC Documents Referenced	NCC Long Term Plan 2018-2028 consultation process and subsequent Council resolutions 1 June 2018 and 29 June 2018. Council's adopted Investment Policy and Liability Management Policy pursuant to Section 102 (1) and Section 104 of the Local Government Act 2002

Purpose

The purpose of this policy is to outline the terms and conditions on which Council may sell non-strategic land included in the Napier City Council's Investment Property Portfolio. The policy also provides guidance relating to the investment of the proceeds of sale.

Background

After public consultation as part of Council's Long Term Plan 2018-2028, Council resolved on 1 June 2018 and confirmed on 29 June 2018:

That the resolutions from the Strategy and Infrastructure Committee meeting on 30 January 2018 be updated to reflect the following:

- To allow freeholding of non-strategic land using as a guide the June 2016 Boffa Miskell report "Napier City Investment Portfolio: Urban Landscape Strategic review" on a case by case basis.
- That recommendations on the freeholding of all identified non-strategic land be considered by the Audit and Risk Committee in the first instance for recommendation to Council.
- That the sale of leasehold land be a Decision of Council.
- That a divestment and investment policy for the sale proceeds is established and approved by Council resolution prior to the release of any leasehold land.

For the reasons that:

1. The current policy provides no flexibility for freeholding specific, non-strategic assets that if sold, could assist in the redevelopment of industrial and/or commercial land in Napier and stimulate private investment.
2. Introducing some flexibility in the policy will allow Council to consider each leasehold property on its merits so that any decisions relating to such land is made with the best intentions for the future of Napier.
3. Freeholding specific properties will enable diversification of the Council's investment portfolio which will reduce market exposure risks.

Using the Boffa Miskell report as guidance to determine the strategic nature of each property and performing an investigation into sale and reinvestment opportunities on a case by case basis, gives Council the ability to adapt to current market conditions whilst also providing the ability for Council to secure better community outcomes and value from the area through project design, urban design, up-zoning the land to encourage better development potential or a combination of these, whilst also ensuring maximum benefit to ratepayers.

Description of Portfolio

The portfolio consists of the ownership of a lessor's interest portfolio, which comprises 74 leases known as the Investment Property Portfolio. Council owns the lessor's interest in these properties and a number of individuals and businesses own the lessee's interest. The leases are perpetually renewable meaning that, subject to continuing to pay rental (which is reviewed at periodical intervals) the lessees have a perpetual right to occupy the land. The improvements on the land are owned by the lessees, not Council.

Freeholding essentially involves the lessees purchasing Council's interest in the land. Council has no automatic right to purchase the Lessees interest and any purchase would require agreement between both parties.

Background to ownership

The Investment Property Portfolio was originally established from:

- Properties transferred to Council from the Hawke's Bay Harbour Board as part of the Local Government reorganisation in 1989. The reason for the transfer was to provide an income generating asset to offset the liability associated with the upkeep of the Inner Harbour and Foreshore Reserves, which transferred at the same time. The income generated from these properties has historically been applied by Council to fund in part the cost associated with these activities.
- Properties already owned by Council as a result of land development in conjunction with the Harbour Board.
- Other sundry properties which have been owned by Council for many years.
- Endowment Properties - Nine of the properties in the portfolio are subject to the Napier Borough Endowments Act 1876 and before freeholding of these can occur any requirements under that Act and Sections 140 and 141 of the Local Government Act 2002 must be satisfied.

Policy Statement

1. Overriding Principle

The Council's ability to sell non-strategic land under this Policy represents a discretion to be executed by Council on a case by case basis. Nothing in this Policy represents a right for any person to insist or require the Council to sell to them and the sale by Council of any land under this Policy does not create precedent or expectation that other land held by Council (whether of a similar nature or not) will be sold.

The above decision by Council sets no deadline for the expiry of the policy allowing consideration of freeholding on a case by case basis. The discretion regarding triggering a freeholding request therefore rests with the lessee.

2. Party to whom Council may sell land to

Sales are only to be made to the registered Lessee at the time of sale.

3. Valuation

Where land is sold it is to be sold at such price as determined by Council at its sole discretion. Full Market Value as determined by a registered valuer, commissioned by Council, is to be used as a guide. There is no right of appeal or right of arbitration.

4. Discount

No discount is to be applied irrespective of whether or not the land is used in full or in part for residential accommodation. The 30% discount on market value applied, as per Council policy, to the freeholding of residential land shall not apply to the land held in the Investment Property Portfolio

5. Payment Method

The purchase price will be paid as follows:

a. A deposit of 15% upon signing a sale and purchase agreement; and

b. The balance in full on settlement

The lessees will also be required to pay Council's costs of sale (including legal fees and disbursements). These costs will also be payable in full on settlement. Lessees will be required to meet all costs in seeking independent advice from their own professional advisors.

6. Factors which may be considered in determining the strategic nature of properties

The 2016 Boffa Miskell report may be used as a guide in determining on a case by case basis the strategic nature of each property. The five site assessment criteria used in the report were:

- **Adjacency to public amenity**
  Is the site adjacent to current or potential future public amenity e.g. coast/walkway? If it is adjacent, additional value may be able to be returned from the site by an investment in that amenity, or by undertaking re-development of the site to leverage value from a new form of activity or building.
- **Potential for collective redevelopment**
  Is the site isolated, or is it within a collection of Council sites that are large enough to enable a potential redevelopment if developed as a package? Larger sites generate opportunities for a collection of buildings and public space together whereas splitting sites reduces potential
- **Located in a transformational area**
  Is it in an area where change is already occurring and where Council might want to consider using the land to help the area to change?
- **Potential to improve connectivity + amenity**
  Can the site be used to improve connections between streets or as part of an open space network, or can it be re-purposed to make a new amenity?
- **Connections to infrastructure**
  Is the site able to be utilised for new infrastructure such as sustainable urban storm water device or for new streets etc.?

In addition, other strategies and plans of Council will also be used to determine the strategic nature a property such as City Vision and the Ahuriri Masterplan.

A financial analysis may also to be carried out to determine whether the land is strategic as an investment. Such analysis to include generally recognised measures and benchmarks in the property sector. Council may engage external professional advice on a case by case basis to assist in any evaluation.

7. Purchase of Lessees improvements

Consideration may be given to the purchase by Council of the Lessees interest in land held in the Investment Property Portfolio. This may be considered where this will result in a better outcome for the future of the property in the best interests of Council and City development. Any such purchase will require a resolution of Council.

8. Investment of sale proceeds

It is recognised that by allowing lessees to freehold with no deadline, Council will have no control over when the proceeds will be realised. This potentially impacts timing issues surrounding the ability for Council to sell down non- strategic properties and make desired investments.

Internal borrowing from Council reserves may be considered in order to facilitate investment opportunities ahead of the receipt of freeholding funds. Sale proceeds are to be ring fenced and initially credited to an interest bearing special fund within Council's accounts.

Investment decisions relating to these funds are to be made on a case by case basis and are to comply with Council's Investment Policy and Liability Management Policy adopted as a requirement under Section 102(1) and Section 104 of the Local Government Act 2002. Council may also refer for guidance to the Investment Strategy Analysis Review Report dated October 2016 prepared by

PricewaterhouseCoopers for Council. Updates to this report may be periodically required along with external professional advice on a case by case basis when evaluating investments.

The underlying goal is to ensure that any investments considered continue to generate sufficient income to replace that lost by properties sold. New investments require a resolution of Council.

9. Process for freeholding

Current registered lessees may make application in writing to have their property considered for freeholding.

An evaluation will then be undertaken by a panel of Council officers appointed by the Chief Executive to determine whether or not the property is strategic in terms of both location and as a financial investment. A market valuation will be conducted at this point in time.

Council officers will then make a recommendation to the Audit and Risk Committee. All recommendations will flow through to the Finance Committee who in turn will make a recommendation to Council.

Should Council resolve to allow the freeholding of a specific property, then a written offer will be made by Council giving a 3-month deadline for the lessee to accept and sign an appropriate agreement. After the three-month deadline the offer will lapse.

Legal work to complete transactions will be made by Council's Solicitors. The purchaser will however pay these costs.

Policy Review

The review timeframe of this policy will be no longer than every three years.

PUBLIC POLICY

Investment Policy			
Adopted By	Council		
Department	Finance		
Original Adoption Date	30 June 2015	**Review Adoption Date**	21 May 2020
Next Review Deadline	21 May 2023	**Control Document ID**	346412
Relevant Legislation	Section 102(1) of the Local Government Act 2002		
NCC Docs Referenced	n.a.	**Published Document ID**	n.a.

For information all administrative aspects of reviewing policy, please refer to Policy Review Procedure, document ID 667482

Purpose

The Investment Policy is adopted under Section 102(1) of the Local Government Act 2002 and must state the local authority's policies in respect of investments.

Policy

Council generally holds investments for strategic reasons where there is some community, social, physical or economic benefit accruing from the investment activity. Generating a commercial return on strategic investments is considered a secondary objective. Investments and associated risks are monitored and managed, and regularly reported to Council in accordance with the relevant sections of the Council's Treasury Management Manual.

In its investment activities Council is guided by the Trustee Act of 1956. When acting as a trustee or investing money on behalf of others, the Trustee Act highlights that trustees have a duty to invest prudently and that they shall exercise care, diligence and skill that a prudent person of business would exercise in managing the affairs of others.

Council is a risk-averse entity and does not wish to incur additional risk from its treasury activities. Its broad objectives in relation to treasury activity are to manage all of Council's investments within its strategic, financial and commercial objectives and optimise returns within these objectives, manage the overall cash position of Council's operations to meet known and reasonable unforeseen funding requirements, and invest surplus cash and the financial investment portfolio in liquid securities and strongly credit-rated counterparties.

Staff seek to develop and maintain professional relationships with Council's bankers, financial market participants and other stakeholders.

Acquisitions of New Investments

With the exception of treasury investments, new investments are acquired if an opportunity arises and approval is given by the appropriate Council committee, based on advice and recommendations from Council officers. Before approving any new investments, Council gives due consideration to the contribution the investment will make in fulfilling Council's strategic objectives, and the financial risks of owning the investment.

The authority to acquire treasury investments is delegated to the Director Corporate Services.

Mix of Investments

Council maintains investments in the following mix of investments:

Equity Investments

Equity Investments are held for various strategic, economic development and financial objectives, as outlined in the Long Term Plan (LTP.) Council Equity Investments include interests in the Hawke's Bay Airport Authority and Omarunui Landfill Operation, and may include other Council Controlled Organisations (CCOs). Council may also make advances to CCOs.

Council seeks to achieve an acceptable rate of return on all its equity investments, consistent with the nature of the investment and Council's stated philosophy on investments.

Council reviews the performance of these investments on a regular basis to ensure strategic and economic objectives are being achieved. Any disposition of these investments requires Council approval. Dividends received and proceeds from the disposition of equity investments are used to repay debt, to invest in new assets or investments or any other purpose that is considered appropriate by Council.

New Zealand Local Government Funding Agency Limited (LGFA)

Council may invest in shares and other financial instruments of the LGFA, and may borrow to fund that investment.
Council's objective in making any such investment will be to:

- Obtain a return on the investment.
- Ensure that the LGFA has sufficient capital to remain viable, meaning that it continues as a source of investment and/or debt funding for the Council.

Council may invest in LGFA bonds and commercial paper as part of its financial investment portfolio.

As a borrower, Council's investment is recognised through shares and borrower notes. As an investor in LGFA shares and as a Guarantor, Council subscribes for uncalled capital in the LGFA.

Property Investments

Council's overall objective is to own only property that is necessary to achieve its strategic and commercial objectives, or deemed to be a core Council function. Council therefore retains an investment in car parking, leasehold land, and rental and retirement housing. Generally, Council will not maintain a property investment where it is not essential to the delivery of relevant services, and property is retained only where it relates to a primary Council output.

Property purchases are supported by registered valuations and, where appropriate, a full business case analysis. Council does not purchase properties on a speculative basis.
Council provides car parking facilities which are operated on a commercial basis, and are run to cover ongoing operational costs.

Rentals and ground rent from property investments, other than land covered by the HB Endowment Land Empowering Act 2002, is included in the consolidated rating account. Council's leasehold land portfolio was transferred from the Hawke's Bay Harbour Board in 1989 as part of the local government reorganisation and Council, by virtue of the Hawke's Bay Endowment Land Empowering Act 2002, is allowing lessees to freehold residential properties, which is diminishing the portfolio.

Council owns various Napier properties which it classifies as the 'Napier City Council Investment Property Portfolio'. The land held in the portfolio is leased to a variety of individuals and entities, and is managed in line with Council's leasehold land policy.

Property disposals are managed to ensure compliance with statutory requirements. Any disposition of a property investment requires Council approval.

Treasury Investments

Council maintains treasury investments for the following primary reasons:

- to invest amounts allocated to loan redemption reserves, trusts, bequests and special funds.
- to invest surplus cash, and working capital funds.

All interest income from Council's treasury investments is included in the consolidated rating account or special activity account.

Treasury Investment Philosophy and Objectives

Council's philosophy in the management of treasury investments is to optimise its capital protection and liquidity objectives while balancing risk and return considerations. Council recognises that as a responsible public authority any investments that it does hold should be low risk. It also recognises that lower risk generally means lower returns.

To provide the greatest benefit, Council utilises its surplus internal funds for internal borrowing to reduce external debt, thus effectively reducing net interest costs.

Council's primary objective when investing is the protection of its investment capital and liquidity of its investment. Accordingly, only creditworthy counterparties are acceptable. Creditworthy counterparties are selected on the basis of their current Standard and Poor's (S&P) or equivalent rating, which must be strong or better.

To avoid undue concentration of exposures, treasury investments/financial instruments should be used with as wide a range of counterparties as practicable. Where possible, transaction notional and principal sizes and maturities should be well spread. Investment in corporate shares is considered to be an inappropriate asset class and therefore expressly forbidden.

Within the above credit constraints, Council also seeks to:

- Ensure investments are liquid
- Maximise investment return
- Manage potential capital losses due to interest rate movements

Credit, Liquidity and Interest Risk Management

- Credit risk is minimised by placing maximum limits for each broad class of non-Government issuer, and by limiting investments to registered banks, strongly rated State-Owned Enterprises, supranationals, local authorities and corporates within prescribed limits.
- Liquidity / Maturity risk is minimised by managing maturity terms within strict policy limits and ensuring that all negotiable investments are capable of being liquidated in a readily available secondary market.
- Interest Rate risk is minimised by investing in fixed rate bonds and bank term deposits spread over a range of maturity terms.

Financial Investment Interest Rate/Maturity Limits

The following control limits are designed to manage interest rate risk and maturity risk on the financial investment portfolio. The portfolio comprises both cash and core treasury investments. Cash investments relate to matching investments with Council's working capital funding requirement and liquidity buffer amount requirements. Core treasury investments relate to unencumbered investments that are invested for terms of greater than three months.

An important objective of the financial investment portfolio is to match the portfolio's maturity term to planned expenditure, thereby ensuring that investments are available when required.

Period	Minimum	Maximum
0-6 months	30%	80%
6-12 months	20%	70%
1-3 years	0%	50%
3-5 years	0%	20%

Counterparty Limits

Counterparty credit risk is the risk of losses (realised or unrealised) arising from a counterparty defaulting on a financial instrument where Council is a party. The credit risk to Council in a default event will be weighted differently depending on the type of instrument entered into. Limits should be spread amongst a number of counterparties to avoid concentrations of credit exposure. Credit ratings are as determined by Standard and Poor's, or equivalent rating. If any counterparty's credit rating falls below the minimum specified in the following table, then all practical steps are taken to eliminate the credit exposure to that counterparty as soon as practicable.

Issuers	Approved Instruments	Minimum Long-Term &Short-Term Credit Rating (S&P)	Maximum per Counter-party	Maximum % of Total Investment Portfolio
NZ Government	Treasury bills Government stock	N/A	Unlimited	100%
NZ Local Government Funding Agency	LGFA Fixed and Floating Rate Bonds Promissory notes / Commercial paper Borrower Notes	AA-/A-1	$40.0m	50%
NZD Registered Supranationals	Promissory Notes / Commercial Paper, Fixed and Floating Rate Bonds	AAA	$20.0m	30%
State-Owned Enterprises	Promissory Notes / Commercial Paper, Fixed and Floating Rate Bonds	A+/A-1	$15.0m	20%

Issuers	Approved Instruments	Minimum Long-Term &Short-Term Credit Rating (S&P)	Maximum per Counter-party	Maximum % of Total Investment Portfolio
New Zealand Registered Banks *	Money market call deposits and term deposits, Registered Certificates of Deposit, Senior Bonds	A+/A-1	$30.0m or 40% of total portfolio (whichever is the lesser)	100%
Corporate Bonds *	Promissory Notes, Commercial Paper, Fixed and Floating Rate Senior Bonds	A+/A-1	$3.0m	20%
Local Authority	Fixed and Floating Rate Bonds and Stock, Commercial Paper	A+/A-1 (if rated) Unrated	$5.0m $3.0m	20%

* Note: An approved exception to the above is other treasury investments made with local registered banks that are regulated by the Royal Bank of New Zealand having a credit rating of at least BBB. Such investments shall be limited to a term of 3 months or less, and be for not more than $2 million in aggregate. At no time should the total exposure to this risk category be greater than 5% of the total investment portfolio.

Any other financial instrument must be specifically approved by Council on a case-by-case basis and is applied to only the one singular transaction being approved.

All secured and unsecured investment securities must be senior in ranking. The following types of investment instruments are expressly excluded:

- No asset backed securities are allowed.
- Structured debt where issuing entities are not a primary borrower/ issuer.
- Subordinated debt, junior debt, perpetual notes and debt/equity hybrid notes such as convertibles.

Council does not adopt the use of interest rate risk management instruments on its investments.

Loan Advances

Council may provide advances to CCOs, charitable trusts and community organisations for strategic and commercial purposes only. New loan advances are by Council resolution only. Council does not lend money, or provide any other financial accommodation.

Loan advances are generally provided on an unsecured basis. Where possible, Council seeks security through a mortgage over land and buildings.

Council reviews performance of its loan advances on a regular basis to ensure strategic and economic objectives are being achieved.

Loan Redemption Reserves

Council establishes specific Loan Redemption Reserves for each new external borrowing. The internal Loan Redemption Reserve is invested in accordance with Council's Investment Policy.

Investment Management and Reporting Procedures

Council's investments are managed on a regular basis, with sufficient minimum immediate cash reserves and a cash buffer maintained. The daily cash position is monitored and managed through the Daily Cash Position Report, and long term cashflow through the annual Cashflow Forecast. To maintain liquidity, Council's short and long term investment maturities are matched with Council's known cashflow requirements.

The performance of Council investments is regularly reviewed to ensure Council's strategic objectives are being met. Both performance and policy compliance are reviewed. Internal investment reports are a vital management tool and, depending on their nature, are produced on a daily, weekly, monthly, quarterly or annual basis. The results are summarised and reported to Council on a quarterly and annual basis.

Foreign Exchange Policy

Council has foreign exchange exposure through the occasional purchase of foreign exchange denominated assets approved through the capital planning process. Generally, all commitments over NZ$100,000 equivalent are hedged using forward foreign exchange contracts, once expenditure is approved, the purchase order is placed, and the exact timing and amount is known. Council uses both spot and forward foreign exchange contracts.

Council does not borrow or enter into incidental arrangements, within or outside New Zealand, in currency other than New Zealand currency.

Policy Review

The review timeframe of this policy will be no longer than every 3 years.

Document History

Version	Reviewer	Change Detail	Date
>1.0.25 (not rolled correctly)	Garry Hrustinsky	NCC Long Term Plan 2015-2025, wording below was reviewed between March and May 2018, and published in the Long Term Plan 2018-2028	2019
2.0.0	Garry Hrustinsky	No change	May 2020

PUBLIC POLICY

NAPIER CITY COUNCIL
Te Kaunihera o Ahuriri

Investment Policy			
Adoption By	Council		
Department	Corporate Services - Finance		
Original Adoption Date	30 June 2015	**Review Adoption Date**	21 May 2020
Next Review Deadline	21 May 2023	**Document ID**	352769
Relevant Legislation	Section 102 and 105 of the Local Government Act 2002		
NCC Docs Referenced	Not applicable		Not Applicable

Purpose

The Investment Policy is adopted under Section 102(1) and 102(2)(c) of the Local Government Act 2002 and must state the local authority's policies in respect of investments.

Policy

Council generally holds strategic investments where there is some social, economic, environmental or cultural benefit accruing from the investment activity. Generating a commercial return on strategic investments is considered a secondary objective.

Specific purposes for maintaining investments include:

- For strategic purposes consistent with Council's LTP;
- To reduce the current ratepayer burden;
- The retention of vested land;
- Holding short-term investments for working capital requirements and liquidity management;
- Holding investments that are necessary to carry out Council operations consistent with Annual Plans, to implement strategic initiatives, or to support inter-generational allocations;
- Holding assets (such as property) for commercial returns;
- Providing ready cash in the event of a natural disaster, the use of which is intended to bridge the gap between the disaster and the reinstatement of normal income streams and assets;
- Investing amounts allocated to accumulated surplus, Council created restricted reserves and general reserves;
- Investing proceeds from the sale of assets.

Investments and associated risks are monitored and managed, and regularly reported to Council in accordance with this policy.

In its investment activities Council is guided by the principles outlined in the Trusts Act of 2019. When acting as a trustee or investing money on behalf of others, the Trusts Act highlights that trustees have a duty to invest prudently and that they shall exercise care, diligence and skill that a prudent person of business would exercise in managing the affairs of others.

For banking and fixed interest investments relating to treasury activities, Council is a risk-averse entity and does not wish to incur excess risk relative to expected returns. With the exception of any portfolio established to receive the proceeds of leasehold property sales (detailed below), Council's broad objectives in relation to treasury activity are to manage all of the investments to meet known and reasonable unforeseen funding requirements. Surplus cash is invested in liquid securities and strongly credit-rated counterparties. Where possible returns should be optimised.

A separate Statement of Investment Policies and Objectives (SIPO) has been established for the receipt and reinvestment of the proceeds of leasehold property. As per the Investment Property Portfolio Policy (leasehold), sale proceeds are ring-fenced and reinvested to provide ongoing income and capital growth to replace that lost from property sales. With consideration to the prudent person test, a separate investment strategy with its own risk and return objectives have been set for these ring-fenced funds.

Staff seek to develop and maintain professional relationships with Council's bankers, financial market participants and other stakeholders.

Acquisitions of New Investments

With the exception of treasury investments, new investments are acquired if an opportunity arises and approval is given by the appropriate Council committee, based on advice and recommendations from Council officers. Before approving any new investments, Council gives due consideration to the contribution the investment will make in fulfilling Council's strategic objectives, and the financial risks of owning the investment.

The authority to acquire treasury investments, with the exception of cash and term deposits (which are provided for in the Financial Delegations Register), is delegated to the Director Corporate Services.

Mix of Investments

Council maintains investments in the following mix of investments:

Equity Investments

Equity Investments are held for various strategic, economic development and financial objectives, as outlined in the Long Term Plan (LTP). Council Equity Investments include interests in the Hawke's Bay Airport Authority and Omarunui Landfill Operation, and may include other Council Controlled Organisations (CCOs) and Local Government Funding Agency shares. Council may also make advances to CCOs.

Council seeks to achieve an acceptable rate of return on all its equity investments, consistent with the nature of the investment and Council's stated philosophy on investments.

Council reviews the performance of these investments on a regular basis to ensure strategic and economic objectives are being achieved. Any disposition of these investments requires Council approval. With the exception of specific ringfencing provisions for some assets (e.g. Omarunui Landfill), dividends received and proceeds from the disposition of equity investments are used to repay debt, to invest in new assets or investments or any other purpose that is considered appropriate by Council.

New Zealand Local Government Funding Agency Limited (LGFA)

Council consulted on, and became a member of, the LGFA in March 2020.

Council may invest in shares and other financial instruments of the LGFA, and may borrow to fund that investment.

Council's objective in making any such investment will be to:

- Obtain a return on the investment.
- Ensure that the LGFA has sufficient capital to remain viable, meaning that it continues as a source of investment and/or debt funding for the Council.

Council may invest in LGFA bonds and commercial paper as part of its financial investment portfolio.

As a borrower, Council's investment is recognised through shares and borrower notes. As an investor in LGFA shares and as a Guarantor, Council subscribes for uncalled capital in the LGFA.

Property Investments

Council's primary objective is to own property that is necessary to achieve its strategic or commercial objectives, or deemed to be a core Council function. Council therefore retains an investment in car parking, leasehold land, and rental and retirement housing.

Property purchases are supported by registered valuations and, where appropriate, a full business case analysis. Council does not purchase properties on a speculative basis.

Council provides car parking facilities which are operated on a commercial basis.

Rentals and ground rent from property investments, other than land covered by the HB Endowment Land Empowering Act 2002, is included in the consolidated rating account. Council's leasehold land portfolio was transferred from the Hawke's Bay Harbour Board in 1989 as part of the local government reorganisation and Council, by virtue of the Hawke's Bay Endowment Land Empowering Act 2002, is allowing lessees to freehold residential properties, which is diminishing the portfolio.

Council owns various Napier properties which it classifies as the 'Napier City Council Investment Property Portfolio'. The land held in the portfolio is leased to a variety of individuals and entities, and is managed in line with Council's leasehold land policy.

Property disposals are managed to ensure compliance with statutory requirements. Any disposition of a property investment requires Council approval. Disposition proceeds from sale of property investments are treated according to each of the following classes of property:

<u>Leasehold Land</u>

Disposition proceeds from the sale of leasehold land after 30 March 2002 are unrestricted under the Hawkes Bay Endowment Land Empowering Act 2002, and ring-fenced as per the Investment Property Portfolio Policy (leasehold) and managed according to the SIPO established for this purpose.

<u>General Land</u>

Disposition proceeds from the sale of General Land (including Roading Land) are used firstly to retire any debt related specifically to that investment prior to use for other purposes.

Treasury Investments – Cash & Fixed Interest Investments

Please note that Local Government Funding Agency borrower notes, bonds and commercial paper are discussed elsewhere in this policy.

Council maintains treasury investments for the following primary reasons:

- to invest amounts allocated to loan redemption reserves, trusts, bequests and special funds.
- to invest surplus cash, and working capital funds.

Treasury Investment Philosophy and Objectives

Council's philosophy in the management of treasury investments is to optimise its capital protection and liquidity objectives while balancing risk and return considerations. Council recognises that as a responsible public authority any investments that it does hold should be low risk. It also recognises that lower risk generally means lower returns.

To provide the greatest benefit, Council utilises its surplus internal funds for internal borrowing to reduce external debt, thus effectively reducing net interest costs.

Council's primary objective when investing is the protection of its investment capital and liquidity of its investment. Accordingly, only creditworthy counterparties are acceptable. Creditworthy counterparties are selected on the basis of their current Standard and Poor's (S&P) or equivalent rating, which must be A- rated or better. Exposure to investments below a strong rating (A rated) are not recommended due to Councils Risk Framework and financial risk appetite.

To avoid undue concentration of exposures, treasury investments/financial instruments should be used with a suitable range of counterparties as practicable. Where possible, transaction notional and principal sizes and maturities should be well spread.

Within allowable credit constraints, Council also seeks to:

- Ensure investments are liquid
- Maximise investment return
- Manage potential capital losses due to interest rate movements and interest break costs if investments need to be liquidated before maturity.

Cash

Cash is defined as money held (physical or in a NZ registered bank) and term deposits.

A cash balance is maintained for liquidity purposes to meet operational needs. Council has daily cashflow surpluses and borrowing requirements due to the mismatch of daily receipts and payments.

If practical, a targeted minimum of $5,000,000 is held at call to meet day-to-day operational cashflow requirements.

Term deposits must be held with NZ registered banks. Maturities are staggered to provide day-to-day cashflow requirements and to avoid early break penalties. Not more than $40,000,000 may be held with any one bank at any point in time.

Overdraft facilities are utilised as little as practical. Council maintains a $300,000 committed bank overdraft facility to meet interim cash and liquidity requirements.

Cash Interest Rate/Maturity Guide

An important objective of the financial investment portfolio is to match the portfolio's maturity term to planned expenditure, thereby ensuring that investments are available when required. This should be considered before applying the maturity guide (discussed below).

The following maturity guide is designed to manage interest rate risk and maturity risk on the treasury investment portfolio. The portfolio comprises both cash and fixed interest investments. Cash investments relate to matching investments with Council's working capital funding requirement and liquidity buffer amount requirements.

Period	Minimum	Maximum
0-6 months	30%	80%
6-12 months	20%	70%
1-3 years	0%	50%
3-5 years	0%	20%

Cash - Foreign Exchange Policy

Council has foreign exchange exposure through the occasional purchase of foreign exchange denominated assets approved through the capital planning process. Generally, all commitments over NZ$100,000 equivalent are hedged using forward foreign exchange contracts, once expenditure is approved, the purchase order is placed, and the exact timing and amount is known. Council uses both spot and forward foreign exchange contracts.

Council does not borrow or enter into incidental arrangements, within or outside New Zealand, in currency other than New Zealand currency.

Fixed Interest

Fixed interest is defined as debt instruments (other than those defined as cash). Fixed interest can include, but is not limited to, bonds, commercial paper, etc.

Fixed interest may be used to supplement cash investments where terms are more favourable than those offered for cash investments or where timeframes are greater than 5 years.

Council preference is for plain vanilla bonds although other structures may be considered on a case-by-case basis. All secured and unsecured investment securities should preferably be senior in ranking. The following types of investment instruments are expressly prohibited:

- No asset-backed securities are allowed
- Structured debt (e.g. CDOs, CLOs or synthetic instruments)
- Subordinated debt or unsecured junior debt
- Perpetual notes
- Debt/equity hybrid notes such as convertibles

Fixed Interest - Credit, Liquidity and Interest Risk Management

- Credit risk is minimised by placing limits for each broad class of non-Government issuer.
- Liquidity / Maturity risk is minimised by managing maturity terms within policy limits and ensuring that all negotiable investments are capable of being liquidated in a readily available secondary market.
- Interest Rate risk is minimised by investing in fixed rate bonds and bank term deposits spread over a range of maturity terms.

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Fixed Interest - Counterparty Limits

Counterparty credit risk is the risk of losses (realised or unrealised) arising from a counterparty defaulting on a financial instrument where Council is a party. The credit risk to Council in a default event will be weighted differently depending on the type of instrument entered into. Limits should be spread amongst a number of counterparties to avoid concentrations of credit exposure. Credit ratings are as determined by Standard and Poor's, or equivalent rating. If any counterparty's credit rating falls below the minimum specified in the following table, then all practical steps are taken to eliminate the credit exposure to that counterparty as soon as practicable.

Fixed Interest Issuers	Approved Instruments	Minimum Credit Rating (S&P)	Maximum per Counter-party	Maximum % of Total Investment Portfolio
NZ Government	Treasury bills Government stock	N/A	Unlimited	100%
NZ Local Government Funding Agency	LGFA Fixed and Floating Rate Bonds Promissory notes / Commercial paper Borrower Notes	N/A	$40.0m	50%

Fixed Interest Issuers	Approved Instruments	Minimum Credit Rating (S&P)	Maximum per Counter-party	Maximum % of Total Investment Portfolio
State-Owned Enterprises and Local Authority	Promissory Notes / Commercial Paper, Fixed Rate Bonds	A-	$5.0m	40%
Corporate Listed Bonds	Commercial Paper, Fixed Rate Bonds	A-	$5.0m	0%

Loan Advances

Council may provide advances to CCOs, charitable trusts and community organisations for strategic and commercial purposes only. New loan advances are by Council resolution only.

As outlined in Section 63 of the Local Government Act 2002, Council does not lend money, or provide any other financial accommodation to a CCO on terms and conditions that are more favourable to the CCO than those that would apply if Council were (without charging any rate or rate revenue as security) borrowing the money or obtaining the financial accommodation.

Loan advances are generally provided on an unsecured basis. Where possible, Council seeks security through a mortgage over land and buildings.

Council reviews performance of its loan advances on a regular basis to ensure strategic and economic objectives are being achieved.

Investment Management and Reporting Procedures

Council's investments are managed on a regular basis, with sufficient minimum immediate cash reserves and a cash buffer maintained. The daily cash position is monitored and managed through the Daily Cash Position Report, and long term cashflow through the annual Cashflow Forecast. To maintain liquidity, Council's short and long term investment maturities are matched with Council's known cashflow requirements.

The performance of Council investments is regularly reviewed to ensure Council's strategic objectives are being met. Both performance and policy compliance are reviewed. Internal investment reports are a vital management tool and, depending on their nature, are produced on a daily, weekly, monthly, quarterly or annual basis. The results are summarised and reported to Council on a quarterly and annual basis.

Policy Review

The review timeframe of this policy will be no longer than every 3 years.

Document History

Version	Reviewer	Change Detail	Date
1	Investment and Funding Manager	NCC Long Term Plan 2015-2025, wording below was reviewed between March and May 2018, and published in the Long Term Plan 2018-2028	2019
2	Investment and Funding Manager	No change	May 2020
3 DRAFT	Investment and Funding Manager		May 2022

NAPIER CITY COUNCIL

LONG TERM INVESTMENT PORTFOLIO

Statement of Investment Policies and Objectives

Contents

1. Purpose

The purpose of this Statement of Investment Policy and Objectives (“SIPO”) is to assist Napier City Council (“Council”), the Audit & Risk Committee and the Investment Manager in effectively supervising, monitoring and evaluating the management of the Investment Fund (“the Fund”).

The SIPO defines the key responsibilities, and the operating parameters within which the investments and their ongoing management are to operate. The SIPO should at all times encourage the use of methodologies and processes that reflect industry best practice, encompass the principles of good governance, and reflect Council’s vision and risk tolerances.

2. Objectives

2.1 Background

Napier was granted municipal status in 1874, with the first meeting held in 1875. In 1931 the earthquake destroyed infrastructure and services. As a result of the earthquake, significant areas of land were raised; assisting with Council land reclamation projects.
Napier was proclaimed a city in 1950.

In 1989 the New Zealand Government legislated a major overhaul of local bodies by the Local Government Commission, which ended or amalgamated most single-purpose bodies. As a result of amalgamation, a number of commercial and residential properties were transferred to Council from the Hawke's Bay Harbour Board. In addition to this property an Investment Property Portfolio was also established from:

- Properties already owned by Council as a result of land development in conjunction with the
- Harbour Board.
- Other sundry properties which have been owned by Council for many years.
- Endowment Properties - Nine of the properties in the portfolio are subject to the Napier Borough Endowments Act 1876 and before freeholding of these can occur any requirements under that Act and Sections 140 and 141 of the Local Government Act 2002 must be satisfied.

Napier City Council owns various properties in Napier which Council classifies as Napier City Council's Investment Property Portfolio. This land, held in the portfolio, is leased to various individuals and entities. All land held in the portfolio was originally commercial and industrial land. Council holds and manages these properties on behalf of the Napier community for the benefit of both current and future generations. The Napier community enjoys the benefit of these properties through a reduction in general rates to the extent of income received.

Under the Hawke's Bay Endowment Land Empowering Act 2002, Council was given the power to sell such land free from endowments to fund purposes listed in s.3 of the Act.

As detailed in the Investment Property Portfolio Policy (leasehold) as at 3rd August 2021, Council resolved on 1st of June 2018 and confirmed 29th June 2018 that a divestment and investment policy for the sale proceeds is established and approved by Council resolution prior to the release of any leasehold land. This SIPO provides the guidelines for establishing and managing such a portfolio.

2.2 Objectives

To protect and maintain the purchasing power of the current investment assets and all future additions to the investment assets for current and future generations.

To maximise investment returns within reasonable prudent levels of risk.

To maintain an appropriate asset allocation in order to make distributions as required while preserving the real value of the Council's capital from the effects of inflation.

As this portfolio was created from the proceeds of NCC leasehold property sales, the portfolio is intended to generate income to supplement revenue from rates in support of Council operations. Please refer to Section 6 (Portfolio Distributions) for further details on this objective.

2.3 Time Horizon

The Fund is an intergenerational/perpetual investment. At a minimum, the investment guidelines are based upon an investment horizon of greater than ten years. Therefore, interim fluctuations should be viewed with appropriate perspective.

2.4 Risk Tolerance

Council is a risk-averse entity but acknowledges that some risk must be assumed to counter the capital-eroding nature of inflation and achieve the long-term investment objectives of the portfolio. Council also recognises that there are uncertainties and complexities associated with investment markets that manifest as risk for the portfolio. It is the express desire of Council to minimise portfolio volatility through the adoption of prudent portfolio management practices.

With a requirement to generate capital growth in excess of inflation, provide some capital stability and income through interest, dividends and distributions, overall a balanced investment approach is adhered to – this is further defined in section 4 (Investment Policy and Implementation).

2.5 Ethical Investment (Socially Responsible Investment)

Council seeks to avoid investing in activities that would be regarded as unethical by a substantial majority of the New Zealand public. Where practical, a negative screen will be applied to the selection process of investments within the Fund (including debt instruments). Council wishes to avoid direct involvement with industries that have a negative impact on the environment or society. Examples of industries to be excluded include:

- Gambling
- Alcohol
- Weapons manufacturing and mercenary activities
- Tobacco
- Coal production (where the producer generates more than 30% of their revenue from coal production)

Council may also exclude investment in entities that don't directly undertake any of the activities above if they hold significant investments (i.e. more than 50%) in entities that themselves engage in those activities.

This list is not exhaustive.

2.6 Performance Expectations

In general, Council would like investment portfolios that are managed by external Investment Managers to earn a long-term targeted net return of 4.3% per annum[1].

[1] Refer to Appendix 1 for return assumptions.

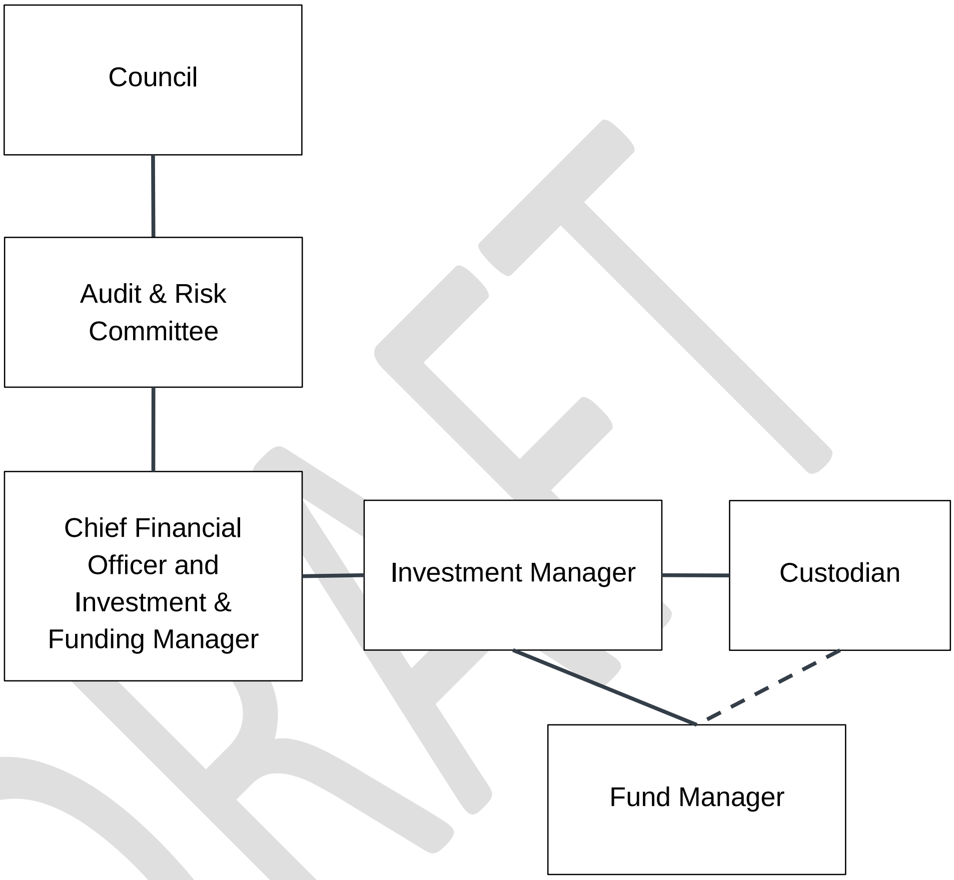
2.7 Policy Setting and Management

Council may from time to time approve/amend the policy parameters set in relation to Council's investment activities. These changes will be resolved and approved by Council and incorporated into the SIPO with the dates of changes noted, and all parties involved with the management of the investments notified.

3. Duties and Responsibilities

3.1 Structure

Council's investment management organisational chart is displayed below. Within this structure the Audit and Risk Committee are responsible for the oversight and monitoring of the Fund.



3.2 Council

Council has the ultimate responsibility for managing investment decisions on the establishment and ongoing operation of the Fund. Council will be responsible for the following:

- Setting the Fund's investment strategy, including the level of risk and investment objectives, and investment policies.
- Selecting and changing the Investment Manager/s as appropriate.
- Reviewing the SIPO annually, including the investment strategy, policies and manager configuration, and instructions to the Investment Manager/s.
- Formally reviewing the SIPO every three years. This includes the investment strategy, return objective, policies and manager configuration, and instructions to the Investment Manager/s. This review may include consultation with the Investment Manager/s and/or other third party specialists.

- Ensuring that the level of redemptions from the Fund is consistent with the Fund's objective to maintain equity, in terms of amounts available for distribution, between present and future rate payer generations.
- Providing cash flow information with respect to future deposits and redemptions.
- Set out the duties and responsibilities of all parties involved with respect to decision-making, planning, investment management, reporting and review.
- Seeking guidance, as appropriate, from the Audit & Risk Committee, CFO and Investment & Funding Manager on matters relating to policy and portfolio management.
- Receiving semi-annual and annual portfolio performance reports from the CFO and Investment & Funding Manager (sourced from Investment Manager/s).

3.3 Audit & Risk Committee

The responsibility for the monitoring and reviewing of Council's investment policies is that of the Audit and Risk Committee, assisted by the Chief Financial Officer, Investment & Funding Manager and the Investment Manager/s.

- Provide guidance and leadership on the appointment, management, monitoring and review of Investment Manager/s.
- Recommend the SIPO to Council.
- Liaise with the Investment Manager/s.
- Ensure that the Investment Manager/s have their own Investment Policy Statement ("IPS") recording how the investor's money is to be managed. Specific information on matters such as asset allocation, risk tolerance, investment securities and liquidity requirements are included in an IPS. Ensure that the IPS is consistent with how Council manage their portfolio.
- Review all matters concerning the SIPO, considering any changes or amendments to the SIPO and making appropriate recommendations.
- Ensure that the practices and policies set out in the SIPO are adhered to on an ongoing basis.
- Review Investment Manager reports and reporting exceptions on a quarterly basis.
- Ensure that all parties overseeing, advising and managing Council's investments disclose any potential conflicts of interest. In the event that conflicts of interest arise, the policies and procedures for managing these are to be clearly defined, although, in principle, such conflicts should be avoided.
- Advise Council of changes or issues regarding the Fund.
- Report to Council on the performance of the Fund on a basis agreed with the Council.
- Confirm the management of investments complies with all applicable laws, Council's policies, risk tolerance and other supporting documents.
- Ensure that contracts for the Investment Manager/s and custodial services are reviewed annually.

- Ensure appropriate risk management standards and procedures are developed and maintained.
- Ensure the overall Fund is prudently diversified to meet the agreed risk/return profile.
- Recommends rebalancing of the Fund.
- Follow formal criteria to monitor, evaluate and compare the investment performance results achieved against relevant benchmarks and objectives on a regular basis.
- Ensure that all service agreements and contracts are in writing and are consistent with fiduciary standards of care.

3.4 Chief Financial Officer and Investment & Funding Manager

The Chief Financial Officer (CFO) and Investment & Funding Manager are the primary point of contact for the Investment Manager/s, and maintain day-to-day oversight over the Fund. Responsibilities include:

- Provide guidance (as required) to Audit & Risk Committee and Council on the appointment, management, monitoring and review of the appropriate Investment Manager and matters relating to portfolio management and investment policy.
- Consolidate and present to Council semi-annual and annual performance reports sourced from the Investment Manager/s.
- Provide quarterly portfolio reports to Audit & Risk (including SIPO breaches) in conjunction with Investment Managers.
- Arrange attendance at Audit & Risk Committee and Council meetings with the Investment Manager/s.
- Advise the Audit & Risk Committee and Council (as appropriate) of any other material events or information that may impact the Fund, are time-bound/critical and require further guidance or a decision to be made. Where no decision is required by the Audit & Risk Committee or Council (i.e. the Investment Manager/s are able to make changes within the scope of the SIPO), an information-only report should be provided to those bodies.

3.5 Investment Manager

With reference to the SIPO, the Investment Manager has discretion to select specific investments and construct a portfolio on behalf of Council. Responsibilities include:

- Use the care, skill, prudence and due diligence under the prevailing circumstances that an experienced investment professional, acting in a like capacity and fully familiar with such matters, would use in like activities for like portfolios, and comply with all applicable laws, rules and regulations.
- Manage the Fund's investments in accordance with the guidelines and objectives as outlined in the SIPO, their IPS and in their service agreements.
- Ensure investment assets are appropriately diversified and conform within the time horizon and agreed risk/return profile. Outline expected returns and risk, or volatility, within the selected strategies.

- Manage the Fund on a day-to-day basis. Administer and attend to the day-to-day financial matters associated with the management of the Fund. The primary points of contact for the Investment Manager are CFO and Investment & Funding Manager.
- Exercise all voting rights, where applicable, in the best interests of the Fund.
- Ensure that “expected” and “modelled” returns for asset classes are based on sound return and risk premium assumptions.
- Provide advice on the asset allocation.
- Specify, and advise on, asset and sub-asset class allocation strategies.
- Recommend a Custodian to hold and report on investment assets. Periodically review custodial arrangements and make recommendations.
- Confirm on an annual basis that best practice with respect to execution, brokerage, money sweep facilities, foreign currency spreads, transaction costs and management fees is being applied.
- Manage the relationship with Fund Managers including:
    - Instructions to lodge or withdraw funds,
    - Overseeing and monitoring performance, and
    - Appointment and removal.
- Rebalance individual investments and asset class groups to within agreed benchmarks as described in the rebalancing policy contained in the SIPO and IPS documents.
- To effect all transactions for the Fund at the best price.
- Compile and account for all investment, record keeping and administrative expenses associated with the management of the Fund.
- Deliver quarterly reports including:
    - Fund valuation,
    - Fund duration,
    - Compliance reporting (including approved exceptions),
    - Performance summary for the Fund and by asset class,
    - Performance against agreed benchmarks,
    - Fund income,
    - Asset transactions summary,
    - Investment management fees,
    - Custodial fees,
    - Individual fund management fees, and
    - Brokerage and other transaction costs.
- Make available appropriate personnel to attend meetings, as agreed.
- Disclose any potential conflicts of interest and steps taken to mitigate such conflicts.

- To report annually the 'Total cost of Delivery' being the sum of:
  - Investment Manager fees,
  - Custodial fees,
  - Administration fees, and
  - Total Fund fees – made up of annual management fees (including annual management fees of underlying investments) and any other fees (including buy/sell spreads) and costs.
- Provide financial information, including income and/or returns projections, as required for forecast budgeting purposes.
- Communicate to Council all significant changes that are material with relation to management of the portfolio. Changes in ownership, organisational structure, financial condition, professional staff and reputation are examples that must be communicated.

3.6 Custodians

Custodians hold investments as bare trustee on behalf of Council and are responsible for the safekeeping of Council's investment assets. The specific duties and responsibilities of the custodian are:

- Maintaining separate accounts.
- Valuation of all investment assets.
- Collect all income and dividends owed to the portfolio.
- Settlement of transactions (buy/sell orders) initiated by the Investment Manager/s.
- Provide access for Investment Manager/s, CFO and Investment & Funding Manager to reports detailing transactions, cash flows, securities held and their current values, changes in value and returns.
- Provide annual audit confirmations to Investment Manager/s, CFO and Investment & Funding Manager.

3.7 Fund Manager

The Fund Manager is tasked with managing an allocated part of the Fund on terms and conditions consistent with their mandate. The Fund Manager/s is chosen by the Investment Manager/s and has no direct contact with Council.

4. Investment Policy and Implementation

4.1 Asset Class Guidelines

Long-term investment performance is primarily a function of strategic asset allocation and asset class mix.

History shows that while interest-generating investments, such as fixed interest portfolios, have the advantage of relative stability of capital value, they provide little opportunity for real long-term capital growth due to their susceptibility to inflation. On the other hand, equity investments have a significantly higher expected return but have the disadvantage of much greater year-on-year variability of return. From an investment decision-making point of view, this year-on-year variability may be worth accepting, provided the time horizon for the equity portion of the portfolio is sufficiently long (10 years or greater).

Council can make investments in the following asset classes and assets:

- Cash – term deposits, cash on call, commercial paper, and bank bills.
- NZ fixed Interest – NZ Government, local authority and NZ State-Owned Enterprise bonds, corporate bonds, and fixed interest funds.
- International fixed interest – either direct, if appropriate, or via managed funds.
- Australasian property – listed property companies, managed property funds and direct property investments.
- Equities (Australasian and international) – managed funds or directly.
- Alternative assets – commodities, private equity and derivatives. Other assets defined as alternative assets may be included on researched advice from Investment Manager/s.

4.2 Asset Allocation

Academic research offers considerable evidence that the strategic asset allocation decision far outweighs security selection and market timing in its impact on portfolio variability and performance. On this basis Council prefers to adopt a strategic asset allocation –with restrictions placed around active and/or tactical asset allocation strategies.

Overall, Council wishes to adopt a broad balanced approach with a 50/50 split between defensive and growth assets. There is an allowable variance of +/-10% to the target defensive and growth split.

The asset allocation benchmark is to be[2]:

Asset Class	Income / Growth	Target Allocation	Acceptable Range	
			Minimum	**Maximum**
NZ Cash	Income	5%	0%*	30%
NZ Fixed Interest	Income	25%	10%	35%
International Fixed Interest	Income	20%	5%	30%
Defensive Assets		***50%***	***40%***	***60%***
Australasian Property	Growth	5%	1%	10%
Australasian Equities	Growth	20%	10%	40%
International Equities	Growth	25%	10%	30%
Alternative Assets	Growth	0%	0%	5%
Growth Assets		***50%***	***40%***	***60%***
Total		**100%**		

* Subject to minimum Cash Management Account requirements.

The asset allocation benchmark will be reviewed annually to ensure that it remains appropriate. Fundamental changes in the investment environment may prompt a review outside of this cycle.

4.3 Cash

4.3.1 Portfolio Objectives for Cash

- To provide liquidity within the portfolio for investment purchases and externally for Council funding.
- To provide diversified exposure to cash investments beyond returns available through conventional deposit accounts (i.e. bank accounts).
- To hold funds that are marked for a specific use within three years.

4.3.2 Portfolio Construction Guidelines

a. Diversification

The portfolio should be constructed with consideration for cash flow/liquidity and specific portfolio requirements (e.g. cash management accounts within custodial portfolios held for transactional purposes).

b. Number of Securities

There is no minimum or maximum number of securities or instruments held.

[2] Subject to consultation with Investment Manager/s and agreement by Council.

c. Duration
Where investments are fixed term, maturity must be 12 months or less.

d. Credit Rating
Fixed investments (e.g. term deposits) must have a Standard and Poor's or equivalent agency short term credit rating of 'A-1' or stronger.

4.4 NZ Fixed Interest

4.4.1 Portfolio Objectives for Direct NZ Fixed Interest

To gain a diversified exposure to the New Zealand fixed interest market through investing in direct securities with the following objectives identified below:

- Provide access to the market in a cost-effective manner,
- Provide a stable income and capital preservation (in nominal terms) over a full market cycle,
- Reduce overall volatility of a strategically diversified portfolio, and
- Provide a high level of transparency.

4.4.2 Portfolio Construction Guidelines

a. Diversification
The portfolio should be constructed to achieve appropriate diversification (in the constraints of the NZ market) relative to:

- New Zealand fixed interest issuers,
- The industries/sectors the issuers are involved with,
- The individual issue and overall portfolio duration, and
- Overall credit risk exposure of a portfolio.

The level of the diversification will be governed by the size of the fixed interest portfolio. Credit ratings will have an impact on the level of diversification. Securities with lower credit ratings require a higher level of diversification.

b. Number of Securities
To achieve sufficient levels of diversification, a minimum of 15 securities where the size of the NZ fixed interest portfolio is more than $1,000,000, and 10 securities where the size of the NZ fixed interest portfolio is less than $1,000,000 is required.

Where appropriate diversification cannot be achieved due to the size of the portfolio or availability in the market, funds may be directed to money market instruments or managed funds until availability improves.

c. Duration
The portfolio should be diversified across all durations to minimise the adverse effects of reinvestment risk on maturity. Council should be aware if the duration of their portfolio deviates from the benchmark duration by more than 1 year.

d. Liquidity

Although Council invests into the direct New Zealand fixed interest market with a "buy-and-hold" philosophy, over time its needs may change and greater levels of liquidity may be required.

The more liquidity is required, the more government and liquid (i.e. senior debt issues of $150m or greater) corporate securities should be included in the portfolio.

e. Exposure Levels by Credit Rating

Guidelines for maximum security exposure levels for individual securities are set by credit rating. The following criteria should be considered when making decisions on exposure levels with a portfolio:

- Consideration should be given to excessive exposure to any single issuer,
- Consideration should be given to the other asset class exposures Council may have to an issuer,
- The portfolio should be distributed across credit ratings, with a core of senior ranking securities rate A or higher, and
- BBB rated and unrated SOE securities can be included so long as they have characteristics in line with Council's investment expectations and objectives.

The following table presents a set of guidelines that must be used when constructing a portfolio:

S&P Rating Band	Overall maximum % of bond portfolio
AAA to BBB-	100%
A+ to BBB-	55%
BBB+ to BBB-	15%
Unrated*	7.5%
Sub-Investment Grade	0%
Government	100%

*Generally, Council will not seek to invest in unrated securities in a bond portfolio unless an implied investment-grade rating has been assigned.

A maximum of 5% of floating rate/annual resettable securities is permitted in a portfolio. However, this does not include perpetual securities (as detailed under the "4.4.2.f Banned Securities" heading).

Where possible, the following maximum individual security guidelines should be followed to gain diversification whilst ensuring sound credit quality within portfolios.

Maximum Individual Security Guidelines:

S&P Rating Band	Security maximum % of bond portfolio
Unrated Corporate	4%
BBB / Unrated SOE	5%
A	7.5%
AA	10%
AAA	15%
Government	20%

Please note that the above table provides guidelines for assessing an individual security. Although there is no maximum issuer exposure specified, diversification guidelines described under the “Diversification” heading are to be followed.

f. Banned Securities

Required fixed interest exposure can be adequately achieved by investing in securities with simple structures which possess typical fixed interest characteristics. The following securities are expressly banned:

- Direct mortgages and individual mortgage loans.
- Subordinated debt.
- Structured credit: including collateralised debt obligations (CDOs) or collateralised loan obligations (CLOs). These investments are generally complex and lack sophisticated monitoring systems required to provide ongoing assessment.
- Sub-investment grade bonds (junk bonds). Junk bonds are defined as having a credit rating of BBB- or below (or equivalent).
- Perpetual securities. Given the equity structure (including potential imputation credits) of perpetual securities, this class of fixed interest is not to be used.

g. Ratings Downgrade

If a security is downgraded, the guidelines table should be revisited to ensure that the new rating falls within the ratings framework. A decision must be made by Council in light of the downgrade as to the future holding of the security (which could potentially be outside the guidelines).

h. Reinvestment

Recommendations to reinvest the proceeds from a maturity should take into account all of the above portfolio construction guidelines.

As noted in 4.4.2.b, where it is uneconomical to gain a direct exposure to NZ or international fixed interest, investment may occur via a recommended managed fund in order to gain an appropriate level of diversification.

4.5 International Fixed Interest

4.5.1 Portfolio Objectives for International Fixed Interest

To provide an exposure to a diversified portfolio of international bonds.

4.5.2 Portfolio Construction Guidelines

Council considers it prudent to gain exposure to international fixed interest via a managed fund or funds in order to gain sufficient diversification and achieve economies of scale.

Where direct investment is made, the portfolio construction guidelines detailed in section 4.4.2 are to be employed (with the exception of the Maximum Individual Security Guidelines).

No more than 5% of the market value of the international fixed interest assets held should be invested in non-benchmark markets (i.e. markets not in the Barclays Capital Global Aggregate Index).

No more than 5% of the assets in this class should be held in any one security or with one single issuer, other than a fund or a security representing a collective investment of other securities (unless the security represents an OECD sovereign borrower, issuer, or agency of an OECD government and supranational borrowers).

4.6 Property Investment

4.6.1 Portfolio Objectives for Property Investment

To provide an exposure to the Australasian listed property sector.

4.6.2 Portfolio Construction Guidelines

a. Investment Philosophy

The inclusion of property stocks in the portfolio should be based on a "buy-and-hold" philosophy. As such, turnover is expected to be low (ideally no more than one change per year).

b. Diversification

The portfolio is to be diversified across different property types and regions. A minimum of 2 property stocks should be held.

c. Liquidity

There should be enough liquidity so that each property stock can be liquidated at a fair market value within one month.

d. Debt Position

Each property stock should have a prudent debt position, be compliant with its covenants, and avoid excessive refinancing risk.

f. Quality

The average quality of the properties within each stock's portfolio should be at least B-grade.

4.7 Australasian Equity

4.7.1 Portfolio Objectives for Australasian Investment

To provide a combination of capital growth and income via a broad exposure to the Australasian equity market.

4.7.2 Portfolio Construction Guidelines

a. Investment Philosophy

High turnover that generates excessive transaction costs must be avoided.

b. Diversification

The portfolio is to be diversified across the respective industries that comprise the Australasian equity market. A minimum of 10 stocks should be held. Property stocks are to be excluded as this sector is treated as a separate asset class.

No investment is allowed in preference shares.

c. Liquidity

There should be enough liquidity so that each stock can be liquidated at a fair market value within one month.

4.8 International Equity

4.8.1 Portfolio Objectives for International Equity Investment

To provide an exposure to investments in the international equities sector.

4.8.2 Portfolio Construction Guidelines

Council considers a strategy which consists predominantly of Exchange Traded Funds (ETFs) to be appropriate, as it will achieve adequate diversification across a number of countries and industries. EFTs are cost-effective and have a high level of liquidity.

An exposure to small-cap shares (via an actively managed fund) and emerging markets is allowed for additional diversification and the potential for higher growth over the long term.

The weighting to each region will take into consideration economic output and not exclusively market capitalisation, so that the strategy is not reliant on any one economy.

No investment is allowed in preference shares.

4.9 Alternative Assets

4.9.1 Portfolio Objectives for Alternative Assets

To provide limited exposure to an asset class that traditionally has low correlation to other, more traditional, asset classes.

No exposure is required to alternative assets. However, this asset class may be employed where there is a demonstrated risk/return benefit.

4.9.2 Portfolio Construction Guidelines

Commodities and private equity may be used. Other alternative assets, excluding those that are expressly banned, may be considered by Council on a case-by-case basis.

Derivatives may be used in the following situations:

- To modify the yield curve or duration for cash and fixed interest investments.
- To alter asset allocation within the stated exposure ranges.
- To manage foreign currency exposure or as a hedge against other investment risks.
- To reduce transaction costs and improve liquidity that would otherwise have to be taken by buying or selling physical securities.

4.9.3 Banned Securities

No investment is allowed in illiquid or typically opaque markets.

Council cannot hold physical assets (e.g. gold, collectable items) for investment purposes. Storage costs, insurance, risk of loss and issues with liquidity make this a highly speculative market. Direct property is excluded from this list.

Due to the varied nature of hedge funds, a fund-of-fund approach is generally recommended to provide diverse exposure. However, hedge funds typically provide very poor benefit for cost. Hedge funds are expressly banned.

4.10 Foreign Currency Management

Historically, fluctuation of the New Zealand dollar against other major currencies has been significant and has resulted in additional portfolio volatility.

To minimise the risk associated with currency fluctuations the following policies apply:

- Holdings of offshore fixed interest (bonds) are to be fully hedged back to NZ dollars at all times.
- When investing in international equities either directly or via managed funds, a neutral currency position is the preferred strategy with at least 50% of the international equities being hedge back to NZ dollars at any one point in time. Any deviation from the preferred hedging level will require Council approval.

4.11 Tax Policy

The Fund is exempt from taxation on both income and capital gains. Any investment strategy employed needs to take into account Council's tax status, although this should not be to the detriment of the long-term strategic asset allocation.

Any tax leakage is to be quantified by the Investment Manager and reported to Council annually.

4.12 Rebalancing Guidelines

The percentage allocation to each asset class may vary depending on market conditions. The strategic asset allocation agreed to between Council and the Investment Manager will have upper and lower limits for each asset class.

The collective exposure to the various asset classes will be monitored quarterly, taking into account the impact of derivatives.

If the actual weighting has moved outside the tolerance levels, the Investment Manager will be required to rebalance the portfolio back towards the recommended weighting. Breaches are to be notified, with advice on how they will be rectified.

Where rebalancing does occur, this procedure should be completed at least annually. To ensure transactional costs are minimised, a pragmatic approach to rebalancing is to be adopted.

The regular cash flow requirements of the Council also provide an opportunity to assist in rebalancing the Fund towards benchmark weights.

5. Monitoring and Evaluation

5.1 Purpose

The goals of performance monitoring are to:

- Assess the extent to which the Fund's investment objectives are being achieved.
- Compare the performance of the Fund's appointed Investment Manager against the agreed performance benchmarks, performance of other relevant professional managers and market indices.
- Understand the existence of any particular weakness in the Investment Manager or the investment product(s) utilised.
- Allow the Audit and Risk Committee to continually assess the ability of both the Council and the Investment Manager to meet the Fund objectives.

5.2 Performance Objectives

Council acknowledge fluctuating rates of return characterise the securities markets, particularly during short time periods. Recognising that short-term fluctuations cause variations in performance, Council intends to evaluate investment performance from a long-term perspective.

Council is aware the ongoing review and analysis of the investment options is just as important as the due diligence process. The performance of the investment options will be monitored on an ongoing basis and it is at Councils' discretion to take corrective action by replacing an Investment Manager if they deem it appropriate at any time. Refer to 5.2.1 below for further discussion on Investment Manager Performance.

On a timely basis, but not less than annually, Council will meet to review whether the Investment Manager and the investment options selected continue to conform to the criteria outlined in the SIPO specifically:

- Adherence to the asset allocation levels set with rebalancing occurring within the agreed parameters and in a timely fashion,
- Adherence to the agreed investment philosophy and constraints,
- The adherence of individual investments to the investment guidelines,
- Material changes in the investment options, organisation, investment philosophy and/or personnel, and
- Any legal or other regulatory agency proceeding affecting the investment options.

5.2.1 Investment Manager Performance

Returns achieved by the appointed Investment Manager will be assessed by the Council in relation to their stated objectives and the objectives of the Fund. Returns will also be compared with returns earned by a suitable peer group, such as a group of other professional Investment Managers.

The Investment Manager will report at least quarterly in accordance with an agreed format.

The Investment Manager's role will be reviewed by Council on an annual basis. Factors taken into account in these reviews will include investment style, resources, organisational strength, investment performance relative to objectives, and any other factors considered relevant to the to meet the applicable investment objectives.

5.3 Benchmarks

Council has determined that performance objectives should be established for each investment option and for the overall investment portfolio. Manager performance will be evaluated in terms of an appropriate market index and the relevant peer group. These are to be agreed to between Council and the Investment Manager. Asset classes and relevant benchmarks could include:

Asset Class	Index
New Zealand Cash	S&P/NZX 90 Day Bank Bill Index
NZ Government Bonds	S&P/NZX NZ Government Bond Index
New Zealand Corporate Bonds	S&P/NZX Investment Grade Corporate Bond Index
International Fixed Interest	Barclays Capital Global Aggregate Bond Index (NZD hedged)
New Zealand Property (50%) Australian Property (50%)	S&P/NZX All Real Estate Index S&P ASX 200 Property Index
New Zealand Equities (50%) Australian Equities (50%)	S&P/NZX 50 Gross Index S&P/ASX 200 Accumulation Index
International Equities	MSCI All Countries World Net Total Return Index (50% hedged)
Private Equity	S&P Listed Private Equity Index
Commodities	Dow Jones Commodity Index

5.4 Watch List Procedures

An investment option and/or Investment Manager may be placed on watch list and a thorough review and analysis may be conducted when:

- Performance is below median for their peer group over a one, three and/or five-year cumulative period,
- The three-year risk-adjusted return falls below the peer group's median risk-adjusted return,
- There is a change in the professionals managing the investment,
- There is an indication the investment option and/or Investment Manager is deviating from the state style and/or strategy,
- There is an increase in fees and expenses,
- Any extraordinary event occurs that may interfere with the investment option and/or Investment Manager's ability to prudently manage investment assets.

This process is delegated to the Investment Manager where investment options are concerned. The process is delegated to the Audit & Risk Committee and/or a nominated third party where Investment Managers are concerned.
Investments or Investment Managers on a watch list will be reported to Council annually.

5.5 Measuring Costs

The total portfolio delivery costs should be fair and reasonable. The appointed Investment Manager should offer a fee-only service with all commissions returned to Council.
The Investment Manager is to report to Council annually on the breakdown and the total costs of delivery including:

- Administration/custodial reporting fees,
- Management expense ratios for managed fund investments,
- Advisory fees,
- Other brokerage or fees.

6. Portfolio Distributions (Option 1)

6.1 Purpose

The purpose of this portfolio is to benefit the Napier community by subsidising general rates through additional income received. At the same time as providing income, Council is tasked with preserving the value of the portfolio for future generations.

As noted previously, the portfolio was established from the sale proceeds of leasehold land owned by NCC. Assuming that the property is occupied, leasehold land provides regular rental income and potential capital growth. Without reinvesting into property, NCC is unlikely to replicate the returns patterns inherent in that property class. Unlike direct property, some capital gains can be realised to supplement income. On that basis, a distribution policy must be set to provide clarity on how much income can be drawn, and how much capital can be realised from the portfolio in any given year.

6.2 Maintenance of Capital Value

Although the investment objective is long-term, Council recognises that returns may fluctuate from year-to-year. The first goal of Council is to preserve the value of capital invested on an inflation-adjusted basis.

The Consumer Price Index (CPI) will be used as the measure of inflation for the purpose of calculating the minimum portfolio value target. The Reserve Bank of New Zealand releases the 12 month CPI value in mid-July every year.

Prior to determining available distributions to Council for the year, the minimum inflation-adjusted portfolio value must be calculated.

The Minimum Portfolio Value (MPV) will be calculated as follows:

(Opening portfolio value + additional investments) x 12 month CPI value = MPV

The MPV is calculated annually and provides an ongoing portfolio target to maintain purchasing power (preserve inflation-adjusted value).

6.3 Distribution Policy

The second goal of Council is to generate income from the Fund. Distributions may be made from the portfolio annually (after the MPV has been calculated).

Distributions are calculated as follows:

Closing Portfolio Value (30th of June) – MPV = Distribution to Council

Where the Closing Portfolio Value is less than the MPV, no distribution will be made. This approach is adopted to preserve portfolio value and maintain the purchasing power of future distributions.

6. Portfolio Distributions (Option 2)

6.1 Purpose

The purpose of this portfolio is to benefit the Napier community by subsidising general rates through additional income received. At the same time as providing income, Council is tasked with preserving the value of the portfolio for future generations.

As noted previously, the portfolio was established from the sale proceeds of leasehold land owned by NCC. Assuming that the property is occupied, leasehold land provides regular rental income and potential capital growth. Without reinvesting into property, NCC is unlikely to replicate the returns patterns inherent in that property class. Unlike direct property, some capital gains can be realised to supplement income. On that basis, a distribution policy must be set to provide clarity on how much income can be drawn, and how much capital can be realised from the portfolio in any given year.

6.2 Maintenance of Capital Value

Although the investment objective is long-term, Council recognises that returns may fluctuate from year-to-year. The first goal of Council is to preserve the value of capital invested on an inflation-adjusted basis.

The Consumer Price Index (CPI) is used as a common measure of inflation in New Zealand. The Reserve Bank of New Zealand (RBNZ) attempts to constrain inflation within a band of 1% to 3%.Iinflation may fall outside of RBNZ banding from time-to-time.
For the purpose of projections, Council assumes a long-term inflation rate of 1.5% (i.e. the mid-point of the RBNZ target band).

To preserve the inflation-adjusted value of Council's Investment Fund, any distribution will be net of inflation plus a buffer of 0.5% (i.e. 2%).

6.3 Distribution Policy

The second Goal of Council is to generate income from the Fund.

A total annual Distribution of 2.3% will be made from the Fund. The distribution is based on a long-term return assumption of 4.3% less an inflation buffer of 2%.

A quarterly distribution of 0.575% of the opening portfolio value will be made. Opening portfolio value will be calculated on the 1st of July each year, with distributions timed for 30th September, 31st December, 31st March and the 30th of June (or the nearest business day prior to those distribution dates).

7. Review of the Statement of Investment Policy & Objectives

This SIPO takes effect from dd/mm/yyyy.

Council will review this SIPO at least annually to determine whether the stated investment objectives are still relevant and it is feasible that they will be achieved. It is not expected that the SIPO will change frequently. In particular, short-term changes in the financial markets should not require adjustment to the SIPO.

Approved by Council:

Name	**Position**	**Date**

Appendix 1 – Returns Assumptions

Projected returns based on asset allocation detailed in Section 4.2 Asset Allocation.

10-Year Projected Portfolio Return

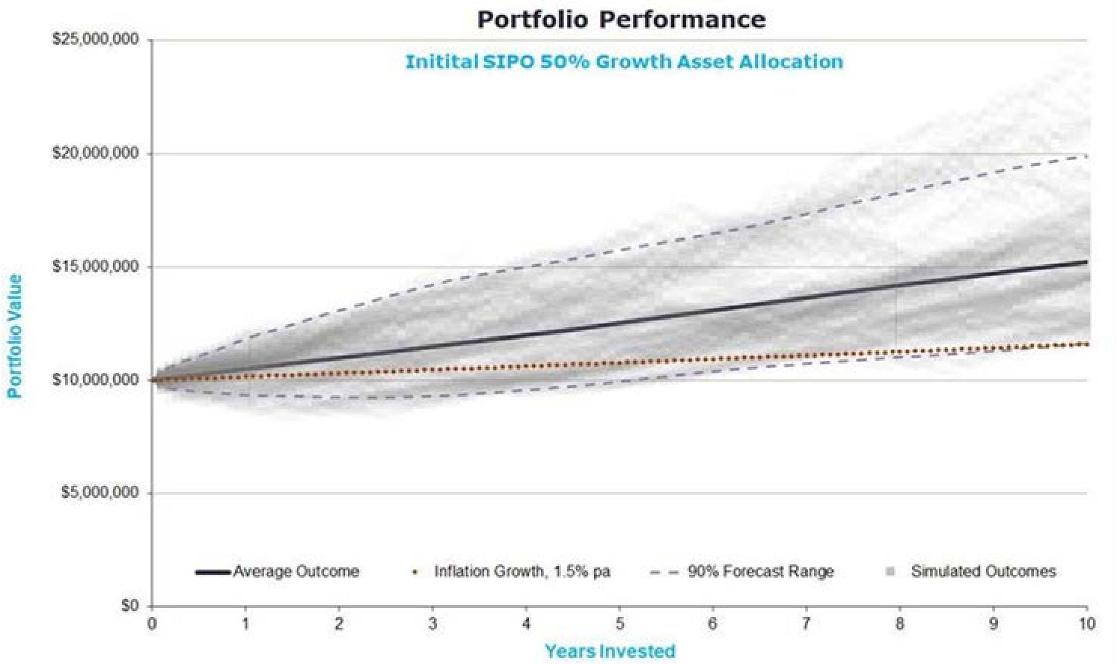
90% likelihood 10 Year Return	1.5% to 7.1%
Average 10 Year Return	4.3%
after Inflation	2.7%

Short-Term Variability

90% likelihood Year to Year Return	-6.7% to 18.2%
Historic best 12 months	19.2%
Historic worst 12 months	-14.8%
Historic worst peak to trough	-17.3%
Period	10/2007 to 03/2009

Source: JBWere 10-year expected returns and market behaviour since 1990.
Average inflation rate of 1.5% expected over the next 10 years.

Portfolio Projections (Monte Carlo Simulation)



PUBLIC EXCLUDED ITEMS

That the public be excluded from the following parts of the proceedings of this meeting, namely:

AGENDA ITEMS

1. Delegation Review
2. Debt write off

The general subject of each matter to be considered while the public was excluded, the reasons for passing this resolution in relation to each matter, and the specific grounds under Section 48(1) of the Local Government Official Information and Meetings Act 1987 for the passing of this resolution were as follows:

General subject of each matter to be considered.	Reason for passing this resolution in relation to each matter.	Ground(s) under section 48(1) to the passing of this resolution.
1. Delegation Review	7(2)(g) Maintain legal professional privilege	48(1)A That the public conduct of the whole or the relevant part of the proceedings of the meeting would be likely to result in the disclosure of information for which good reason for withholding would exist: (i) Where the local authority is named or specified in Schedule 1 of this Act, under Section 6 or 7 (except 7(2)(f)(i)) of the Local Government Official Information and Meetings Act 1987.
2. Debt write off	7(2)(a) Protect the privacy of natural persons, including that of a deceased person	48(1)A That the public conduct of the whole or the relevant part of the proceedings of the meeting would be likely to result in the disclosure of information for which good reason for withholding would exist: (i) Where the local authority is named or specified in Schedule 1 of this Act, under Section 6 or 7 (except 7(2)(f)(i)) of the Local

		Government Official Information and Meetings Act 1987.

PROSPEROUS NAPIER COMMITTEE
Open Minutes

Meeting Date:	Thursday 9 June 2022
Time:	10.42am – 11.14am *(Open)* 11.20am – 12.32pm *(Public Excluded)*
Venue	Small Exhibition Hall War Memorial Centre Marine Parade Napier
	Livestreamed via Council's Facebook site

Present	**Chair:** Councillor Taylor **Members:** Mayor Wise, Deputy Mayor Brosnan, Councillors Boag, Browne, Chrystal, Crown, Mawson, McGrath, Price, Tapine and Wright
In Attendance	Acting Chief Executive (Richard Munneke) Acting Executive Director Corporate Services (Caroline Thomson) Executive Director City Services (Lance Titter) Executive Director Infrastructure Services (Debra Stewart) Acting Executive Director Community Services (Darran Gillies) Manager Communications and Marketing (Julia Atkinson) Acting Director Programme Delivery (Jamie Goodsir) Pou Whakarae (Mōrehu Te Tomo) Health and Safety Lead (Michelle Warren) Investment and Funding Manager (Garry Hrustinsky)
	Mr Gregg Reddington (Public Excluded Item 1)
Administration	Governance Advisors (Carolyn Hunt and Anna Eady)

Karakia

Apologies

Councillors Tapine / Browne

That the apology from Councillor Simpson be accepted.

Carried

Conflicts of interest

Nil

Public forum

Nil

Announcements by the Mayor

Nil

Announcements by the Chairperson

Nil

Announcements by the management

Nil

Confirmation of minutes

Councillors Mawson / Price

That the Minutes of the meeting held on 28 April 2022 were taken as a true and accurate record of the meeting.

Carried

AGENDA ITEMS

1. HEALTH AND SAFETY REPORT - Q3

Type of Report:	Operational
Legal Reference:	N/A
Document ID:	1465765
Reporting Officer/s & Unit:	Michelle Warren, Health and Safety Lead Adele Henderson, Director Corporate Services

1.1 Purpose of Report

The purpose of this paper is to provide the Audit & Risk Committee with an overview of Health & Safety activity for the period Quarter 3 FY22.

At the meeting

The Health and Safety Lead spoke to the report and provided a brief update in relation to Covid with 24 positive cases and 3 persons isolating.

In response to questions the following was noted:

- City Services was the Depot and Infrastructure Services were employees situated in the Cape View building.
- In regard to the Leader Indicator Types there was a significant number from July to September and normally the increase in cases would be seen between December to February.
- Positive comments on competencies and recognising the skills of the trainer were received for the Aggressive Customer Training, however t in-house training would be undertaken for Hazardous Substances.
- Employees injury have halved since 2020 and this could be attributed to training and employee safety awareness with near miss reporting promoted over the last couple of years.
- That employee injuries in the attachment was reflected over a two year period split and no home injuries were recorded. Injury count by type would be included for future reports.
- Congratulations noted on the increase in near miss reporting positive safety observations.

COMMITTEE RESOLUTION	Councillors Browne / Chrystal
	The Prosperous Napier Committee: a. **Receive** the Quarter 3 Health and Safety report.
	Carried

2. LOAN GUARANTEE

Type of Report:	Enter Significance of Report
Legal Reference:	Enter Legal Reference
Document ID:	1457973
Reporting Officer/s & Unit:	Adele Henderson, Director Corporate Services Caroline Thomson, Chief Financial Officer Garry Hrustinsky, Investment and Funding Manager Talia Foster, Accounting Manager

2.1 Purpose of Report

To seek Council approval to provide a loan guarantee to the Regional Indoor Sports and Events Centre Trust (RISEC Trust), who own and operate Pettigrew Green Arena (PGA).

At the meeting

The Acting Executive Director Corporate Services, Ms Thomson spoke to the report which was seeking approval for a loan guarantee up to $2m to the Regional Indoor Sports and Events Centre Trust (RISEC Trust), who own and operate Pettigrew Green Arena (PGA). The PGA had raised significant funding for the court expansion project, plus they are now requiring to draw down a $2m loan to complete the project.

The $2m loan can only be drawn down once the PGA bank has security in the form of a loan guarantee. The PGA had provided financial statements for the last two years, together with financial forecasts for the years 2022 through to 2028, which shows they can comfortably meet the cost of any debt servicing.

Council currently provides financial guarantees for two other community organisations and Council's liability management policy stipulates that Council can only guarantee up to 7% of its non-targeted rate income. The $2m guarantee would take Council up to 7%.

COMMITTEE RESOLUTION Councillors Price / McGrath

The Prosperous Napier Committee:

a. **Receive** the report titled 'Loan Guarantee'

b. **Approve** providing a loan guarantee up to $2,000,000 to the Regional Indoor Sports and Events Centre Trust (RISEC Trust) for a period of up to 10 years

Carried

3. PROJECTS IN DEVELOPMENT

Type of Report:	Legal and Operational
Legal Reference:	Local Government Act 2002
Document ID:	1459309
Reporting Officer/s & Unit:	Adele Henderson, Deputy Chief Executive / Director Corporate Services

3.1 Purpose of Report

The purpose of this report is to provide visibility of major unfunded or partially funded projects so that financial risk and implications are noted in advance of future decisions.

At the meeting

The Acting Executive Director Corporate Services, Ms Thomson spoke to the report which provided visibility of major unfunded or partially funded projects so that the financial impact of any future decisions are not considered in isolation.

Many items listed in the report are large enough to trigger the significance and engagement policy requirements should Council require these to be funded in the future. If funded as a whole these items may result in Council breaching its debt caps.

In response to questions at the meeting it was noted:

- The Matāruahou Project has already been budgeted for and included in Council's Long Term Plan, however does not included development of the land.
- When considering the various projects and funding it is important that Council looks at the whole picture and takes into account the projects on the list and how they might impact rates, loans or reserves going forward.
- Collectively all these fully funded items would amount to tens of millions.
- Central Government has indicated support packages that will be to facilitate Councils being able to produce regional spatial plans etc. However, this is still in the drafting phase of legislation but will come after the Bills have been introduced.
- A number of the projects listed are subject to decision of Council in regard to options and level of investment that may require significant budget.

COMMITTEE RESOLUTION Councillor Crown / Mayor Wise

The Prosperous Napier Committee:

a. **Note** the following projects of Council are currently not fully funded in the Long Term Plan 2021-31 with pre-work and scoping currently underway:

   i. New Aquatic Facility

   ii. Civic Building – it is unlikely the current funding can service both a new library (including Council Chambers) as well as Civic accommodation for Council officers

   iii. Significant upgrade/new National Aquarium – recommendation to further discussions with Central Government on funding

iv. Housing - long term plan amendment proposed for consultation to include rates funding gap, based on community feedback to continue with social housing

v. Inner Harbour – the Ahuriri Masterplan is currently not fully funded

vi. Three Waters Transition – there are a number of work streams that have been set up that require Councils input and contribution. There may be some potential funding from Central Government to support this initiative, but will require Council approval to access this.

vii. Resource Management Act Reform – there is transitional funding required to support this both internally, regionally and nationally. No funded has currently been provided

viii. Regional Spatial Plan – currently no funding for this national initiative

ix. HB Museum Storage – budgets yet to be finalised

x. Climate Change funding – noting the national requirements moving forward

xi. i-Site building requirements – noting that this may form part of the new Library location

xii. City Vision Initiatives – funding was removed from the 2021-31 Long Term Plan, with requests coming from developers to support changes within the CBD for their projects

xiii. Inflation above Long Term Plan projections provided by BERL for the assumption development

xiv. Long Term Plan Amendment funding – audit and engagement ($150,000).

Carried

4. LONG TERM PLAN AMENDMENT

Type of Report:	Information
Legal Reference:	Local Government Act 2002
Document ID:	1459319
Reporting Officer/s & Unit:	Adele Henderson, Director Corporate Services

4.1 Purpose of Report

To provide Council with background information around the requirements for the preparation of a Long-Term Plan Amendment.

At the meeting

The Acting Executive Director Corporate Services, Ms Thomson spoke to the report which included a number of unfunded projects that Council are currently considering were not included in the existing Long Term Plan 2021-31.

The report outlined a number of sections of the Local Government Act and its requirements when undertaking an amendment to the Long Term Plan. It was important to note that often Long Term Plan amendments tend to be undertaken in isolation. Council needs to ensure that it provides for integrated decision making, co-ordinating its resources accordingly and provide adequate budgeting for auditing.

Ms Thomson noted that the next Long Term Plan effective from 1 July 2024 and the closer an amendment gets to the in cycle Long Term Plan the costs of an amendment start to outweigh the benefits. The general cost of undertaking an amendment to the Long Term Plan is $150,000 regardless of the number of items and whether it was a capital or operation item.

COMMITTEE RESOLUTION	Mayor Wise / Councillor Brosnan The Prosperous Napier Committee: a. **Note** the process that is required under the Local Government Act, Section 93D for the preparation for a Long-Term Plan Amendment Carried

5. INVESTMENT AND DEBT REPORT

Type of Report:	Enter Significance of Report
Legal Reference:	Enter Legal Reference
Document ID:	1467615
Reporting Officer/s & Unit:	Caroline Thomson, Chief Financial Officer

5.1 Purpose of Report

To consider the snapshot report on Napier City Council's Investment and Debt as at 30 April 2022.

At the meeting

The Acting Executive Corporate Services Director, Ms Thomson spoke to the operational and procedural report and advised that Council had $51.2m on deposit at the end of April 2022 at an average interest rate of 1.8%.

It was noted that interests rates have started to trend back upwards on the back of increased housing demand, inflation, OCR increases and global events. Council's internal debt balance was $65.6m at the end of April 2022.

Ms Thomson advised that Council had joined the Local Government Funding Agency however have not utilised any external borrowing through them at this stage. In the Long

Term Plan there was provision to draw down on external debt but have not required to do so yet.

COMMITTEE RESOLUTION Councillors Chrystal / Boag

The Prosperous Napier Committee:

a. **Receive** the snapshot report on Napier City Council's Investment and Debt as at 30 April 2022.

Carried

6. PROPOSED AMENDMENT TO 2022 MEETING SCHEDULE

Type of Report:	Procedural
Legal Reference:	Local Government Act 2002
Document ID:	1468788
Reporting Officer/s & Unit:	Helen Barbier, Team Leader Governance

6.1 Purpose of Report

The purpose of this report is to consider an amendment to the schedule of Council and Committee Meetings for the 2022 Meetings Calendar which was originally adopted by Council on 28 October 2021.

At the meeting

It was noted that there were two additional changes to include on the meeting scheduled and these were

- Napier People and Places Committee followed by Prosperous Napier Committee Rescheduled From: 21 July 2022, 9.30am To: 26 July 2022, 9.30am; and
- Hearings Committee (for the consideration of Tenders) Rescheduled From: 12 July 2022, 1.00pm To: 28 June 2022, 1.00pm

COMMITTEE RESOLUTION Councillors Wright / Crown

The Prosperous Napier Committee:

a. **Make** a Decision of Council under delegated authority for the reason that the schedule change needs to be adopted prior to the next scheduled Council meeting.

b. **Receive** the report titled "Proposed Amendment to the 2022 Meeting Schedule".

c. **Adopt** the change to the schedule of meetings 2022 as follows:

Audit and Risk Committee	Rescheduled	From: 17 June 2022, 1pm To: Wednesday, 29 June 2022, 1pm
Napier People and Places Committee followed by Prosperous Napier Committee	Rescheduled	From: 21 July 2022, 9.30am To: 26 July 2022, 9.30am
Hearings Committee (for the consideration of Tenders)	Rescheduled	From: 12 July 2022, 1.00pm To: 28 June 2022, 1.00pm

Carried

PUBLIC EXCLUDED ITEMS

Councillors Mawson / Tapine

a) That the public be excluded from the following parts of the proceedings of this meeting, namely:

1. Request for Rates Remission for Special Circumstances (1)
2. Request for Rates Remission for Special Circumstances (2)
3. Hawke's Bay Airport Ltd Report to Shareholders to 31 March 2022
4. Appointment - Audit and Risk Committee

b) That Mr Greg Reddington be allowed to remain in the Public Excluded session to provide information in relation to a Request for Rates Remission for Special Circumstances.

Carried

The general subject of each matter to be considered while the public was excluded, the reasons for passing this resolution in relation to each matter, and the specific grounds under Section 48(1) of the Local Government Official Information and Meetings Act 1987 for the passing of this resolution were as follows:

General subject of each matter to be considered.	**Reason for passing this resolution in relation to each matter.**	**Ground(s) under section 48(1) to the passing of this resolution.**

1. Request for Rates Remission for Special Circumstances 1	7(2)(a) Protect the privacy of natural persons, including that of a deceased person	48(1)A That the public conduct of the whole or the relevant part of the proceedings of the meeting would be likely to result in the disclosure of information for which good reason for withholding would exist: (i) Where the local authority is named or specified in Schedule 1 of this Act, under Section 6 or 7 (except 7(2)(f)(i)) of the Local Government Official Information and Meetings Act 1987.
2. Request for Rates Remission for Special Circumstances (2)	7(2)(a) Protect the privacy of natural persons, including that of a deceased person	48(1)A That the public conduct of the whole or the relevant part of the proceedings of the meeting would be likely to result in the disclosure of information for which good reason for withholding would exist: (i) Where the local authority is named or specified in Schedule 1 of this Act, under Section 6 or 7 (except 7(2)(f)(i)) of the Local Government Official Information and Meetings Act 1987.
3. Hawke's Bay Airport Ltd Report to Shareholders to 31 March 2022	7(2)(h) Enable the local authority to carry out, without prejudice or disadvantage, commercial activities	48(1)A That the public conduct of the whole or the relevant part of the proceedings of the meeting would be likely to result in the disclosure of information for which good reason for withholding would exist: (i) Where the local authority is named or specified in Schedule 1 of this Act, under Section 6 or 7 (except 7(2)(f)(i)) of the Local Government Official Information and Meetings Act 1987.

4. Appointment - Audit and Risk Committee	7(2)(a) Protect the privacy of natural persons, including that of a deceased person	48(1)A That the public conduct of the whole or the relevant part of the proceedings of the meeting would be likely to result in the disclosure of information for which good reason for withholding would exist: (i) Where the local authority is named or specified in Schedule 1 of this Act, under Section 6 or 7 (except 7(2)(f)(i)) of the Local Government Official Information and Meetings Act 1987.

The meeting adjourned at 11.14am and reconvened in

Public Excluded session at 11.20am

The meeting closed with a karakia at 12.32pm

Approved and adopted as a true and accurate record of the meeting.

Chairperson ....

Date of approval ....