REPORTS

AURORA ENERGY LIMITED - OPTIONS REPORT

Department: Legal Services and Finance

EXECUTIVE SUMMARY

1 The purpose of this report is to provide information to enable the Council to decide how it wants to proceed regarding Aurora Energy Limited (Aurora).

2 The two main options are:

a) To retain Aurora; or

b) To approve a sale of Aurora, subject to a reserve price being met, with the sale proceeds being used to:

i) Repay Aurora's debt (forecast to be $581 million by mid-2025); and

ii) Establish a diversified investment fund aimed at generating income for Council.

3 Aurora is wholly owned by Dunedin City Holdings Limited (DCHL), which in turn is wholly owned by Council. A sale cannot proceed without Council's approval as shareholder.

4 Aurora is increasing in value and is generating a profit, but it will need significant capital expenditure in the coming years. That expenditure will consume operating cash flows and require more debt, and any dividend in the short to medium term would need to be funded by debt.

5 Councillors were concerned about the level of shareholder returns the Council was receiving from the DCC Group of companies. As part of developing an Investment Plan and through its Letters of Expectation, Council expressed a desire for non-rates revenue to help fund Council's work programme.

6 In March 2024, DCHL prepared a report to Council recommending that Council sell Aurora, repay Aurora's debt, and reinvest in a diversified fund. The capital in the diversified fund would be protected, but the income would be available for Council (e.g., to offset rates or repay debt).

7 DCHL made this recommendation because it expects that a sale would:

a) Increase income to Council through a higher and more consistent income stream.

b) Reduce DCC's Group debt through the repayment of Aurora's debt and limiting further growth in DCC Group debt.

c) Reduce risk through having a more diversified portfolio.

d) Attract a price premium given the current market.

8 In March to May 2024, Council consulted the public on the proposal to sell Aurora.

9 At a workshop on 1 July 2024, DCHL provided Council with further information regarding concerns raised as part of public submissions.

10 This report presents information to aid Council's decision making. The report:

a) Provides an overview of public submissions.

b) Attaches a September 2024 report from DCHL.

c) Compares the financial implications of selling or retaining Aurora.

11 For the purposes of this report, the financial analysis assumes that 3 Waters will remain within the DCC Group (i.e., that 3 Waters will either be delivered in house or by a single Council-Owned Organisation (CCO)). The DCC Group position would remain the same in either situation.

RECOMMENDATIONS

That the Council:

a) **Considers** the information in this report.

b) **Decides** whether it wants to:

i) Approve a sale of Aurora Energy Limited, subject to a reserve price being met (such reserve price to be set by Council); or

ii) Retain Aurora Energy Limited.

<u>**If Council decides to approve a sale of Aurora Energy Limited, subject to a reserve price being met, then the Council**</u>:

c) **Decides** its reserve price (noting that this would be considered in the public excluded part of a future Council meeting).

d) **Notes** that if the reserve price is met, the proceeds of the sale of Aurora Energy Limited (less sale costs) are to be used to:

i) Repay Aurora Energy Limited's debt as at the date of sale; and

ii) Establish a diversified investment portfolio with the balance of the proceeds.

e) **Notes** that:

i) The diversified investment portfolio would have mechanisms to protect the capital in the portfolio, including against inflation, and that these protections would be determined following consultation through the 9 Year Plan process; and

ii) The decision on how the diversified investment portfolio would be held would be made following consultation on Council's Investment Plan through the 9 Year Plan process.

f) **Identifies** that the decision to approve a sale of Aurora Energy Limited is inconsistent with the current Long-Term Plan (2021-2031) as the Plan does not refer to a potential sale of Aurora Energy Limited. Council will incorporate any decision regarding Aurora Energy Limited into the 9 Year Plan.

If the Council decides to retain Aurora Energy Limited then the Council:

g) **Advises** DCHL of Council's decision to retain Aurora Energy Limited.

h) **Notes** that the Investment Plan will be redrafted as part of the 9 Year Plan with the focus on increasing the capital value of Council's investment assets rather than generating cash returns.

Under either scenario, the Council:

i) **Notes** that staff will prepare draft 9 Year Plan budgets on the following basis:

 i) No dividend will be budgeted from DCHL from the 2026/27 year.

 ii) Increased debt levels will be required to meet Council's proposed capital programme.

 iii) Revenue assumptions will require a review of future rates rises.

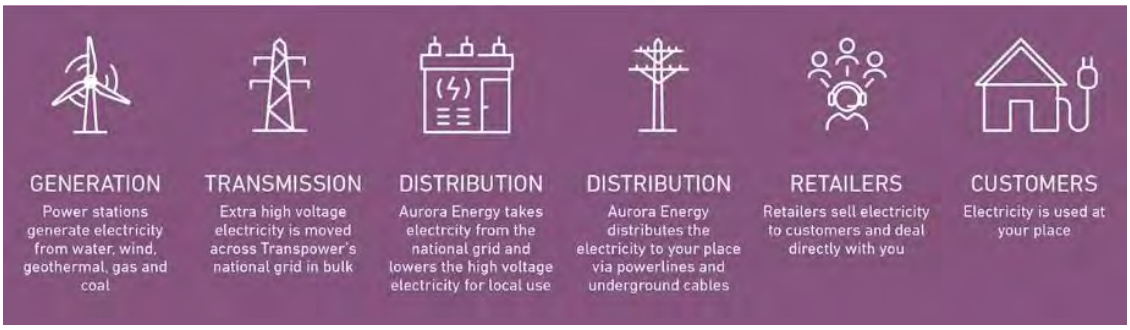
BACKGROUND

About Aurora

12 Aurora is wholly owned by DCHL, which in turn is wholly owned by Council.

13 Aurora is an Electricity Distribution Business (EDB), often referred to as a "lines company".

14 Aurora takes electricity from the national grid and lowers the high voltage electricity for local use. It then distributes the electricity via powerlines and underground cables. This is illustrated in the diagram below:



15 Aurora owns and operates the regulated electricity distribution networks for Dunedin, Central Otago (including Wānaka) and Queenstown Lakes.

16 Aurora's electricity network was largely built in the 1950s and 1960s. It now requires significant capital investment to renew aged assets, build resilience in its network, meet population growth in Central Otago and meet greater demand for electricity due to decarbonisation.

17 Aurora agreed a Customised Price Path (CPP) with the Commerce Commission in 2021 to enable higher prices to be charged to customers than under the default price path (DPP), allowing funding of Aurora's capital expenditure programme to improve the network. However, even with that funding, it is expected that significant capital expenditure requirements will consume operating cash flows and require more debt.

About DCHL

18 DCHL's purpose is to achieve the best for Dunedin from its investments.

19 This purpose is supported by more strategic objectives and activities, as shown in the company's strategic framework:

20 The Board of DCHL has been appointed by Council for their commercial expertise. The Board is comprised of highly experienced professional directors, including two directors who are specialists in investment banking and corporate finance.

The DCC Group

21 DCHL wholly owns seven companies and is a 50% shareholder in Dunedin International Airport Limited.

22 The Council, DCHL and the companies owned by DCHL are known as "the DCC Group".

23 The DCC Group is shown in the diagram below:

Request by Council and Investment Plan

24 Councillors were concerned about the level of shareholder returns the Council was receiving from the DCC Group of companies. Aurora for example, has not delivered a dividend to DCHL since 2017.

25 This lead Council, in conjunction with DCHL, to begin developing an Investment Plan to manage Council's various investments with the aim of generating a return to the shareholder. These investments include, the DCC Group of companies, the investment property portfolio, and the Waipori Fund.

26 While only in draft, the Investment Plan focussed on generating non-rates revenue for Council.

27 Council's Letter of Expectation to DCHL for the financial year ending 30 June 2024 had a particular focus on dividends and return on investment. The Letter of Expectation was one of the reasons that the Directors of DCHL put forward the proposal to sell Aurora. In their assessment, the best way of meeting the shareholder objectives of an increased return was to change Aurora into a liquid asset (by way of the diversified investment fund) that would then generate returns year on year for the shareholder. There were other benefits that they identified which are covered in their report.

28 A copy of the Councils Letters of Expectation for the year 2023/24 is attached as Attachment A. There is a similar expectation in Council's Letter of Expectation for the financial year ending 30 June 2025 (also attached as Attachment A).

29 Council's Investment Plan will be considered further through the 9 Year Plan process (2025-2034).

DCHL Recommendation to Sell Aurora, Repay Aurora's Debt and Reinvest in Diversified Fund

30 In March 2024, DCHL prepared a report to Council recommending that Council sell Aurora, repay Aurora's debt, and reinvest in a diversified investment fund.

31 DCHL made this recommendation because it expects that a sale would:

i) Increase income to Council through a higher and more consistent income stream.

ii) Reduce DCC's Group debt through the repayment of Aurora's debt and limiting further growth in DCC Group debt.

iii) Reduce risk through having a more diversified portfolio.

iv) Attract a price premium given the current market.

32 DCHL did not see the sale of any company other than Aurora as a means of meeting Council's investment objectives, partly due to the size of the other companies.

33 DCHL considered the possibility of selling only part of Aurora, but it did not see this as a good option. DCHL expects a higher premium and a higher probability of a successful outcome, if Aurora is sold as a whole.

Council resolutions

34 At Council's meeting of 12 March 2024, after considering DCHL's recommendation, Council resolved to consult the public on the potential sale of Aurora. Given the importance of the issue, Council decided to use the special consultative procedure under section 83 of the Local Government Act 2002 (LGA 2002). It is implicit in the special consultative procedure that a preferred option is required. Council therefore resolved that its preferred option for consultation purposes was to divest Aurora and to use the proceeds of any sale to repay Aurora's debt and use the remainder to generate income through a diversified investment fund.

35 A full copy of Council's resolution of 12 March 2024 is attached as Attachment B.

36 At Council's meeting of 20 March 2024, Council resolved to adopt the draft statement of proposal (consultation document) with some changes, and to approve the communication and engagement plan.

37 A full copy of Council's resolution of 20 March 2024 is attached as Attachment C.

Consultation process

38 Council invited submissions on whether Council, through DCHL, should keep or sell Aurora.

39 Council undertook a comprehensive consultation process which included:

a) Postcards with QR codes being mailed to all domestic households and distributed to libraries and Council service centres in Dunedin, Queenstown Lakes and Central Otago districts.

b) A printed consultation document being made available from libraries and Council service centres in Dunedin, Queenstown Lakes and Central Otago districts.

c) Extensive content on Council's website, including a broad range of additional related content.

d) Face-to-face engagement opportunities with DCC's Elected Members.

e) Media releases and advertisements.

f) Engagement with mana whenua and mātāwaka.

40 The Aurora consultation period ran from 28 March 2024 to 2 May 2024. A total of 760 submissions were received during the consultation period.

41 Of the 760 submissions, the majority were in favour of Council retaining Aurora.

42 Submitters were given the opportunity to be heard on 14, 15 and 16 May 2024.

43 There is a detailed discussion on the submissions later in this report.

Further information provided by DCHL to Council

44 At a workshop on 1 July 2024, DCHL provided Council with further information regarding concerns raised as part of public submissions. The workshop included information from Sapere, Mafic, Neil Holdom from TX1 Insight and Forsyth Barr.

Sale can only proceed if Council consents

45 DCHL can only sell Aurora and reinvest in a diversified investment fund if Council consents to the sale and use of proceeds. This is because a sale of Aurora would constitute a major transaction for DCHL under the Companies Act 1993, which requires shareholder approval (by a Special Resolution). The sale also requires Council's approval under DCHL's Statement of Intent, which requires DCHL to obtain Council approval before disposing of any shares exceeding $5 million in value.

DISCUSSION

Public submissions

A summary of the public submissions received as part of Council's consultation process

46 Council invited submissions on two options, as follows:

> *"Option One – the preferred option – Sale of Aurora Energy*
> *Council to approve a sale of Aurora Energy Limited, on the basis that the proceeds are used:*
> a. *To repay Aurora Energy's debt (forecast to be $576 million by mid next year); and*
> b. *To establish a diversified investment fund worth many hundreds of millions of dollars to create income for Council.*
>
> *Option Two – the alternative option – Keep Aurora Energy*
> *Council to keep Aurora Energy. If Council keeps Aurora Energy, then it will likely increase in value over time, but a regular income to Council is uncertain. If Aurora Energy was to pay dividends (income) to Council, this would probably be funded by debt."*

47 Council received 760 submissions during the consultation period.

48 It was evident that people had taken the time to consider the proposal and to provide detailed written feedback. Fifty-five submitters also took the opportunity to present their submissions orally.

49 Staff have prepared a memorandum called "Summary of Submissions on the Dunedin City Council's Proposal to sell Aurora Energy Limited." This summary is attached as Attachment D.

50 In essence, the summary of submissions records that:

a) 22% of submissions selected Option One – to sell Aurora (170).

b) 77% of submissions selected Option Two - to retain Aurora (586).

c) Four submissions did not select Option One or Option Two but did provide comments.

51 Almost all submissions were from submitters located within the Dunedin area. Only 24 submissions were received from outside the Council boundary. Of these 24 submissions, most preferred Option Two (to retain Aurora).

52 Some organisations provided written submissions. Most submissions were against a sale, but some were in favour of a sale. The Queenstown-Lakes District Council provided a submission that did not specify a preferred option but asked that the challenges faced by the district regarding capacity of supply, appetite for rapid decarbonisation and need for resilience be considered and given profile during the sale process if it proceeds.

53 The 170 submissions in favour of a sale of Aurora generally focused on one or more of the following themes:

Key reasons for Option One - sell Aurora	Number of submissions
1) Sell Aurora to reduce the DCC's debt	38
2) Sell Aurora but with conditions (e.g., not outside New Zealand)	25
3) Sell Aurora as it will be better managed by a private company	7
4) Sell Aurora for other reasons (e.g., lack of dividends)	15
5) No specific reason	13

54 The 586 submissions against a sale of Aurora generally focused on one or more of the following themes:

Key reasons for Option Two – Keep Aurora Energy	Number of submissions
1) Do not sell Aurora as it is a strategic asset	99
2) Do not sell Aurora as we need to learn from past mistakes when selling publicly owned assets	84
3) Do not sell Aurora as privatisation puts profit before community's needs	71
4) Do not sell Aurora as there is more public benefit from ownership (e.g., social and economic benefits)	59
5) Do not sell Aurora as it places more financial burden on ratepayers (e.g., because of potential electricity price increases)	55
6) Do not sell Aurora as the Council needs to fix its issues rather than privatise its assets	40
7) Do not sell Aurora as doubt benefit to ratepayers and/or perception that information biased	25
8) Do not sell Aurora, the Council needs to analyse different types of ownership models (e.g., community ownership)	18
9) Do not sell Aurora, stop selling assets	13
10) Do not sell Aurora as the public needs more information and analysis	12
11) Do not sell, other reasons (e.g., mistrust in Council's financial management)	36
12) Do not sell, no specific reason	19

55 The full text of submissions is on Council's website [Aurora Submissions received - Dunedin City Council].

56 Oral submitters expressed a wide range of views. Some spoke in favour of a sale given the potential for income from a diversified investment fund to be used to reduce rates increases and/or repay DCC Group debt. Others were concerned about a proposed sale of Aurora and expressed a range of views, including:

a) There are structural sector wide problems across local government, and a proposed sale of Aurora is symptomatic of wider funding issues for local government.

b) The sale of Aurora would be a one-off short-term gain.

c) Council needs to take a long-term view, as opposed to just looking at the next 10 years.

d) Aurora will increase in value over time and will at some time in the future be able to pay dividends from profits.

e) Aurora is a profitable company, and there is deferred income.

f) Aurora is a natural monopoly so should not be privatised. Linked to this, many submitters were concerned about potential electricity price increases and were not confident that the Commerce Commission and Electricity Authority would adequately control prices and/or prevent the network from becoming run down. Some submitters were also concerned that the regulatory settings may be changed by a future government.

g) Aurora has strategic value because it is a utility that provides a public function/essential service. The electricity network was likened to Council's three waters network. Some submitters considered the role of Aurora to be as a utility rather than to be profit driven.

h) There is value in having Aurora's head office in Dunedin. There is a risk that a prospective purchaser may want to relocate the head office.

i) Some submitters were concerned that Delta Utility Services Limited may be adversely affected if Aurora is sold.

j) Many submitters spoke about examples of public asset sales that they considered unsuccessful.

k) Many submitters felt that they did not have enough information and/or that the consultation document was biased towards a sale and/or the question of whether or not to sell should be something considered prior to an election or through a Long Term Plan (LTP) process.

l) Many submitters were worried that Council would:

    i) Dip into the investment fund, even if protections were put in place; and/or

    ii) Take on more debt after repaying Aurora's debt.

Consideration of public submissions

57 Council must consider all public submissions with an open mind.

58 The number of submissions in favour of and opposed to the sale of Aurora is a valid consideration for Council to assess, but Council is under no legal duty to decide based on the option that is supported by the greatest number of submissions.

59 The number of submissions and the issues submissions raise both in favour of and opposed to a sale will be a matter that each elected member needs to weigh up when debating and voting on whether to approve a sale or retain Aurora.

DCHL report

60 A report from DCHL dated September 2024 is attached as Attachment E. Elected members will need to read DCHL's report in full. This staff report does not seek to summarise the DCHL report. However, at a high level, staff note that the DCHL September report:

a) Confirms DCHL's recommendation to approve a sale of Aurora.

b) Discusses the reasons for DCHL's recommendation.

c) Discusses some concerns raised in public submissions, and summarises information provided by Sapere, Mafic, TX1 Insight and Forsyth Barr.

d) Discusses what DCHL sees as the implications of retaining Aurora.

61 A copy of the Sapere, Mafic, TX1 Insight and Forsyth Barr reports are attached as Attachments F, G, H and I.

Financial implications of selling or retaining Aurora

62 Council staff have modelled seven scenarios so that Council can assess the likely financial implications if Council approves a sale of Aurora compared with if Council retains Aurora. The modelled scenarios are attached as Attachment J.

63 The modelled scenarios are indicative only. This is because:

a) By necessity, they contain assumptions. This is because there are matters that have not yet been decided or which cannot yet be determined, such as:

i) What the Council's annual rates will be from next year onwards;

ii) What interest rates will be from next year onwards;

iii) What Council projects will be included in the 9 Year Plan, and what those projects will cost;

iv) How much NZTA Waka Kotahi funding will be available;

v) How much funding will be required by Council Controlled Organisations (CCOs); and

vi) What will be required as part of 3 Waters Reform.

b) The modelled scenarios are over a 9-year period to be consistent with the development of the 9 Year Plan 2025-2034. Modelling past three years becomes increasingly unreliable.

64 The assumptions used in the financial modelling for each scenario are set out in Attachment K.

65 Of the seven scenarios prepared by staff, three relate to Council retaining Aurora and four relate to Council selling Aurora.

66 There are four scenarios for selling Aurora so that Council can see the difference if the diversified investment fund was to provide a return of 3% (following an adjustment for inflation) rather than the forecast 5% (following an adjustment for inflation).

67 Staff reiterate that these are modelled assumptions to show trends and the numbers are indicative only. They assume different levels of rate increases, operational and capital expenditure. The purpose of these scenarios is to demonstrate the impact on Council and DCC Group debt and associated interest expense.

68 The Council's Financial Strategy, as adopted in the LTP 2021-2031, includes a debt limit of 250% of revenue. This metric is shown in each of the modelled scenarios. Where this metric is not met, the number is shaded red. Where the metric is within 20% of the metric, the number is shaded yellow.

69 The current DCC Group borrowing arrangements require the level of DCHL uncalled share capital to be greater than DCC Group debt.

70 Uncalled capital is currently $1.6 billion. This metric is shown in each of the modelled scenarios.

71 The uncalled capital amount will need to be reviewed each year following approval of the DCHL Statement of Intent. Each of the retain scenarios presented would require an increase to the uncalled capital amount prior to the 2025/26 financial year.

72 The modelled scenarios do not reflect actual asset revaluations for the 2023/24 financial year (such as the roading/3 waters networks and property/land portfolios), as these numbers are currently unconfirmed and subject to external audit.

73 The asset revaluations impact on depreciation and therefore the Council's surplus/deficit position.

74 Preliminary numbers indicate a significant reduction in the valuation and therefore depreciation expense of 3 waters assets. As the audit of the 2023/24 financial statements, including revaluations, is underway, these numbers cannot be incorporated. The impact of this uncertainty in relation to the scenarios provided is on the surplus/deficit position only because depreciation expense is a non-cash expense.

75 DCHL has provided CCO debt and revenue projections.

76 Aurora debt, revenue and capital expenditure is based on their current long term planning forecast with a 10% loading on capital expenditure which, following discussion with DCHL, appears to be a more likely expenditure level. The Aurora capital expenditure programme and therefore debt level is highly uncertain and could be significantly higher than projected in these scenarios.

Financial Implications of retaining Aurora

77 A detailed analysis of each retain scenario is provided below. In Attachment J, these are referred to as Scenario Analysis 1, 2 and 3.

78 **<u>For Council</u>**: In the three scenarios provided:

a) Debt increases to between $1.3 billion - $1.9 billion, an increase of $0.6 billion to $1.2 billion over the 9 years.

b) One of the scenarios (scenario 3), has a debt repayment in years 8 and 9. There is no debt repayment in the other two scenarios.

c) Debt as a percentage of revenue increases from between 203%-207% in year 1 to 182%-344% in year 9 in scenarios 1 and 2. In scenario 3, debt as a percentage of revenue reduces from 207% to 182%. In all three retain scenarios, this metric is not met in at least two years of the 9-year period. Scenario 3 does not meet the metric in years 4 and 5 but then meets the metric from year 6 onwards. In scenario 3, a rate increase of 12% in year 1, would result in all years' meeting the current financial strategy limit.

d) Interest expense increases from $38 million in year 1 to between $56 million - $79 million in year 9.

e) Interest expense as a percentage of total revenue increases in two of the scenarios from 8.7%-8.8% in year 1 to between 10.4%-13.6% in year 9. In scenario 3, this metric reduces from 8.8% in year 1 to 7.4% in year 9.

79 **<u>For DCC Group</u>**: In the three scenarios provided:

a) The DCC Group would need to borrow an additional $0.8 billion - $1.5 billion over 9 years increasing total group debt to between $2.3 - $2.9 billion.

b) Interest expense increases from between $76 million - $77 million in year 1 to between $99 million - $122 million in year 9.

c) Interest expense as a percentage of total revenue reduces in two of the scenarios from 9.5% in year 1 to 7.8%-9.4% in year 9. In scenario 2, this metric increases from 9.5% in year 1 to 11.0% in year 9.

80 A detailed analysis of each retain scenario is provided below.

Scenario 1 – Retain Aurora, Base Scenario

Council

•	Debt increases to $1.5 billion, an increase of $0.8 billion over the 9 years.
•	No debt repayment in any of the 9 years.
•	Debt as a percentage of revenue increases from 203% to 266% in year 9, peaking in year 7 at 270%.
•	Interest expense increases from $38 million in year 1 to $62 million in year 9.
•	Interest expense as a percentage of total revenue increases from 8.7% in year 1 to 10.4% in year 9, peaking in year 8 at 10.5%.

DCC Group

•	Group debt increases to $2.5 billion, an increase of $1.0 billion over the 9 years.
•	Interest expense increases from $76 million in year 1 to $104 million in year 9.
•	Interest expense as a percentage of total revenue reduces from 9.5% in year 1 to 9.4% in year 9.
•	The value of Aurora is expected to increase over time.

Scenario 2 – Retain Aurora, Base Scenario (with high operational and capital expenditure)

Council

•	Debt increases to $1.9 billion, an increase of $1.2 billion over the 9 years.
•	No debt repayment in any of the 9 years.
•	Debt as a percentage of revenue increases from 207% to 344% in year 9.

•	Interest expense increases from $38 million in year 1 to $79 million in year 9.
•	Interest expense as a percentage of total revenue increases from 8.8% in year 1 to 13.6% in year 9.

DCC Group

•	Group debt increases to $2.9 billion, an increase of $1.5 billion over the 9 years.
•	Interest expense increases from $77 million in year 1 to $122 million in year 9.
•	Interest expense as a percentage of total revenue increases from 9.5% in year 1 to 11.0% in year 9.
•	The value of Aurora is expected to increase over time.

Scenario 3 – Retain Aurora, with a 10% rates increase each year (with high operational and capital expenditure)

Council

•	Debt increases to $1.3 billion, an increase of $0.6 billion over the 9 years.
•	A debt repayment is achieved in years 8 and 9.
•	Debt as a percentage of revenue reduces from 207% to 182% in year 9. Note: in year 4 this metric is 257%.
•	Interest expense increases from $38 million in year 1 to $56 million in year 9.
•	Interest expense as a percentage of total revenue reduces from 8.8% in year 1 to 7.4% in year 9. Note: in year 5 this metric is 9.8%.

DCC Group

•	Group debt increases to $2.3 billion, an increase of $0.8 billion over the 9 years.
•	Interest expense increases from $77 million in year 1 to $99 million in year 9.
•	Interest expense as a percentage of total revenue reduces from 9.5% in year 1 to 7.8% in year 9.
•	The value of Aurora is expected to increase over time.

81 Any downside ratings from Standard & Poor's is uncertain but would likely increase the possibility of a downgrade the more the key metrics (debt to revenue and interest to operational revenue) come under pressure. Standard & Poor's sometimes apply more subjective outcomes if metrics deteriorate marginally but show improvement soon afterwards.

82 The Council is required to comply with LGFA Covenants as measured on a DCC Group basis. Individual Councils can apply or request for Covenants to be measured on a bespoke basis. At the current time, this would require approval by a majority of LGFA shareholders.

Financial implications of approving a sale of Aurora

83 A detailed analysis of each sell scenario is provided below. In Attachment J, these are referred to as Scenario Analysis 4, 5, 6 and 7.

84 **For Council**: In the four scenarios provided:

a) Debt increases to between $0.9 billion - $1.7 billion, an increase of $0.2 billion to $1.0 billion over the 9 years.

b) Scenario 6 has a debt repayment in years 7, 8 and 9. Scenario 4 has a debt repayment in year 9. There is no debt repayment in the other two scenarios.

c) Debt as a percentage of revenue increases from 207% to 261%-289% in year 9 in scenarios 5 and 7. Debt as a percentage of revenue reduces from between 203%-207% to

125%-189% in year 9 in scenarios 4 and 6 – these two scenarios are within the Council limit of 250%. The difference between scenario 4 (sell) and scenario 1 (retain), with both being base scenarios, is that the increased revenue from the diversified investment fund reduces debt. The financial impacts are increased revenue, increased surplus and less debt.

d) Interest expense increases from $38 million in year 1 to between $42 million - $70 million in year 9.

e) Interest expense as a percentage of total revenue reduces from between 8.7%-8.8% in year 1 to 2.2%-8.8% in year 9.

85 **For the DCC Group**: In the four scenarios provided:

a) Debt increases to between $1.1 billion - $1.9 billion, ranging from a reduction of $0.3 billion to an increase of $0.4 billion over the 9 years. Noting that the Aurora debt is repaid in year 1.

b) Interest expense increases in two of the scenarios (scenarios 5 and 7) from $62 million in year 1 to between $73 million - $78 million in year 9. Interest expense reduces in two of the scenarios (scenarios 4 and 6) from $61 million - $62 million in year 1 to between $50 million - $56 million in year 9.

c) Interest expense as a percentage of total revenue reduces from 10.0% - 10.1% in year 1 to between 2.5%-7.2% in year 9.

86 A detailed analysis of each sell scenario is provided below.

Scenario 4 – Sell Aurora, Base Scenario

Council

•	Debt increases to $1.1 billion, an increase of $0.4 billion over the 9 years.
•	A debt repayment is achieved in year 9.
•	Debt as a percentage of revenue reduces from 203% to 189% in year 9.
•	Interest expense increases from $38 million in year 1 to $48 million in year 9.
•	Interest expense as a percentage of total revenue reduces from 8.7% in year 1 to 3.7% in year 9.

DCC Group

•	Group debt reduces to $1.3 billion, a reduction of $154 million over the 9 years. Noting in year 1, Aurora debt is repaid.
•	Interest expense reduces from $61 million in year 1 to $56 million in year 9.
•	Interest expense as a percentage of total revenue reduces from 10.0% in year 1 to 3.6% in year 9.

Scenario 5 – Sell Aurora, Base Scenario (with high operational and capital expenditure)

Council

•	Debt increases to $1.6 billion, an increase of $0.9 billion over the 9 years.
•	No debt repayment in any of the 9 years.
•	Debt as a percentage of revenue increases from 207% to 261% in year 9, peaking in year 7 at 269%.
•	Interest expense increases from $38 million in year 1 to $66 million in year 9.

• Interest expense as a percentage of total revenue reduces from 8.8% in year 1 to 6.7% in year 9.

DCC Group

• Group debt increases to $1.7 billion, an increase of $0.3 billion over the 9 years. Noting in year 1, Aurora debt is repaid.
• Interest expense increases from $62 million in year 1 to $73 million in year 9.
• Interest expense as a percentage of total revenue reduces from 10.1% in year 1 to 5.7% in year 9.

Scenario 6 – Sell Aurora with a 10% rates increase each year (with high operational and capital expenditure)

Council

• Debt increases to $0.9 billion, an increase of $0.2 billion over the 9 years.
• A debt repayment is achieved in years 6, 7, 8 and 9.
• Debt as a percentage of revenue increases from 207% to 220% in year 4 and then reduces to 125% in year 9.
• Interest expense increases from $38 million in year 1 to $50 million in year 6, then reduces to $42 million in year 9.
• Interest expense as a percentage of total revenue reduces from 8.8% in year 1 to 2.2% in year 9.

DCC Group

• Group debt reduces to $1.1 billion, a reduction of $347 million over the 9 years. Noting in year 1, Aurora debt is repaid.
• Interest expense reduces from $62 million in year 1 to $50 million in year 9.
• Interest expense as a percentage of total revenue reduces from 10.1% in year 1 to 2.5% in year 9.

Scenario 7 – Sell Aurora, Base Scenario (with high operational and capital expenditure), Fund Return at 3%

Council

• Debt increases to $1.7 billion, an increase of $1.0 billion over the 9 years.
• No debt repayment in any of the 9 years.
• Debt as a percentage of revenue increases from 207% to 289% in year 9, peaking at 292% in years 7 and 8.
• Interest expense increases from $38 million in year 1 to $70 million in year 9.
• Interest expense as a percentage of total revenue reduces from 8.8% in year 1 to 6.4% in year 2 and 3 and then increases to 8.8% in year 9.

DCC Group

• Group debt increases to $1.9 billion, an increase of $0.4 billion over the 9 years. Noting in year 1, Aurora debt is repaid.
• Interest expense increases from $62 million in year 1 to $78 million in year 9.
• Interest expense as a percentage of total revenue reduces from 10.1% in year 1 to 5.5% in year 3 and then increases to 7.2% in years 7-9.

87 Staff have not modelled the difference in value between Aurora in 2034 and a diversified investment fund in 2034. This is for a range of reasons, including the number of potential variables.

88 Aurora is expected to increase in value over time. DCHL expects the RAB to be $1.6 billion by 2034.

89 While it is expected that the fund would also appreciate, staff have no ability to provide any certainty about what that might look like, because of variability of investment returns, and other decisions taken by Council.

Potential reasons to approve a sale of Aurora

90 DCHL have set out in detail in Attachment E their reasoning on why Council should approve a sale of Aurora. These reasons are not repeated here and Councillors should carefully read the view of the independent directors with regard to reasons to sell Aurora.

Potential reasons to retain Aurora

Alignment with majority of public submissions

91 Out of 760 submissions, 586 submissions (77% of all submissions) opposed a sale of Aurora.

92 As outlined earlier in this report, the number of submissions in favour of and opposed to the sale of Aurora is a valid consideration for Council to assess but Council is under no legal duty to decide based on the option that is supported by the greatest number of submissions. The Council will also need to weigh the issues raised.

Recent profits

93 There is no doubt that Aurora is a profitable company. DCHL's Quarterly Report (covering quarter 4 of the 2024 financial year) to the Finance and CCOs Committee on 7 August 2024 showed that Aurora had a <u>draft</u> net profit before tax of $35.9 million for the 2024 financial year. This was shown as a preliminary result in the Committee report. The draft net profit does however need to be read in the context of increased borrowing that is required.

94 DCHL went on to say in its Quarterly Report for quarter 4 of the 2024 financial year that:

> *"Aurora Energy contributed strongly to group net profit before tax. However, continuing elevated investment requirements mean the company will remain in a negative free cash flow position for the foreseeable future. Borrowings increased by $44m to $539m during the year. Net profit before tax exceeded budget by $13.8m, mostly due to higher use of system revenues (favourable $3.1m), higher capital contributions to customer-initiated works (favourable $5.6m), and below budget operating expenses. From a funding perspective, however, the company's favourable earnings result for the year is more than offset by higher gross capital expenditure ($16.4m higher than budget). Consistent with Aurora Energy's FY2024 Statement of Intent, all profits were reinvested into the network, borrowings increased, and no dividend was paid to DCHL."*

Growth in value of Aurora

95 Aurora is expected to increase in value over time. The increase in capital value will partly be due to the capital that will be invested in Aurora over the coming years and partly due to the market desire for assets like Aurora.

96 DCHL expects Aurora to have a regulated asset base (RAB) of approximately $1.6 billion by the 2034 Financial Year.

Potential for dividends in the long term

97 In the long term, it may be possible for Aurora to generate dividends that are not funded by debt.

98 However, Aurora has not generated a dividend since 2017. This is because funds that may otherwise be available as a dividend have been invested in Aurora's network to remedy historical underinvestment and address other requirements such as growth in Central Otago.

99 DCHL expects that, at least until 2035 and possibly longer, dividends would need to be funded by debt (i.e., it would be balance sheet borrowing based on the increased capital value of Aurora).

Potentially strategic nature of Aurora

100 Aurora can be viewed as a strategic asset given the supply of electricity is an important enabler of economic and population growth. Keeping functional control of a lines company may enable Council to determine the shape and scale of future urban development. The prioritisation of new service provision also enables Council (through its companies) to progress strategic initiatives. While Council is arm's length from Aurora, as DCHL shareholder, Council is able to set requirements around strategic outcomes as part of the Letter of Expectation process.

Uncertainty over 3 Waters Reform

101 When considering how Council will eventually deliver water services under Local Water Done Well (LWDW), the retention of Aurora does provide an interesting opportunity to consider. Aurora currently provides infrastructure services, operates at a regional level, is a regulated industry and has good systems and processes to support service delivery. It may be worth considering if Aurora could be involved in some way in the delivery of water services (eg through a management contract). Until Council has considered LWDW and its preferred delivery model, very little work has been done to consider if this would be a feasible option, but the retention of Aurora leaves this as an option that could be considered.

Use of sale proceeds

102 If Council decides to approve a sale of Aurora, then:

a) Decisions on how the diversified investment fund will be held will be made following consultation on Council's Investment Plan through the 9 Year Plan. The fund could for example be held by Council or DCHL or an entity specifically established to hold the fund.

b) Decisions around the nature of the fund (e.g., whether it is a growth fund or a more conservative fund), would also be made following consultation on Council's Investment Plan through the 9 Year Plan.

103 DCHL considers that an average long-run total return of 8% per annum with a cash distribution policy of 5% per annum is reasonable based on historical equity returns, noting a less conservative profile than the Waipori Fund.

104 As with any managed fund, there is the potential for a loss in any year, but if held over the long term then historically losses have generally been offset by gains in subsequent years. The risk of losses is mitigated through the diversification of the portfolio so that if one sector has a negative year then this only affects a portion of the fund.

Potential protection mechanisms for a diversified investment fund

105 There are already obligations on Council in respect of its financial management of its assets. For example, Part 6 of the LGA 2002 sets out requirements around financial management (including a requirement to have funding and financing policies) and a general obligation to manage Council's revenues, expenses, assets, liabilities, investments, and general financial dealings prudently and in a manner that promotes the current and future interests of the community.

106 There are a wide range of additional protection mechanisms that could be used to protect the capital in a diversified investment fund. Options include:

a) The same protections used for the Waipori Fund, such as Council preparing a Statement of Investment Policy and Objectives and having Council's Standing Orders record that Council may only divest all or any part of the capital of the diversified investment fund by a three quarters majority of the members present and voting.

b) Adding the diversified investment fund to Council's list of Strategic Assets.

c) Seeking a local Act of Parliament. A recent example of this is the New Plymouth District Council (Perpetual Investment Fund) Act 2023.

107 A further discussion on the protection mechanisms would be included in the consultation document for the 9 Year Plan as the protection mechanisms for the diversified investment plan would form part of Council's Investment Plan.

Section 80 of the LGA 2002

108 If Council wants to approve a sale of Aurora, then it would need to comply with section 80 of the LGA 2002. This means that, when making its decision, Council would need to:

a) Clearly identify that the proposed sale of Aurora is inconsistent with the LTP for 2021-2031 as the LTP for 2021-2031 does not include any reference to a potential sale of Aurora; and

b) Explain that Council would incorporate any decision regarding Aurora into the 9 Year Plan (i.e., the next LTP 2025-2034).

OPTIONS

109 The two main options are for Council to:

a) Approve a sale of Aurora, subject to a minimum price being met; or

b) Retain Aurora.

110 While Council could defer a decision on whether to approve a sale of Aurora until next year's 9 Year Plan process, there are considerable process risks with such an approach. For example, the 9 Year Plan would need to be prepared in the alternative, but that is complex given that the 9 Year Plan will at the same time also need to deal with the potential options regarding different models for the delivery of water services. For this reason, the option of deferring the decision to next year has not been considered further.

111 If Council decides to retain Aurora, this does not preclude Council from considering a sale in subsequent years (e.g., once the 3 Waters Reform has been completed or as part of the next

10 Year Plan process in 2027). This option is not considered further as any subsequent proposal to sell Aurora would need to be considered based on the circumstances at the time.

112 This is a challenging decision for Council given the public sentiment that has to be considered alongside the financial challenges and economic conditions that the Council has to navigate over the next few years.

113 The decision that Council needs to make is difficult because it involves decisions which inherently involve some uncertainty.

114 One option sees Council retain a profitable company that requires ongoing capital investment in at least the medium term, but is then likely to be in a position to provide Council with a cash dividend.

115 On the other hand, the independent advice from DCHL directors is that a premium price is lilely if Aurora is sold now and the Council would receive a higher income in the short to medium term through having a diversified investment fund.

116 Council staff are not able to provide advice on which is the best option. However, in either case, the implications for the Council debt levels will need to be considered along with the requirements for how various activities will be funded if alternative revenue sources, other than rates, fees and charges, are not identified.

117 The advantages and disadvantages of both options are now presented below for consideration.

Option One – Approve a sale of Aurora, subject to a minimum price being met

118 Under this option, Council would:

a) Consider the information before it, including all public submissions.

b) Decide to approve a sale of Aurora, subject to a reserve price being met.

c) Council's ability to determine a reserve price ensures that Aurora is sold at market value.

d) Direct that if the reserve price is met, then the proceeds of the sale of Aurora Energy Limited (less sale costs) are to be used to:

i) Repay Aurora Energy Limited's debt as at the date of sale; and

ii) Establish a diversified investment portfolio with the balance of the proceeds.

e) Note that:

i) The diversified investment portfolio would have mechanisms to protect the capital in the portfolio, including against inflation, and that these protections would be determined following consultation through the 9 Year Plan process; and

ii) The decision on how the diversified investment portfolio would be held would be made following consultation on Council's Investment Plan through the 9 Year Plan process.

f) Identify that the decision to approve a sale of Aurora is inconsistent with the current Long-Term Plan (2021-2031) as the Plan does not refer to a potential sale of Aurora. Council will incorporate any decision regarding Aurora into the 9 Year Plan.

g) Note that staff will prepare draft 9 Year Plan budgets on the following basis:

i) No dividend will be budgeted from DCHL from the 2026/27 year.

ii) Increased debt levels will be required to meet Council's proposed capital programme.

iii) Revenue assumptions will require a review of future rates rises.

Advantages

- A sale of Aurora is expected to increase income to Council through a higher and more consistent income stream (estimated to be an average of more than $37 million with a net 5% return and more than $24 million per annum with a net 3% per annum). DCHL expects that, in the long term, the regulated rate of return from Aurora will be lower than the return from a diversified investment portfolio with a growth profile.

- Council would own an asset in the form of a diversified investment fund worth hundreds of millions of dollars.

- Income from the diversified investment fund would be cash, whereas any dividends from Aurora would be funded from debt (at least in the short to medium term).

- A sale of Aurora would reduce DCC Group debt. If Aurora is retained, then forecast DCC Group debt in 2034 is $2.4 billion. If Aurora is sold, then forecast DCC Group debt in 2034 is $1.3 billion (and less if Council applies the income from the Aurora Fund towards interest and debt repayment).

- A sale of Aurora would diversify Council's investments and therefore reduce risk.

- The capital in the diversified investment fund would be protected, including against inflation.

- The income from the diversified investment fund would be available for Council to use as it chooses, including potentially to offset future rates increases and/or repay debt.

- A price premium on RAB is potentially available in the market at present.

Disadvantages

- There is considerable public opposition to a sale of Aurora.

- Council would no longer own (through DCHL) a regulated asset that is expected to deliver capital growth and potentially dividends in the long term.

- Council would no longer own (through DCHL) an asset which potentially has strategic value.

- There is a risk that future Councils may use the debt "head room" created by a sale of Aurora to borrow more money.

- While there would be protections in place, unless there was an Act of parliament, any protections could be revoked by Council allowing the capital of the fund to be spent.

- There are national and international examples where asset sales have not produced the desired results.

- A lines company is a non-replicable unique asset and if sold Council is unlikely to be in a position to own an asset of its type.

- A sale of Aurora may remove potential options for the delivery of water services.

- There is a potential risk, albeit low, that there would not be adequate controls applied by the Commerce Commission and/or- the Electricity Authority.

Option Two – Retain ownership of Aurora Energy Limited

119 Under this option, Council would:

a) Consider the information before it, including all public submissions.

b) Decide to retain ownership of Aurora Energy Limited.

c) Advise DCHL of Council's decision to retain Aurora Energy Limited.

d) Note that the draft Investment Plan will be redrafted as part of the 9 Year Plan with the focus on increasing the capital value of Council's investment assets rather than generating cash returns.

e) Note that staff will prepare draft 9 Year Plan budgets on the following basis:

    i) No dividend will be budgeted from DCHL from 2026/27 year.

    ii) Increased debt levels will be required to meet Council's proposed capital programme.

    iii) Revenue assumptions will require a review of future rates rises.

Advantages

- Retaining Aurora would recognise the extent of public submissions opposing a sale of Aurora.

- Council could decide at anytime to approve a potential sale of Aurora, if the market conditions are favourable.

- The value of Aurora will increase over time.

- Aurora is a profitable company and may deliver cash dividends in the long term.

- Council would continue to own (through DCHL) a unique regulated asset that is expected to deliver capital growth and potentially dividends in the long term.

- Aurora can be viewed as a strategic asset given the supply of electricity is an important enabler of economic and population growth. Keeping functional control of a lines company may enable Council to determine the shape and scale of future urban development. The prioritisation of new service provision also enables Council (through its companies) to progress strategic initiatives. While Council is arm's length from Aurora, as DCHL shareholder, Council can set requirements around strategic outcomes as part of the Letter of Expectation process.

- Council could revisit the decision later once there is more certainty around 3 Waters Reform, and retaining Aurora leaves all options on the table for potential models for the delivery of water services.

Disadvantages

- Council and the DCC Group would need to take on more debt to fund Aurora's capital requirements.

- The level of debt may put pressure on future credit ratings, debt covenants and borrowing costs.

- If Aurora were to return a dividend, it would need to be funded by debt, at least in the short to medium term.

- Lower cash distributions from DCHL in the short and medium term will mean higher rates, lower expenditure on services or higher debt.

- At the recent Local Government New Zealand conference in Wellington, the government indicated that rates caps may be applied in certain yet to be specified circumstances. If that was to happen, then this may constrain Council's ability to deliver some projects and services if Council does not have alternative revenue streams.

- None of the advantages under Option 1 are realised.

- Council's ownership of Aurora may limit its ability to expand.

NEXT STEPS

120 If Council approves a sale of Aurora subject to a reserve price being met, then DCHL would proceed to market Aurora.

121 If Council decides that it does not approve a sale of Aurora, then DCHL would be advised accordingly.

122 Whether Council approves a sale of Aurora or decides to retain Aurora, staff will prepare draft 9 Year Plan budgets on the following basis:

a) No dividend will be budgeted from DCHL from the 2026/27 year.

b) Increased debt levels will be required to meet Council's proposed capital programme.

c) Revenue assumptions will require a review of future rates rises.

123 Staff note that Council's Financial Strategy will be reviewed as part of the 9 Year Plan 2025-2034 process. While developing these scenarios, it became apparent that the Local Government Funding Agency (LGFA) offsets Council and DCC Group debt by the value of liquid investments (such as the Waipori Fund). Council's Financial Strategy does not do this. Council may wish to consider this when reviewing the Financial Strategy as part of the 9 Year Plan 2025-2034 process.

Signatories

Author:	Karilyn Canton - Chief In-House Legal Counsel Hayden McAuliffe - Financial Services Manager Carolyn Allan - Chief Financial Officer
Authoriser:	Sandy Graham - Chief Executive Officer

Attachments

SUMMARY OF CONSIDERATIONS

Fit with purpose of Local Government

This decision promotes the economic well-being of communities in the present and for the future. This decision also enables democratic local decision making and action by, and on behalf of communities as the decision was consulted on through the special consultative procedure.

Fit with strategic framework

	Contributes	Detracts	Not applicable
Social Wellbeing Strategy	☐	☐	✓
Economic Development Strategy	✓	☐	☐
Environment Strategy	☐	☐	✓
Arts and Culture Strategy	☐	☐	✓
3 Waters Strategy	☐	☐	✓
Spatial Plan	☐	☐	✓
Integrated Transport Strategy	☐	☐	✓
Parks and Recreation Strategy	☐	☐	✓
Other strategic projects/policies/plans	☐	☐	✓

Council holds a variety of assets, including Aurora Energy Limited that contribute to the delivery of the Council's broader strategic direction.

Māori Impact Statement

There was engagement with mana whenua and mātāwaka regarding the proposal to sell Aurora leading to submissions from Te Rūnanga ō Ōtākou Inc as part of this process.

Sustainability

Sustainability issues are likely to be the same or similar whether Aurora is retained or sold.

LTP/Annual Plan / Financial Strategy /Infrastructure Strategy

A sale of Aurora is inconsistent with Council's current LTP 2021-2031. Council's legal advice is that a decision to sell Aurora would not trigger an amendment to the LTP. However, in accordance with section 80 of the Local Government Act 2002, Council would need to identify that a sale of Aurora is inconsistent with the current LTP 2021-2031, and the next LTP (i.e., the 9 Year Plan) would need to be updated to reflect the decision.

Financial considerations

The financial considerations are discussed in depth in this report.

Significance

This decision is considered high in terms of Council's Significance and Engagement Policy. Accordingly, Council has undertaken a Special Consultative Procedure regarding this decision.

Engagement – external

There has been significant external engagement and advice. DCHL have consulted with various specialist advisers and those reports are included as attachments for Council to consider. External legal advice has been sought by Council from Anderson Lloyd.

SUMMARY OF CONSIDERATIONS
Engagement - internal There has been extensive internal engagement with senior leaders, Finance, Legal, 3 Waters, and Corporate Policy teams.
Risks: Legal / Health and Safety etc. There are no identified Health and Safety Risks. Legal considerations are discussed in the body of this report.
Conflict of Interest There are no known conflicts of interest.
Community Boards The issue is of interest to all members of the community including those covered by Community Boards. All community boards had the opportunity to submit on the proposal.

DUNEDIN CITY COUNCIL | kaunihera a-rohe o Ōtepoti

1 February 2023

The Board of Directors
Dunedin City Holdings Ltd
PO Box 5045
Dunedin 9054

Dear Directors

LETTER OF EXPECTATIONS FOR THE YEAR ENDING 30 JUNE 2024

1. This Letter of Expectations (the Letter) outlines the matters the Dunedin City Council (DCC) expects the board of Dunedin City Holdings Ltd (DCHL) to address in the business planning process for the 2023/2024 financial year.

2. The Letter is intended to create an opportunity for DCHL and DCC to have strategic alignment through enhanced communication and engagement.

DCHL purpose

3. DCHL oversees eight subsidiary and associate companies. DCHL's portfolio comprises 100% shareholdings in Aurora Energy Ltd, City Forests Ltd, Delta Utility Services Ltd, Dunedin City Treasury Ltd, Dunedin Railways Ltd, Dunedin Stadium Property Ltd and Dunedin Venues Management Ltd. It also owns 50% of Dunedin International Airport Ltd.

4. DCHL's purpose is to achieve for Dunedin the best from its investments and provide leadership and oversight of its subsidiary and associated companies on behalf of the ultimate Shareholder, the Dunedin City Council. It is imperative that DCHL provides a commercial return relative to the value of the investments owned.

5. DCHL is responsible for setting the strategic direction of Dunedin City Council's CCOs as a group, monitoring their operational performance, appointing directors to their boards, providing input to annual planning documents, and providing or withholding approval for transactions where approval is required.

6. DCHL's Statement of Intent lists its current objectives as:

   - Enhance the value of the DCC's assets and investments for future generations
   - Sustainably grow the value of the DCC's investments
   - Provide a sustainable dividend for the DCC
   - Contribute to the DCC's goals for the city

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DunedinCityCouncil @DnCityCouncil

Focus for the 2023/24 financial year

7. In the 2023 financial year, we expect DCHL to continue with its purpose of achieving for Dunedin the best from its investments. We specifically expect DCHL to:

- Work with the DCC on the possible transition of some Council Controlled Organisations from DCHL to direct DCC investments.
- Work with the DCC in relation to what the future outlook is for DCHL (including subsidiaries) and provide a high level forecast of the financial returns and dividends to the DCC for the next 1-5 years to assist with informing a DCHL dividend policy.
- Provide the DCC with strategic options for consideration (including consideration as to the future composition and direction of the portfolio) that allows the DCC to consider the implications for the DCC as shareholder with a particular focus on dividends/return on investment from DCHL. This should also include an assessment of historic performance to relevant benchmarks and what this context means for expected future performance.
- Continue to ensure each company measures and reports its carbon footprint, maintains emission reduction targets, and implements emissions reduction plans so as to contribute to Council's goal of reducing Dunedin's carbon emissions to net zero (excluding biogenic methane) by 2030, with a focus on gross emissions reduction consistent with 1.5o-aligned pathways.
- Continue to align with DCC living wage policies.

Climate Change

8. The Council is committed to addressing climate change including the impact of DCHL's activities on the environment, the need to build resilience and understand and manage risk.

9. The Council has set a target to be net zero carbon by 2030 for its activities, with a focus on gross emissions reduction consistent with 1.5o-aligned pathways. The Council is taking a leadership role on this matter and is asking all members of its wider group to also adopt this target, with the focus being on reducing greenhouse gas emissions and then offsetting any residual amount.

10. The Council notes that DCHL is committed to this but asks the DCHL group to continue to review its activities from an emissions reduction perspective and advise Council how the DCHL group will contribute to the Council's Zero Carbon work programme.

11. The DCC acknowledges the work to date baselining emissions for each company, and to set targets and goals focused on gross emissions reduction. The Council acknowledges some of DCHL's subsidiaries face challenges that are not easily addressed, at least in the short term. The Council supports the approach that DCHL is taking to become net carbon zero as a group initially. However, DCHL must not lose sight of the goal of each company achieving the 2030 target; this is what the Council will report progress against publicly.

12. We would like DCHL to continue to provide ongoing reporting including the extent to which the DCHL group itself may be able to reduce emissions, the challenges to which solutions are not readily apparent or available and the potential cost of offsetting residual emissions.

General expectations of DCHL

13. We also require DCHL and subsidiary and associate companies to:

- Manage operations in accordance with company constitutions, Statements of Intent and relevant legislation
- Be cognisant of the political context in which they operate, and recognise that Council is accountable to the community for DCHL group companies' performance
- Observe the practice of "no surprises"
- Ensure best practice governance for all companies
- Be transparent and accountable, including compliance with Local Government Official Information and Meetings Act 1987 (LGOIMA) and information disclosure policies
- Ensure health and safety is a top priority across the group, and that appropriate policies and structures are in place to support this
- Ensure appropriate risk management structures are in place
- Act within investment and divestment approval thresholds defined in Statements of Intent
- Obtain all debt funding from Dunedin City Treasury Ltd (DCTL)
- Use the group insurance broker and tax advisor appointed by Council
- Comply with group-wide considerations in DCC's Procedure for the Appointment and Remuneration of Directors of DCHL
- Seek opportunities for companies to contribute to Council's Strategic Framework
- Ensure group wide policies are put in place where appropriate and that policies are aligned with those of Council and related guidelines established by the Office of the Auditor-General (OAG).

Dividends and debt

14. DCHL's current dividend policy is to pay a minimum 60% of the DCHL parent company's after-tax profit, subject to the Directors' obligations to act in accordance with their statutory duties and in the best interest of DCHL.

15. The dividend policy between Council and DCHL needs to achieve a greater level of certainty and transparency when it comes to dividend payments and retentions.

16. Council acknowledges that the group needs to retain cash for reinvestment in their various businesses as well as for debt servicing and repayment. Consistent with 7 above, the Council however wishes to have a Group wide view of where debt and debt servicing is best placed and wants to work proactively with DCHL to ensure the capital needs of the group, debt financing and repayment obligations and distributions available to the Council are mutually acceptable and effective for all. This work will be informed by the forecast short-medium terms results and will take into account the results of the subsidiary companies.

17. The outcome from this would then be a clear statement of dividend policy of DCHL as parent and the subsidiary companies in each Statement of Intent.

18. The DCC requests a dividend from the DCHL Trading companies of $11.0 million for the 2023/24 financial year. This dividend along with the $5.90 million interest payment will make a total annual distribution of $16.9 million.

Group Investment Plan

19. Council is developing an investment plan to govern purpose and how we manage our investment, including the DCHL trading companies, the Waipori Fund and the Council's investment property portfolio. This plan will establish a framework for future cash dividends from each of the investments held. The expectation for the DCHL Trading companies will result in a higher distribution than that requested above.

20. DCHL's input into this process is expected in time for inclusion in the Council's next 10 year plan.

Reports

21. Council requests that the DCHL Group standardises financial reporting from each company, including content and presentation of financial information in the Statements of Intent.

Working with DCC

22. We expect DCHL to keep Council informed as to companies' financial performance and progress towards achieving the goals set in the Statements of Intent.

23. We expect DCHL to provide input into the development of the DCC's investment plan.

24. We expect DCHL to work on what the future outlook is for DCHL (including subsidiaries) and to provide a high level forecast of the financial returns and dividends to shareholders for the next 1-5 years.

25. We expect DCHL to provide the DCC with strategic options (including the future composition and direction of the portfolio) that allows the DCC to consider the implications for the DCC as shareholder with a particular focus on dividends/return on investment from DCHL.

26. We require DCHL to provide:

    - Quarterly updates to the Finance and Council Controlled Organisations Committee

- Half-yearly and Annual Reports in accordance with the Local Government Act 2002

- A two-monthly update to DCC's Audit and Risk Subcommittee on DCHL/DCTL Audit and Risk Activity

- Briefings for Councillors on matters of significance as required.

27. We also expect DCHL to invite the Mayor, Deputy Mayor, Chair and Deputy Chair of the Finance and Council Controlled Organisations Committee, DCC Chief Executive and Chief Financial Officer to a session with the DCHL board meeting each quarter, to review the achievement of financial targets and other performance measures identified in the Statement of Intent (SoI).

Next steps

28. The Letter of Expectations forms the basis for the development of your Statement of Intent for the year ending 30 June 2024.

29. Draft Statements of Intent of DCHL Group companies are due to be delivered to Council on or before 1 March 2023. Your Statements of Intent should reflect the Letter of Expectations and comply with the requirements of the Local Government Act (see s64 and Schedule 8).

30. We look forward to working with you in the coming financial year on the Group Investment Plan and other matters. Please contact me if you have any queries relating to this letter or Council's expectations of DCHL.

Yours sincerely

Jules Radich
MAYOR OF DUNEDIN

5

DUNEDIN CITY COUNCIL | kaunihera a-rohe o Ōtepoti

6 December 2023

The Board of Directors
Dunedin City Holdings Ltd
PO Box 5045
Dunedin 9054

Dear Directors

LETTER OF EXPECTATION FOR THE YEAR ENDING 30 JUNE 2025

1. This Letter of Expectation (the Letter) outlines the matters the Dunedin City Council (DCC) expects the board of Dunedin City Holdings Ltd (DCHL) to address in the business planning process for the 2024/2025 financial year.

2. The Letter is intended to create an opportunity for DCHL and DCC to have strategic alignment through enhanced communication and engagement.

DCHL purpose

3. DCHL oversees eight subsidiary and associate companies. DCHL's portfolio comprises 100% shareholdings in Aurora Energy Ltd, City Forests Ltd, Delta Utility Services Ltd, Dunedin City Treasury Ltd, Dunedin Railways Ltd, Dunedin Stadium Property Ltd and Dunedin Venues Management Ltd. It also owns 50% of Dunedin International Airport Ltd.

4. DCHL's purpose is to achieve for Dunedin the best from its investments and provide leadership and oversight of its subsidiary and associated companies on behalf of the ultimate Shareholder, the Dunedin City Council. It is imperative that DCHL provides a commercial return relative to the value of the investments owned.

5. DCHL is responsible for setting the strategic direction of Dunedin City Council's CCOs as a group, monitoring their operational performance, appointing directors to their boards, providing input into annual planning documents, and providing or withholding approval for transactions where approval is required.

6. DCHL's Statement of Intent lists its current objectives as:
   - Enhance the value of Council's assets and investments for future generations
   - Sustainably grow the value of the Council's investment portfolio
   - Provide a sustainable dividend to Council
   - Contribute to Council's goals for the city
   - Ensure independence between council and companies' operations

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Focus for the 2024/25 financial year

7. In the 2024/25 financial year, we expect DCHL to continue with its purpose of achieving for Dunedin the best from its investments. We specifically expect DCHL to:

- Continue to work with the DCC on the possible transition of some Council Controlled Organisations from DCHL to direct DCC investments.
- Continue to work with the DCC on what the future outlook is for DCHL (including subsidiaries) and provide a high level forecast of the financial returns and dividends to the DCC for the next 1-5 years to assist with informing a DCHL dividend policy.
- Provide the DCC with strategic options (including the future composition and direction of the portfolio) that allows the DCC to consider the implications for the DCC as shareholder, with a particular focus on dividends/return on investment from DCHL. This should also include an assessment of historic performance to relevant benchmarks and what this means for expected future performance.
- Continue to ensure each company measures and reports its carbon footprint, maintains emission reduction targets, and implements emissions reduction plans, to contribute to Council's goal (as set out in the Carbon Zero Plan 2030) of reducing Dunedin's carbon emissions to net zero (excluding biogenic methane) by 2030, with a focus on gross emissions reduction consistent with 1.5°-aligned pathways.
- Ensure each company sets, measures, and reports on progress towards waste minimisation goals, and implements waste reduction plans. As set out in the Waste Minimisation Management Plan, Council's waste minimisation goals are to reduce Dunedin's solid waste to less than 638kg per person per annum, and reduce solid waste disposed to landfill to less than 47,264 tonnes per annum.
- Work with each company to develop measures and targets for inclusion in their Statements of Intent that are relevant, measurable, clear, and fit for purpose. In DCHL's Statement of Intent, include performance objectives for the group as required by the Local Government Act 2002.
- Develop a sponsorship policy for all companies, that aligns with the Council's strategic framework.
- Reinstate the internship programme.
- Continue to align with DCC living wage policies.

Climate Change

8. The Council is committed to addressing climate change with a focus on gross emissions reduction consistent with 1.5°-aligned pathways.

9. The Council is taking a leadership role on this matter and is asking all members of its wider group to also adopt the target to be net zero carbon by 2030, with the focus being on reducing greenhouse gas emissions and then offsetting any residual amount.

10. The Council notes that DCHL is committed to this but asks the DCHL group to continue to review its activities from an emissions reduction perspective and advise Council how the DCHL group will contribute to the Council's Zero Carbon work programme.

11. The DCC acknowledges the work to date baselining emissions for each company, and to set targets and goals focused on gross emissions reduction. The Council acknowledges some of

DCHL's subsidiaries face challenges that are not easily addressed, at least in the short term. The Council supports the approach that DCHL is taking to become net carbon zero as a group initially. However, DCHL must not lose sight of the goal of each company achieving the 2030 target; this is what the Council will report progress against publicly.

12. We would like DCHL to continue to provide ongoing reporting including the extent to which the DCHL group itself may be able to reduce emissions, the challenges to which solutions are not readily apparent or available and the potential cost of offsetting residual emissions.

General expectations of DCHL

13. We require DCHL and subsidiary and associate companies to:

- Manage operations in accordance with company constitutions, Statements of Intent and relevant legislation
- Be cognisant of the political context in which they operate, and recognise that Council is accountable to the community for DCHL group companies' performance
- Observe the practice of "no surprises"
- Ensure best practice governance for all companies
- Be transparent and accountable, including compliance with Local Government Official Information and Meetings Act 1987 (LGOIMA) and information disclosure policies
- Ensure health and safety is a top priority across the group, and that appropriate policies and structures are in place to support this
- Ensure appropriate risk management structures are in place
- Act within investment and divestment approval thresholds defined in Statements of Intent
- Obtain all debt funding from Dunedin City Treasury Ltd (DCTL)
- Use the group insurance broker and tax advisor appointed by Council
- Comply with group-wide considerations in DCC's Procedure for the Appointment and Remuneration of Directors of DCHL
- Take diversity into account when appointing directors to DCHL and subsidiary companies
- Seek opportunities for companies to contribute to Council's Strategic Framework
- Ensure group wide policies are put in place where appropriate and that policies are aligned with those of Council and related guidelines established by the Office of the Auditor-General (OAG).

Dividends and debt

14. DCHL's current dividend policy is to pay a minimum 60% of the DCHL parent company's after-tax profit, subject to the Directors' obligations to act in accordance with their statutory duties and in the best interest of DCHL.

15. The dividend policy between Council and DCHL needs to achieve a greater level of certainty and transparency when it comes to dividend payments and retentions.

16. Council acknowledges that the group needs to retain cash for reinvestment in their various businesses as well as for debt servicing and repayment. Consistent with 7 above, the Council however wishes to have a Group wide view of where debt and debt servicing is best placed.

Council wants to work proactively with DCHL to ensure the capital needs of the group, debt financing and repayment obligations and distributions available to the Council are mutually acceptable and effective for all. This work will be informed by the forecast short-medium terms results and will take into account the results of the subsidiary companies.

17. The outcome from this would be a clear statement of dividend policy of DCHL as parent and the subsidiary companies in each Statement of Intent.

18. The DCC requests a dividend from the DCHL trading companies of $11.0 million for the 2024/25 financial year. This dividend along with the $5.90 million interest payment will make a total annual distribution of $16.9 million.

Group Investment Plan

19. Council has nearly completed the development of an investment plan that will oversee how Council manages its investment, including the DCHL trading companies, the Waipori Fund and the Council's investment property portfolio. This plan will establish a framework for future dividends. The expectation for the DCHL trading companies will be for a higher distribution than that requested above.

20. DCHL's input into this process is expected as the investment plan is adopted and implemented.

Reports

21. Council requests that the DCHL Group continues to standardise financial reporting from each company, including content and presentation of financial information in the Statements of Intent.

Working with DCC

22. We expect DCHL to keep Council informed of the companies' financial performance and progress towards achieving the goals set in the Statements of Intent.

23. We expect DCHL to provide input into the development of the investment plan.

24. We expect DCHL to work on what the future outlook is for DCHL (including subsidiaries) and to provide a high level forecast of the financial returns and dividends to shareholders for the next 1-5 years.

25. We expect DCHL to provide the DCC with strategic options (including the future composition and direction of the portfolio) that allows the DCC to consider the implications for the DCC as shareholder with a particular focus on dividends/return on investment from DCHL.

26. We require DCHL to provide:

- Quarterly updates to the Finance and Council Controlled Organisations Committee
- Half-yearly and Annual Reports in accordance with the Local Government Act 2002
- A two-monthly update to DCC's Audit and Risk Subcommittee on DCHL/DCTL Audit and Risk Activity
- Briefings for Councillors on matters of significance as required.

27. We also expect DCHL to invite the Mayor, Deputy Mayor, Chair and Deputy Chair of the

Finance and Council Controlled Organisations Committee, DCC Chief Executive and Chief Financial Officer to a session with the DCHL board meeting each quarter, to review the achievement of financial targets and other performance measures identified in the Statements of Intent.

Next steps

28. The Letter of Expectation forms the basis for the development of your Statement of Intent for the year ending 30 June 2025.

29. Draft Statements of Intent of DCHL Group companies are due to be delivered to Council on or before 1 March 2024. Your Statements of Intent should reflect the Letter of Expectation and comply with the requirements of the Local Government Act (see s64 and Schedule 8).

30. We look forward to working with you in the coming financial year. Please contact me if you have any queries relating to this letter or Council's expectations of DCHL.

Yours sincerely

Jules Radich
Mayor of Dunedin

Council

CONFIDENTIAL MINUTES EXTRACT

Extract of the Confidential Minutes of an ordinary meeting of the Council held in the Council Chamber, Dunedin Public Art Gallery, The Octagon, Dunedin, on Tuesday 12 March 2024, commencing at 1.12 pm.

C1 POTENTIAL SALE

A report from Legal Services and Finance provided information to enable Council to make a decision on whether it wanted to proceed to public consultation on the potential sale of Aurora Energy Limited (Aurora); and if so, whether the preferred option for consultation would be the divestment of Aurora.

Dunedin City Holdings Ltd (DCHL) Directors (Greg Anderson and Chris Milne) and General Manager DCHL (Peter Hocking) spoke to the DCHL recommendation that Council proceed with the sale of Aurora and create a diversified investment fund from the proceeds of the sale.

Messrs Chris Milne; Greg Anderson and Peter Hocking left the meeting at 2.25 pm.

Moved (Mayor Jules Radich/Cr Marie Laufiso):

That the Council:

Adjourns the meeting for 5 minutes.

Motion carried

The meeting adjourned at 2.25 pm and reconvened at 2.36 pm

Moved (Mayor Jules Radich/Cr Steve Walker):

That the Council:

Extends the meeting beyond 6 hours.

Motion carried

The Chief Executive Officer (Sandy Graham), Chief Financial Officer (Carolyn Allan) and Senior In-House Legal Counsel (Karilyn Canton) spoke to the report and responded to questions.

Mr Warren Allen (Chair, Audit and Risk Subcommittee), Mr Michael Garbett, Ms Sarah Simmers (Anderson Lloyd) and Messrs Kyle Cameron and Josh Cuming (Deloitte) responded to questions in their area of expertise.

Moved (Mayor Jules Radich/Cr Marie Laufiso):

That the Council:

Adjourn the meeting for 5 minutes.

Motion carried

The meeting adjourned at 3.25 pm and Messrs Kyle Cameron and Josh Cuming (Deloitte) left the meeting.

The meeting reconvened at 3.46 pm.

Moved (Mayor Jules Radich/Cr Cherry Lucas):

That the Council:

a) **Decides:**

i. To consult with the public on the potential sale of Aurora Energy Limited;

ii. To use the special consultative procedure for the consultation; and

iii. Its preferred option for consultation is to divest Aurora Energy Limited and to use the proceeds of any sale to repay Aurora's debt, and use the remainder to generate income through a diversified investment Fund.

Division

The Council voted by division

For:	Crs Bill Acklin, Sophie Barker, David Benson-Pope, Christine Garey, Kevin Gilbert, Carmen Houlahan, Cherry Lucas, Mandy Mayhem, Lee Vandervis, Steve Walker, Brent Weatherall, Andrew Whiley and Mayor Jules Radich (13).
Against:	Cr Marie Laufiso (1).
Abstained:	Nil

The division was declared CARRIED by 13 votes to 1

Motion carried (CNL/2024/030)

Moved (Mayor Jules Radich/Cr Cherry Lucas):

That the Council:

b) **Notes** that mechanisms will be developed to protect the Fund's capital.

Division

The Council voted by division

For:	Crs Bill Acklin, Sophie Barker, David Benson-Pope, Christine Garey, Kevin Gilbert, Carmen Houlahan, Cherry Lucas, Mandy Mayhem, Lee Vandervis, Steve Walker, Brent Weatherall, Andrew Whiley and Mayor Jules Radich (13).
Against:	Nil

Abstained: Cr Marie Laufiso (1).

The division was declared CARRIED by 13 votes to 0 with 1 absetention.

Motion carried (CNL/2024/031)

Moved (Mayor Jules Radich/Cr Cherry Lucas):

That the Council:

c) **Identifies** in accordance with section 80 of the Local Government Act 2002 that:

i. A sale of Aurora would be inconsistent with the current Long Term Plan 2021-31 because a proposed sale of Aurora Energy Limited is not contemplated by the current Long Term Plan 2021-31; and

ii. The 9 Year Plan would be updated to reflect any Council decisions regarding Aurora.

Division

The Council voted by division

For: Crs Bill Acklin, Sophie Barker, David Benson-Pope, Christine Garey, Kevin Gilbert, Carmen Houlahan, Cherry Lucas, Mandy Mayhem, Lee Vandervis, Steve Walker, Brent Weatherall, Andrew Whiley and Mayor Jules Radich (13).
Against: Nil
Abstained: Cr Marie Laufiso (1).

The division was declared CARRIED by 13 votes to 0 with 1 abstention.

Motion carried (CNL/2024/032)

Moved (Mayor Jules Radich/Cr Cherry Lucas):

That the Council:

d) **Notes** that:

i. The decision on how the diversified investment portfolio would be held and by whom would be made following consultation on Council's Investment Plan through the 9 Year Plan process;

ii. A statement of proposal and communications plan will be prepared and brought to Council on 20 March 2024 for Council approval; and

iii. Council's decision in relation to the proposed sale of Aurora is to remain confidential until the Council agenda for the 20 March 2024 meeting is released. At that time, a media release will be issued by Council.

Division

The Council voted by division

For: Crs Bill Acklin, Sophie Barker, David Benson-Pope, Christine Garey, Kevin Gilbert, Carmen Houlahan, Cherry Lucas, Mandy Mayhem, Lee Vandervis,

	Steve Walker, Brent Weatherall, Andrew Whiley and Mayor Jules Radich (13).
Against:	Nil
Abstained:	Cr Marie Laufiso (1).

The division was declared CARRIED by 13 votes to 0 with 1 abstention.

Motion carried (CNL/2024/033)

Council

MINUTES EXTRACT

Extract of the Minutes of an ordinary meeting of the Dunedin City Council held in the Council Chamber, Dunedin Public Art Gallery, The Octagon, Dunedin on Wednesday 20 March 2024, commencing at 1:02 p.m.

6 POTENTIAL SALE - AURORA ENERGY LIMITED - STATEMENT OF PROPOSAL AND COMMUNICATION AND ENGAGEMENT PLAN

A report from Legal Services and Finance advised that Aurora Energy Limited (Aurora) was an electricity distribution business that owned and operated regulated electricity distribution networks in Dunedin, Central Otago (including Wanaka) and Queenstown Lakes.

The report sought Council's approval to the draft statement of proposal and draft communication and engagement plan.

Cr Carmen Houlahan entered the meeting at 1.07 pm.

Moved (Mayor Jules Radich/Cr Cherry Lucas):

That the Council:

Adjourns the meeting for 5 minutes.

Motion carried

The meeting adjourned at 2.05 pm and reconvened at 2.10 pm.

Moved (Mayor Jules Radich/Cr Bill Acklin):

That the Council:

a) **Adopts** the statement of proposal (consultation document)]referred to in this report.

b) **Approves** the communication and engagement plan referred to in this report.

c) **Decides** that a further summary document to summarise the statement of proposal is not required under section 83(1)(a)(ii) of the Local Government Act 2002.

d) **Delegates** to Council's Chief Executive Officer the authority:

i) To make any amendments to the statement of proposal and/or communication and engagement plan as are requested by Council.

ii) To make minor editorial changes to the statement of proposal.

iii) To amend the communication and engagement plan if the Council's Chief Executive Officer considers that further or different consultation would assist in the consultation process.

e) **Includes** in the statement of proposal a section on the strategic value of Aurora Energy.

f) **Includes** the updated section on Aurora Energy Returns.

Division

The Council voted by division

For: Crs Bill Acklin, Sophie Barker, David Benson-Pope, Christine Garey, Kevin Gilbert, Carmen Houlahan, Cherry Lucas, Mandy Mayhem, Jim O'Malley, Lee Vandervis, Steve Walker, Brent Weatherall, Andrew Whiley and Mayor Jules Radich (14).
Against: Nil
Abstained: Cr Marie Laufiso (1).

The division was declared CARRIED by 14 votes to 0 with one abstention

Motion carried (CNL/2024/055)

Memorandum

TO:	Legal
FROM:	Manahautū – Policy and Partnerships
DATE:	10 May 2024
SUBJECT:	**SUMMARY OF SUBMISSIONS ON THE DUNEDIN CITY COUNCIL'S PROPOSAL TO SELL AURORA ENERGY LIMITED**

SUMMARY

1 This memo summarises submissions received on the Dunedin City Council's (DCC) proposal to approve Dunedin City Holdings Limited's (DCHL) request, to sell Aurora Energy Limited (Aurora).

2 A total of 760 submissions were received during the consultation period.

3 In summary:

- 22% of submissions selected Option One – to sell Aurora (170)
- 77% of submissions selected Option Two - to retain Aurora (586)
- Four submissions did not select Option One or Option Two but did provide comments.

BACKGROUND

4 The DCC's proposal to approve the sale of Aurora was open for public submissions on 28 March 2024, and closed on 02 May 2024.

5 Similar to the DCC's annual plan submission process, online digital content and print material was presented to the public to seek feedback on its proposal to approve the sale of Aurora. Promotion material via social media was also produced to encourage the public to make submissions.

6 Engagement focused on:

a) updating the community on DCHL's request to the DCC to sell Aurora;

b) outlining the two options for the public to submit on; and

c) identifying the DCC's preferred option.

7 The DCC publicly invited submissions on two options:

Option One – the preferred option – Sale of Aurora Energy

Council to approve a sale of Aurora Energy Limited, on the basis that the proceeds are used:

a) To repay Aurora Energy's debt (forecast to be $576 million by mid next year); and

b) To establish a diversified investment fund worth many hundreds of millions of dollars to create income for Council.

Option Two – the alternative option – Keep Aurora Energy

Council to keep Aurora Energy. If Council keeps Aurora Energy, then it will likely increase in value over time, but a regular income to Council is uncertain. If Aurora Energy was to pay dividends (income) to Council, this would probably be funded by debt.

8 Submissions were collected via an online forms, emails and written letters.

9 Social media comments are not considered as 'submissions', but their analysis has been included in this memo.

Submissions

10 A total of 760 submissions were received during the consultation period.

11 This total includes 45 submissions that indicated no preferred option, however analysis of their submission comments identified that 10 were support of Option One, 31 were in support of Option Two, and four selected 'neither option' but submitted comments and/or attachments.

12 Of the 760 submissions, 561 submissions included comments and/or file attachments while 199 submissions only selected their preferred options.

13 In summary:

- 22% of submissions selected Option One – Sale of Aurora Energy (170)
- 77% of submissions selected Option Two – Keep Aurora Energy (586)
- Four submissions did not select Option One or Option Two but did provide comments.

Key Terms used in this Memo

14 The term 'submission' describes the written material submitted to the DCC in response to the options.

15 The term 'submitter' describes an individual or organisation who provided the submission material.

16 Where appropriate, 'substantial' has been used to describe submissions that have included comments and attachments.

Postcodes

17 Submitters were asked for their postcode so that analysis of submissions received from those who live inside the DCC's boundaries, compared with those who live outside of the DCC's boundaries could take place.

18 There was no guidance provided to organisations in regard to postcodes. It is assumed that submitters either used the postcode associated with their organisation's premises, or their personal residential property.

19 Unlike the DCC's annual and long term plans, demographic information such as age and ethnicity of submitters (individuals making a submission) was not collected during the Aurora submission period.

20 Tables 1 and 2 below quantifies submissions categorised by postcode and by the DCC's geographical boundary. The data below shows that the majority of submissions (97%) were from submitters from within the Dunedin area.

Aurora Submissions by Postcode	
Alexandra	6
Auckland	1
Balclutha	1
Clyde	1
Cromwell	1
Dunedin	736
Lower Hutt	1
Oamaru	1
Queenstown	3
Wanaka	4
Unknown	5
Total	**760**

Table 1: Aurora submissions by postcode

Distribution of Submissions by DCC Boundary	
In DCC Boundary	736
Outside of DCC Boundary	24
Total	**760**

Table 2: Aurora submissions by DCC boundary

21 Tables 3-5 below quantifies submissions sorted by postcode and the option selected. The data below shows that the majority of submissions (77%) selected Option Two.

22 The majority of submissions were generated from submitters using Dunedin postcodes across both Options One and Two.

Option One – Council's Preferred Option – Sale of Aurora Energy	
Postcode inside DCC boundary	166
Postcode outside of DCC boundary (Alexandra, Cromwell, Ōamaru and Lower Hutt)	4
Total	**170**

Table 3: Aurora submissions by postcode and Option One

Option Two – The Alternative Option – Keep Aurora Energy	
Postcode inside DCC boundary	567
Postcode outside of DCC boundary (Alexandra, Auckland, Balclutha, Clyde, Queenstown, and Wanaka)	14
Postcodes invalid	5
Total	**586**

Table 4: Aurora submissions by postcode and Option Two

Neither Options	
Postcode inside DCC boundary	3
Postcode outside of DCC boundary	1
Total	**4**

Table 5: Aurora submissions by postcode and Neither Options

Social Media

23 The DCC made 14 Facebook posts inviting submissions on the DCC's proposed sale of Aurora between the 27 March and 18 April. At the same time, the DCC also made posts related to the DCC's annual plan consultation. There were 83 comments that referred to Aurora in response to the DCC's posts.

24 During this period, the DCC also made one Facebook post about the Town Belt and Harbour Reserves Consultation, noting it was also open for submissions. There were eight comments on this post that referred to Aurora.

25 During this period, a total of 91 comments were made that related to Aurora across DCC posts as explained above. Analysis of the comments show that:

- Three comments supported Option One (to sell Aurora), however all three comments were from one commenter.
- Thirty-nine comments supported Option Two (to retain Aurora), however many individuals commented more than once. In total, there were 27 commenters who supported Option Two.
- Forty-nine comments discussed the sale of Aurora and/or Council processes but offered no clear indication of their preferred option.

DISCUSSION

26 An analysis of submissions divided by Option One and Option Two is outlined below.

27 Key topics have been identified to describe the main reasons why submitters felt their preferred option was valid.

Submissions that support 'Option One – the preferred option – Sale of Aurora Energy'

28 A total of 170 submissions (22%), from the total pool of 760 submissions were received in support of 'Option One – the preferred option - Sale of Aurora Energy' (Option One).

29 Submissions that selected Option One and provided comments and/or attachments, were sorted by identifying key reasons or topics. In summary five key reasons were common across those who selected Option Two, with many submissions mentioning more than one reason. These are summarised in Table 6 below along with the number of submissions.

30 There were 13 submissions that provided no specific reason for why they selected Option One.

Key reasons for Option One - sell Aurora	Number of submissions
1) Sell Aurora to reduce the DCC's debt	38
2) Sell Aurora but with conditions	25
3) Sell Aurora as it will be better managed by a private company	7
4) Sell Aurora for other reasons	15
5) No specific reason	13

Table 6: Key reasons noted in submissions in support of Option One

31 Below is a summary of the key reasons why submitters selected Option One from their comments and/or attachments.

1) *Sell Aurora to reduce the DCC's debt (38)*

Thirty-eight submissions supported the selling of Aurora in order to reduce debt. More than half of these commented that reducing and/or clearing the DCC's debt should be prioritised. A further six submissions expressed support for the establishment of a diversified investment fund for long-term gain. Seven submissions specifically commented on reducing rates, three of which suggested the DCC consider the sale of assets, including the Forsyth Barr Stadium. Other comments included the need to compare Aurora with other assets to better determine which asset should be sold, a change in directors of DCHL using diversified funds for both short and long term goals, the sale of all other DCHL companies; and reference to the Waipori Fund as a successful example.

Substantial submission: In this category, there was one submission that provided substantial material from Ōtākou Rūnaka. Key comments included: support for minimising rates increases, consumer rights protected by the Commerce Commission and Electricity Authority, Aurora being a capital intensive investment with minimal dividends, and the long-term benefit of the establishment of a diversified investment fund.

2) *Sell Aurora but with conditions (25)*

There were 25 submissions that support selling Aurora but with conditions. Seven of these were opposed to selling Aurora to a buyer outside of New Zealand. Two submissions supported establishing a community trust to oversee Aurora. Four submissions did not want profits post selling Aurora to be placed in a diversified fund, including one suggesting that the sale proceeds should be put into property within the region, to appreciate capital and generate income. Three submissions suggested there was a need to establish a clear plan for the proceeds. One submission sought clarify around the sale price. Three submissions sought a guarantee on cost affordability, and one submission sought more information on the potential impact of the sale on Delta.

Substantial submission: In this category, there were two substantial submissions supporting a conditional sale of Aurora. One submission supported the sale on the proviso that the sale price was at least $100 million, and one submission supported the sale on the condition that the DCC could provide a clear plan of what it intended to do with the proceeds from the sale.

3) *Sell Aurora as it is better managed by a private company (7)*

There were seven submissions related to questioning the capacity and role of the DCC in owning businesses. Three submissions were in support of privatisation to increase efficiency and improve business management. Another requested a mechanism is established to limit the increase of electricity prices on local consumers. Two supported the management of a diversified fund by professionals. One submission argued that a power company should be run by a New Zealand private company as it is not DCC's core business.

Substantial submission: Nil

4) *Sell Aurora for other reasons (15)*

There were 15 submissions that provided other reasons for their support. Six submissions supported the development of an investment fund, one proposing that it would outperform Aurora's regulated market, one focused on ethically and socially responsible investing practices, and one submission promoted that investing should be according to the communities' needs or goals. Three submissions focused on the situation that led to the selling such as the mismanagement of Aurora, the borrowing capacity of the DCC now reaching its limit, and no returning dividends. One submission proposed that after the fund is established, that any divestment would require 75% majority of votes. One submission identified selling Aurora as beneficial for economic wellbeing. One submission proposed to reserve some shares for the DCC and for purchase by employees and ratepayers who still wishes to own Aurora.

Substantial submission: Nil

Option Two – the alternative option – Keep Aurora Energy

32 A total of 586 submissions (77%), from the total pool of 760 submissions were received in support of 'Option Two – the Alternative Option – Keep Aurora Energy' (Option Two).

33 Submissions that selected Option Two and provided comments and/or attachments, were sorted by identifying key reasons or topics. In summary 12 key reasons were common across those who selected Option Two, with many submissions mentioning more than one reason. These are summarised in Table 7 below along with the number of submissions.

34 There were 19 submissions that indicated no specific reason for supporting for Option Two.

Key reasons for Option Two – Keep Aurora Energy	Number of submissions
1) Do not sell Aurora as it is a strategic asset	99
2) Do not sell Aurora as we need to learn from past mistakes when selling publicly owned assets	84
3) Do not sell Aurora as privatisation puts profit before community's needs	71
4) Do not sell Aurora. There is more public benefit from ownership	59
5) Do not sell Aurora as it places more financial burden on ratepayers	55
6) Do not sell Aurora. The Council needs to fix its issues rather than privatise its assets.	40
7) Do not sell Aurora. Doubt benefit to ratepayers and/or concerned with biased information.	25
8) Do not Sell Aurora, the Council needs to analyse different types of ownership models	18
9) Do not sell Aurora, stop selling assets	13
10) Do not sell Aurora as the public needs more information and analysis	12
11) Do not sell, other reasons	36
12) Do not sell, no specific reason	19

Table 7: Key reasons noted in submissions in support of Option Two

35 Below is a summary of the key reasons why submitters selected Option Two from their comments and/or attachments.

1) Do not sell Aurora as it is a strategic asset (99)

There were 99 submissions arguing for retaining Aurora as it is a strategic asset. 41 submissions focused on the potential earnings capacity of Aurora in the future, while 37 submissions alerted the risk associated with the long-term consequences of the sale in order to achieve a short-term boost on the Council's finances. 31 submissions expressed concern for the future of service delivery, jobs as well as community protection. 29 submissions focused on the essential nature of Aurora as a Council owned asset and its role in delivering key infrastructure allowing to cater for the communities' needs now and into the future. 11 submissions questioned the likelihood of the projected fund estimated return and potential usage.

Substantial submissions: In this category, there were 10 substantial submissions that provided further analysis on Aurora's lack of dividends (diversion toward the Stadium), indications on financial forecasting for Aurora in the long term, details on the potential consequences of the sale for other DCC owned compagnies (Delta), risk for customers; and arguments questioning the projected return of the potential new fund post the sale of Aurora. These submissions also identified contradictions in the consultation documentations provided.

2) ***Do not sell Aurora as we need to learn from past mistakes when selling publicly owned assets (84)***

There were 84 submissions that discussed the insights we have learned from past asset sales. 34 submissions commented on decision making without considering long-term consequences or potential impacts. 12 submissions based their argument on past examples of public asset sales that did not succeed as originally intended and offered examples such as the privatisation of British Rail, Water and Wastewater Services, and to the sale of the Waipori Electricity Generation Scheme. 21 submissions were concerned with selling Aurora and the potential impact it would have in increasing electricity costs for the wider community.

Substantial submission: In this category, there were five substantial submissions relating to learning opportunities from the past. These submissions provided further rationales why the DCC should not sell Aurora. Rationales such as privatization being too risky, Aurora once sold cannot be replaced and views of Council being short sighted.

3) ***Do not sell Aurora as privatisation puts profit before community's needs (71)***

There were 71 submissions that highlighted the potential negative impact that selling Aurora would have on the community. 31 submissions commented on the risks associated with privatisation, along with a further 17 submissions arguing that there were no benefits from the privatisation of assets. Overall, these submitters were concerned that the selling of Aurora would be a short-sighted decision, risking the loss of control of a critical asset for no tangible financial benefit and the potential for electricity prices to rise.

Substantial submission: In this category, there were four substantial submissions that were opposed to selling Aurora as privatisation was seen as too risky, citing loss of control, lack of government monitoring, and prices increases as some of the potential risks. Two of the submissions referenced experiences from previous sales of government assets to private companies as reasons why privatisation was a risk.

4) ***Do not sell Aurora, there is more public benefit from ownership (59)***

There were 59 submissions that supported Council owned assets as a way to promote and support public and community benefits and economic opportunities. 32 submissions discussed the risks of increased power prices for communities. Nine submissions commented on the positive impacts that retaining Aurora provides such as local job provision, innovation and renewable energy and community accountability. Three comments offered suggestions of selling other DCC-owned commercial buildings instead, such as the Forsyth Barr Stadium and Sammy's.

Substantial submission: In this category, there were seven substantial submissions relating to the opportunities and benefits from not selling Aurora. These submissions focused on rationales as the DCC should own power and it is a critical asset with public benefits. Rationales focused on the possible risks of selling with more benefits from retaining the asset. Discussion also bridged the importance is more than collecting dividends with social and economic benefits for communities.

5) *Do not sell Aurora as it places more financial burden on ratepayers (55)*

There were 55 submissions that argued that selling Aurora would place a financial burden on the community through increased electricity prices on ratepayers. Thirteen submissions commented that the sale of Aurora was short-sighted, and two submissions commented that there would be a decrease in the level of government monitoring of the provision of power services after Aurora is privatised.

Substantial submission: In this category, there was one substantial submission that, based on reasoning that Aurora is a profitable company, was against selling as it would lead to price increases and subsequent government monitoring would be inefficient.

6) *Do not sell Aurora. The Council needs to fix its issues rather than privatise its assets. (40)*

There were 40 submissions related to preference for improving the management of Aurora over privatisation. 21 submissions commented on the long-term gain from retaining ownership and fixing management issues. A further 14 submissions were focused on improving and fixing the management. Five submissions argued that a potential sale could lead to an increase in the price of electricity.

Substantial submission: In this category, there were three submissions that provided substantial material. One submission criticised insufficient financial information provided in the consultation document to determine what would be ratepayers' best interests, while arguing retaining Aurora would bring the long-term value to the ratepayers. One submission questioned the make-up of the directors of Aurora and the DCHL, with only one each residing in Dunedin, and if the directors outside Dunedin would have the ratepayer's best interests in mind when making decisions. It argued that the sale of Aurora would incur greater costs to ratepayers in the long term, as a result of likely power price increase and reduced dividends from Delta as Aurora's preferred contractor. One referred to the outcome of the Bradford reforms of 1998/99 (power price increase over 35%) and commented that the same outcome would be expected from the sale. It argued that the debt situation is Council's own creation and is not a problem that needs to be rectified by selling assets like Aurora.

7) *Do not sell Aurora. Doubt benefit to ratepayers and/or concerned with biased information. (25)*

There were 25 submissions that argued that the Council's preferred option to sell Aurora in order to produce increase benefits to the ratepayers is false or misleading. Nine of these submissions stated that the Council's consultation documentation presented options in a prejudicial way, and seven submissions argued that Aurora was an asset with the potential to provide future income, which was not articulated in the Council's consultation information.

Substantial submission: In this category, there were four substantial submissions that had a view that the way a potential sale was posited presented a false promise of ratepayer benefit, with two of the view that the way options were presented in the consultation document was prejudiced towards Option One (selling).

8) *Do not Sell Aurora, the Council needs to analyse different types of ownership models (18)*

There were 18 submissions that suggested different types of ownership. Nine submissions proposed community ownership. Five submissions proposed ownership through a trust entity. Three submissions proposed a joint ownership model across Otago. One submission proposed to form a super Council with all councils involved.

Substantial submission: In this category, there were three substantial submissions suggesting different types of ownership. These submissions detailed why public ownership is preferable or proposed different structures (e.g. trust).

9) Do not sell Aurora, stop selling assets (13)

There were 13 submissions that requested Council to consider not selling any more Council-owned assets. Seven focused on for the need of Council to consider long-term perspectives, six commented on the Council's priority to ensure the needs of the community are meet and that Aurora remains to be a positive asset to help do this.

Substantial submission: In this category, there was one substantial submission relating to this theme. This submission commented that the sale of Aurora was not discussed in local elections. They also commented on profitability of Aurora, privatisation and council priorities.

10) Do not sell Aurora as the public needs more information and analysis (12)

There were 12 submissions that highlighted the lack of public information on the selling of Aurora. Four submitters raised the potential for returns that must make Aurora appealing to buyers and requested a business case is made public. Two submissions requested exploration of alternative options like partial ownership. Two submissions pointed that due diligence must be conducted. One submission questioned the selling process, precisely who can buy such an asset. One submission related to the future needs in energy as well as its costs. One submission related to the nature of the electricity distribution business and requested clarity on a potential monopoly situation. One submission underlined that such a decision should not be taken without in-depth analysis.

Substantial submission: In this category, there were two substantial submissions highlighting the lack of public information on the selling of Aurora. One submission presented past examples of sale and one requested specific information on Aurora, the selling process or the statements attached to the consultation.

11) Do not sell Aurora, other reasons (36)

There were 36 submissions relating to other reasons. 13 submissions expressed mistrust in the Council's financial management abilities. Seven submissions proposed to keep a majority share of the company to retain control. Three submissions asked for lowering spending on projects, events or salaries rather than selling an asset. Three submissions requested the delay of the decision until the next election. Three submissions focused on the absence of benefit for other Councils residents. Two submissions blamed capitalism. One submission questioned why anyone would buy a company like Aurora, with its current debt.

Substantial submission: In this category, there were three substantial submissions relating to other rationales. One submission presented an article from 1998 about Dunedin awarding electricity contract to outside firms. One submission detailed potential consequence and reminded of relevant legislation. One submission focused on potential future returns of Aurora.

Neither Option Selected

36 There were four submissions that opted not to choose either option. One submission was from Queenstown-Lakes District Council (QLDC) that stated it wishes to work closely with Aurora or subsequent owners to provide a plan for the needs of QLDC, highlighting its aspirations for significant decarbonisation and electrification, its vulnerability to natural hazard disruptions

and its existing strong relationships with Aurora and other key actors. Two submissions suggested an alternative option of forms of shared ownership (e.g. 51% Council own and 49% public own; 50% private own and 50% public own). One submission opted out due to the lack of information on minimum sale prices.

Key reasons for Neither Options	Number of submissions
Alternative options – shared ownership	2
Favour the sale but cannot vote without minimum sale price	1
No preferred options. Welcomes discussion with Aurora or subsequent owners (QLDC)	1

Table 8: Summary of submissions that indicated 'neither option'.

Late Submissions

37 There was one late submission received during this consultation period. The submitter was granted their request to speak to their submission at Council. The submission was from the Dunedin area and selected Option Two – the alternative option – Keep Aurora Energy.

38 Given there was only one late submission, this has minimal impact in the overall numbers.

Proposal to divest Aurora Energy Limited and reinvest in diversified portfolio

Final Recommendation Paper
September 2024

DUNEDIN CITY HOLDINGS LIMITED

Contents

1. Executive summary

DUNEDIN CITY HOLDINGS LIMITED

Executive summary

DCHL recommends 100% divestment of Aurora Energy, with proceeds reinvested into the 'Aurora Fund'.

Council has clearly signalled its desire for higher and more consistent, sustainable cash returns from its investments. To achieve this, **Council needs different assets**.

Aurora is delivering reasonable capital growth but, as an infrastructure business with growing demand, significant capital expenditure requirements will consume operating cash flows and require a substantial increase in debt funding. Divestment of Aurora will **reduce group debt** by a forecast ~$581m, limit further growth in group debt and reduce risk to Council's future credit ratings, debt covenants and borrowing costs.

Transaction evidence indicates that major infrastructure investors, with different objectives to Council's, are willing to pay attractive premiums to buy regulated infrastructure businesses. This creates an opportunity to realise additional value that might not be there in the future.

Investing the proceeds in a diversified investment portfolio will reduce the single asset risk that DCHL is currently exposed to. A growth-oriented equity fund will also **deliver a higher rate of return than Aurora over the long-term**, recognising that Aurora operates in a highly regulated sector and is restricted to generating a regulated rate of return.

DCHL understands public interest in the proposal and welcomed the feedback expressed during the consultation process. Some significant concerns were raised.

- ✓ Increase income to Council
- ✓ Reduce debt
- ✓ Reduce risk
- ✓ Realise value available now

Expert analysis, insights and advice were presented to Council in response to these concerns. Based on the expert advice provided, our view is that the concerns raised should not materially alter Council's objective assessment of the case to divest.

Our advice is that the divestment of Aurora remains compelling – this is the right thing to do to meet the investment objectives that Council has articulated.

2. Background

DUNEDIN CITY HOLDINGS LIMITED

Background

Council has asked DCHL to provide strategic options as to the future composition and direction of its portfolio.

Dunedin City Holdings Limited (DCHL) is entrusted by Council to govern its portfolio of Council-Controlled Organisations (CCOs). The portfolio comprises both:

- Commercial enterprises – which are held primarily to deliver returns to the shareholder; and
- Non-commercial entities – the primary purpose of each of these investments is to drive economic, cultural or other community benefits.

The purpose of Dunedin City Holdings Limited (DCHL) is to achieve the best for Dunedin from its investments. Dunedin City Council's Letter of Expectation for the year ending 30 June 2024 included an expectation:

> *"To provide the DCC with strategic options for consideration (including consideration as to the future composition and direction of the portfolio) that allows the DCC to consider the implications for the DCC as shareholder with a particular focus on dividends/return on investment from DCHL."*

The recommendation to divest Aurora Energy is a considered response and arises from a cumulative body of work undertaken by DCHL, with insights and analysis from various third-party experts.

The board of DCHL has been appointed by Council and comprises highly experienced professional directors with a broad commercial skill mix. This has been enhanced by the recruitment in 2023 of two directors with deep investment banking and corporate finance experience. The board is well-qualified to provide this advice.

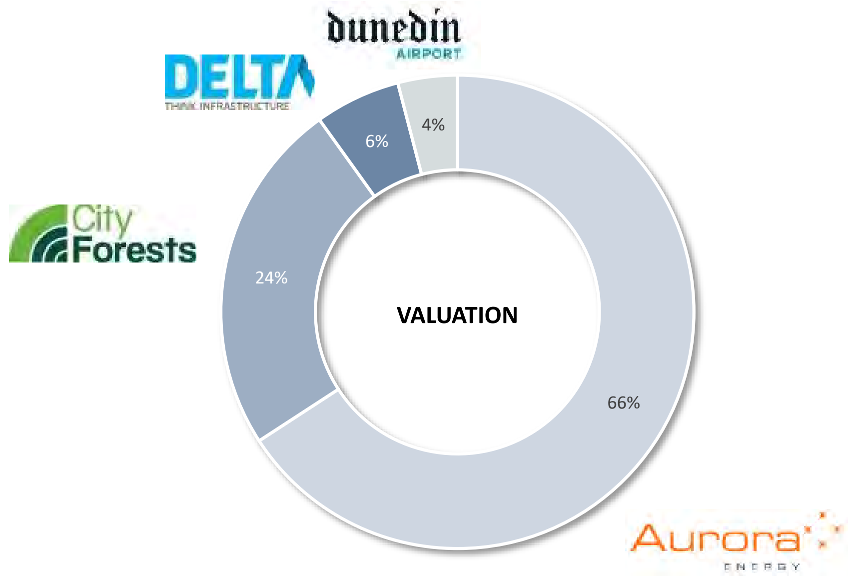
Current commercial portfolio

The current commercial portfolio is substantial, with a valuation of over $1bn. However, the portfolio is undiversified, illiquid and over-weighted to capital-intensive infrastructure.

Council's current commercial portfolio comprises only four legacy assets – Aurora Energy Ltd, City Forests Ltd, Delta Utility Services Ltd and Dunedin International Airport Ltd. They are owned by Council due to their history. Whilst we consider them now to be held primarily to generate returns for the shareholder, none of these investments has been actively chosen. Active management of a portfolio would typically involve allocating capital to a range of investments, carefully selected to meet the objectives of the investor, noting risk appetite, investment horizon, desire for cash income etc.

The portfolio is substantial, with a valuation of $1.1bn in 2021. However,, it is unbalanced and heavily over-weighted to Aurora Energy and City Forests. Accordingly, the portfolio lacks diversification and has high concentration risk, both in dollar terms and geographically e.g. AF8 exposure.

Return on investment comprises both capital growth (growth in the value of the investor's shares) and distributions (cash returned to the investor). Low distributions are not necessarily a measure of a poor investment, but if Council desires increased cash income from its investments, the current asset mix is not appropriate.



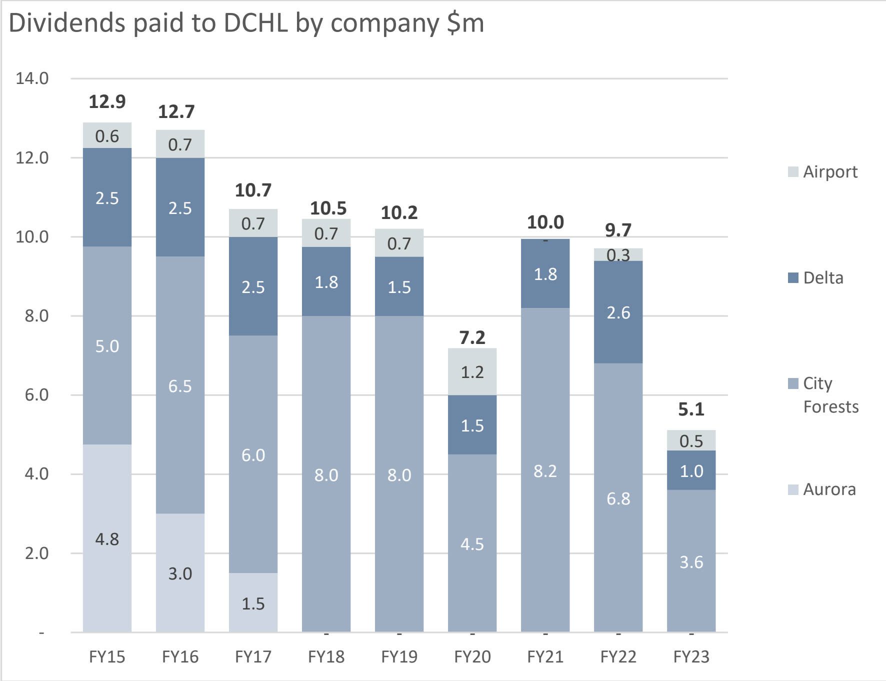
Current commercial portfolio

The current commercial portfolio has delivered reasonable capital growth but low dividends.

In recent years, the DCHL commercial portfolio has delivered reasonable capital growth, but dividends (distributions) have been unacceptably low. The outlook for dividends in future years remains very challenging, especially since the group's largest investment, Aurora Energy, requires significant capital investment over coming years to renew aged assets, build resilience in its network, meet population and economic growth in Central Otago and meet greater demand for electricity due to decarbonisation. In other words, cash from earnings will need to be reinvested in the company rather than returned to the shareholder.

Notwithstanding the relative performance of individual companies, the shortfall in dividends reflects the portfolio being over-weighted to capital-intensive infrastructure.

Another important characteristic of the current portfolio is a lack of liquidity. Liquidity is the ability to turn assets into cash when the investor needs it. All investments in the portfolio are shares in privately held companies, with no other shareholders, except for the Crown (in the case of Dunedin International Airport Ltd). Accordingly, raising cash quickly through a sale process would be difficult, time-consuming and could erode value. By contrast, shares in companies listed on recognised stock exchanges can be traded easily.



Source: DCHL analysis

Portfolio options analysis

To achieve a different outcome, Council needs different assets. Aurora requires large capital investment which will lift DCC group debt and increase financial risks. Divesting Aurora is the best option to reshape and reduce risk.

Council has strongly signalled a desire for greater, more sustainable, consistent dividends. Council's current investment portfolio will not meet these objectives.

Our advice is, if Council wants a different outcome, then we need to do something different – we need different assets.

The portfolio needs to be reshaped with these requirements:

- Diversifying, reducing concentration risk and rebalancing across investment classes, industries, markets, geography etc;
- Reflecting Council's risk appetite; and
- With an appropriate weighting to investments delivering cash income.

Since Council does not have funds to make new investments to reshape the portfolio, the only plausible course of action is to divest, or sell down, shares in existing group companies and recycle capital into different assets.

Based on our analysis and external advice and insights, Aurora Energy is the primary candidate for divestment.

Updates to Aurora's Asset Management Plan, supported by Mafic Partners' strategic review and sector-wide projections from Boston Consulting Group (BCG), indicates that capital investment spend across the next 10 years is likely to be significantly higher than previously planned. This increased capex spend will lift Aurora's debt levels across the next 10 years to exceed $900m by 2034.

Combined with expected increases in core Council's borrowing requirements, DCC scenario analysis projects group debt of between $2.3 billion and $2.9 billion (compared to $1.3 billion today). Increased group debt to the levels forecast could lead to a S&P credit rating downgrade. A downgrade in credit rating would increase the cost of borrowing.

Elevated capex spend will grow the company's Regulated Asset Base (RAB), whilst also increasing debt levels. However, if a cash dividend stream is required by Council, this will also require funding by increased debt and may be constrained by maximum acceptable debt limits.

Divestment of the largest investment in the current portfolio offers the greatest potential to reduce concentration risk and reshape the portfolio.

Our considered view is that Aurora Energy does not require public ownership in order to ensure that community and consumer interests are protected. Consumer outcomes are protected by the now mature regulatory regime under which Aurora operates. Analysis indicates no discernible difference in performance of privately owned EDBs in other regions of New Zealand.

Timeline

This recommendation to sell Aurora follows a considered process, responding to the investment objectives that DCC has articulated.

- Deloitte — Investment Framework development
- Letter of Expectations – strategic options for portfolio Feb 2023
- Director appointments Jul 2023

- DCHL Portfolio Strategy and Options Analysis Nov/Dec 2023
- Recommendation to proceed to consultation Mar 2024
- Public consultation Apr/May 2024
- Post-consultation workshops Jul/Aug 2024

Recommendation

DCHL recommends 100% divestment of Aurora Energy, reinvesting into the 'Aurora Fund' – delivering higher distributions, lower debt and lower risk.

Council has clearly signalled a desire for a higher and more sustainable cash return from its investments. This requires different assets.

DCHL recommends full divestment of Aurora Energy and reinvestment of proceeds into a diversified investment fund, the 'Aurora Fund', held for the long-term and structured to meet its investment objectives.

In the context of higher forecast capital expenditure and increasing debt profiles in both Aurora and core Council, divestment of Aurora would materially reduce group debt and risks to Council's credit rating, debt limits and lender covenant compliance.

International infrastructure investors are actively seeking investments in regulated infrastructure assets and paying attractive premiums – we consider that now is the time to realise value that might not be available in the future.

We believe that the divestment case is compelling, and this is not a marginal call. If Council wishes to achieve a materially different outcome, a material change is required. Supporting this recommendation would represent a large step towards achieving the investment objectives that Council has articulated.

	Aurora Energy Limited	Aurora Fund
NATURE OF INVESTMENT	One company, one industry	Many companies, many industries (and other assets)
RISK PROFILE Volatility/certainty of returns	Regulated but single asset, industry & geographic risks	Risk reduced by diversification
DISTRIBUTIONS Cash income to the shareholder	Low Esp. short-/medium-term Funded by debt	Higher More sustainable Less volatile
CAPITAL GROWTH Growth in value of investments	Strong	Strong
CAPITAL REQUIREMENTS Need for reinvestment of cash and higher debt	High	Nil
LIQUIDITY Ability to turn into cash when needs change	Highly illiquid	Liquid
MARKET PREMIUM Additional value priced in by investors	Uncertain in the future	Available now

3. Response to consultation

DUNEDIN CITY HOLDINGS LIMITED

Response to consultation

Submissions raised some key concerns – additional advice was provided.

DCHL understands public interest in the proposal and welcomed the feedback expressed during the consultation process. Some significant concerns were raised.

We identified four main themes – set out opposite.

DCHL appreciated the opportunity to obtain independent expert advice on these matters and to invite those advisors to present their analysis, insights and expert advice in the Council workshop of 1 July, and in written reports which followed. Our intention was to enable Council to be fully informed in assessing the validity of the concerns expressed and to assign relative weight to them in their decision-making.

The following experts were engaged to provide further information to Council:

- Sapere
- Mafic
- Neil Holdom, TX1 Insight
- Forsyth Barr

1. "The sale will lead to higher lines charges"
2. "Aurora is a strategic asset which DCC must control"
3. "Aurora is a very profitable company and can pay dividends"
4. "The sale is a one-off cash gain and benefit will be short-lived"

Expert advice

Expert advisors provided additional information to support Council's decision.

Toby Stevenson, Director

Sapere Research Group is an expert consulting firm that has been providing independent analysis and advice on strategic issues across government and industry since 1997. Their core values are independence, integrity, and objectivity. Toby Stevenson is Director at Sapere with 35 years' experience in strategic risk management, mostly in the energy sector. Toby was responsible for the trading and risk management in the electricity market at Contact Energy from 1996 – 2003. Since then, he has been providing independent advice on a wide range of energy issues.

Vincent Bennett, Partner, and Campbell Will, Director

Mafic is a boutique infrastructure advisory firm. Areas of expertise include financial and commercial advisory, debt and equity raising, green finance and assistance in facilitating acquisitions and divestments in the infrastructure sector. Mafic provides practical and effective advice combined with deep analytical capability.

Neil Holdom, Principal

The principal of governance and management advisory TX1 Insight, Neil has more than 20 years' experience in infrastructure, both public and private working in both Australia and New Zealand. Neil was the Corporate Affairs Manager at Powerco in 2016 when he was elected Mayor of New Plymouth. Neil oversaw many changes to NPDC's perpetual investment fund and has also provided advice to other councils reviewing their investment strategies.

Matt Henry, Head of Wealth Management Research

Forsyth Barr offers a world-class team of advisers, delivering innovative financial services and investment opportunities, supported by award-winning local and global research. Forsyth Barr's Wealth Management Research team provides macro, asset allocation, equity, credit, and funds research to its adviser network and client base.

Regulatory framework – price protections

Electricity consumers are protected under price and quality regulation.

➊ "The sale will lead to higher lines charges"

Several submissions raised a concern that a different owner would be motivated to increase lines charges in order to maximise profits, to the detriment of electricity consumers.

Sapere reported that electricity consumers are **protected under price and quality regulation, whoever the owner of an Electricity Distribution Business (EDB) is**. There is no scope for Aurora to raise lines charges beyond what is allowed by the Commerce Commission, under Part 4 of the Commerce Act.

EDBs have been subject to a default price-quality path (DPP) since 2009. A DPP imposes maximum allowed prices and minimum service standards. The main components of a DPP are:

- The maximum prices and revenues allowed at the start of the regulatory period;
- The annual maximum rate at which prices can increase; and
- The minimum service quality standards that must be met.

EDBs may apply to the Commission for a customised price-quality path (CPP) for a finite period, with bespoke allowances. Aurora is currently operating under a CPP, which gives Aurora the ability to recover additional costs through line charges for the purposes of fixing, upgrading and maintaining its network. This illustrates that investment might drive higher line charges; however, regulation protects against higher charges due to 'profiteering'.

There is no scope for either a new owner or the existing owner to set prices outside the Commission's DPP or CPP process. The Commission monitors and comments on each EDB's return on investment against expected returns publicly.

Regulatory framework – community protections

The regulator protects community interests and has become more effective over time.

2 "Aurora is a strategic asset which DCC must control"

Some submissions shared a view that the electricity distribution network is a strategic asset for the region and therefore it should be in public ownership to protect the interests of the community.

Sapere reported that **consumers are equally protected from adverse outcomes in <u>both</u> the price and <u>quality</u> of lines services** they receive, regardless of who owner of the EDB is. The scope to defer maintenance or underinvest is limited by the transparency of the information disclosure requirements, improvements to the monitoring regime over the years, director liability, the reputational risk of failures on the network and the risk of a fine for a breach.

It has been noted that neither Council ownership of Aurora nor the regulator prevented what Deloitte, in their December 2016 report, referred to as: *"an under investment on asset inspections / condition monitoring, planned maintenance and asset replacement over the last 25 – 30 years."*

Sapere reported that the regulatory framework has evolved such that a decline in quality standards would be picked up more quickly than was the case in 2016. **The Commission sets quality performance targets for each EDB** based on close scrutiny of Asset Management Plans and an understanding of maintenance requirements for assets. Independent reports are used to verify what is happening on a network as required. The performance of all EDBs is monitored based on the targets and the Commission's expectations of performance. Performance is disclosed publicly. Inside the Commission a monitoring team keeps track of each EDB's performance and uses a series of escalations if data shows that something might be amiss. Investigations can lead to a finding of a breach and fines.

The regulator has the expertise, scale, resources and responsibility to protect consumer interests. A Council owner of a single EDB does not have access to these capabilities.

Profitability

Over the long-term, actual returns should revert to regulatory return levels.

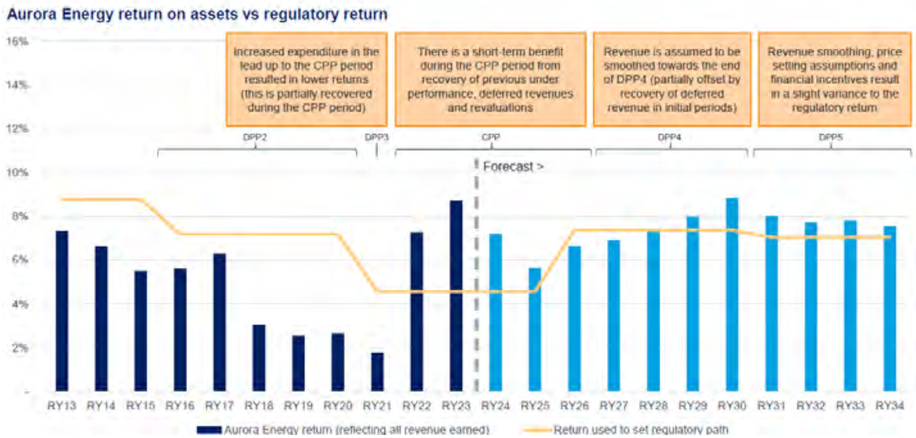
mafic

❸ "Aurora is a very profitable company and can pay dividends"

Mafic reported that, as prescribed by the Commerce Commission, EDBs generate an asset return in line with the regulatory return. This is calculated every five years and is primarily driven by the risk-free interest rate (New Zealand government bond rate). The current period (DPP3) return is 4.6% and the forecast return for the next period (DPP4) is ~7.4%.

In the short-term, EDB returns can differ to the regulatory return for various reasons. Prior to the 2022 regulatory year, Aurora underperformed the regulatory return, especially during the 2018 to 2021 period, due to increased expenditure in the lead-up to the CPP period. There is a short-term benefit during the CPP period from recovery of previous under-performance, deferred revenues and revaluations. However, **over the long-term, actual returns should revert to regulatory return levels**.

Any realisation of deferred revenues in the short-term would be incorporated by acquirers when determining value.



Note the return on assets shown above represents the return on the book value of the assets. Returns based on market value would be considerably lower.

Capital expenditure and cashflow

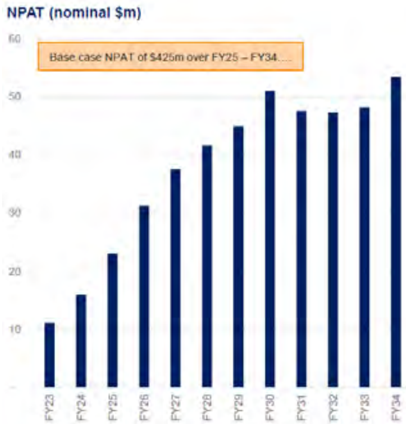
Aurora Energy is expected to incur significant negative free cash flows over the foreseeable future.

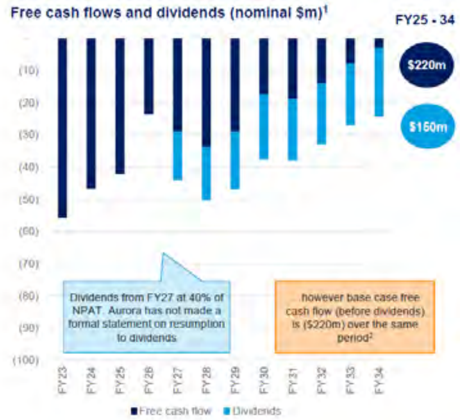
❸ "Aurora is a very profitable company and can pay dividends"

Mafic noted that regulatory returns can differ from shareholder cashflows. Whilst profitability is expected to lift during the CPP period, **Aurora is expected to incur significant negative free cash flows over the foreseeable future**. Free cash flows are calculated as operating cashflows minus capital expenditure (capex). Significant negative free cash flows arise from capex exceeding the cash generated by the business through profitable operations.

Aurora has experienced a period of significant capex to address past issues. While these issues have been addressed, Aurora is expected to remain in an environment of elevated capex driven by:

- Capex inflation
- Significant capex required to replace ageing assets
- Economic and population growth in Central Otago / Queenstown
- Decarbonisation and climate change resilience





Aurora forecast capex is in line with peers, normalised for size. Mafic noted that there is **upside risk to the base case in relation to decarbonisation capex and ongoing capex inflation pressures**.

Debt levels and capacity

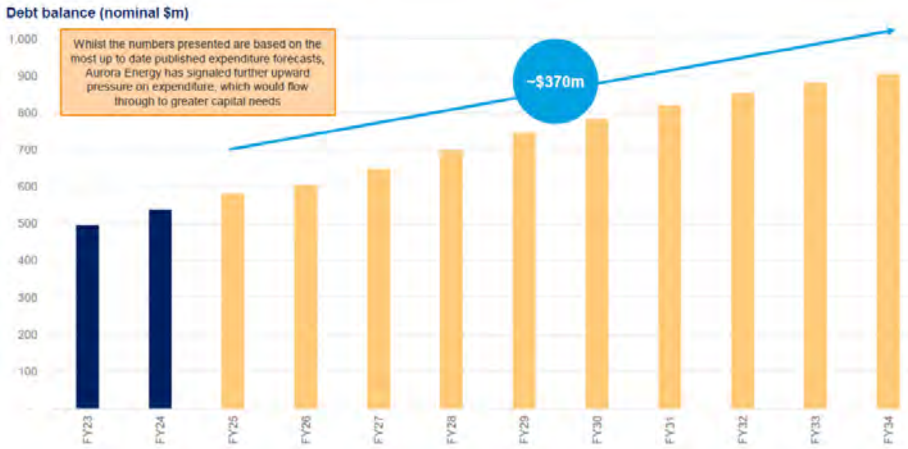
Aurora Energy requires significant additional capital funded by debt.

mafic

❸ “Aurora is a very profitable company and can pay dividends”

Mafic noted that Aurora Energy is one of the most leveraged EDBs and its current debt ratios are in line with an aggressive assessment by S&P. On an absolute basis, **Aurora Energy requires significant additional capital**. The base case forecast sees Aurora debt increasing by ~$370m to ~$900m by FY34, with significant upside risk. Whilst some of Aurora Energy’s credit metrics should improve over time, the company’s debt will be constrained by acceptable maximum limits and there is limited financial resiliency to respond to unexpected economic factors.

However, DCC group metrics are likely to be challenged. Recent infrastructure spending by both DCC and Aurora has seen group debt increase from $571m in FY17 to $1.3 billion in FY24. Forecast infrastructure investment is expected to drive significantly higher debt for core Council. The deferral of the long-term plan means that Council has yet to make budgetary decisions beyond FY25 and we note uncertainty around water infrastructure. However, scenario modelling indicates DCC group debt increasing to a range of $2.3 billion - $2.9 billion by FY34. Higher debt creates risk to credit ratings and Council’s own debt limits.



A credit rating downgrade would lead to higher borrowing costs for Council and all group companies. Avoiding a downgrade might have impacts for Council decisions around rates increases and Council’s ability to fund essential infrastructure.

Benefits of a diversified investment fund

A diversified investment fund could provide a sustainable income stream – and its value can be protected.

4 "The sale is a one-off cash gain and benefit will be short-lived"

TX1 FORSYTH BARR

Neil Holdom, TX1 Insight, reported that there are a range of council investment models in place across New Zealand with New Plymouth District Council's (NPDC) Perpetual Investment Fund (PIF) considered one of the more mature examples in the sector following 20 years of evolution.

NPDC sold its stake in Powerco, an EDB, in 2004 and subsequently created the Perpetual Investment Fund, a diversified investment portfolio. The fund illustrates the types of protections that can be put in place to **protect capital and provide a sustainable income**:

- A fully independent board – the PIF Guardians
- Fully outsourced agent
- Governance Deed and Statement of Investment Policy and Objectives
- Sustainable dividend policy, requiring a super majority (>75% vote) of council to change
- Act of Parliament protects the capital base

Matt Henry of Forsyth Barr reported that a diversified investment fund should provide the Council with **higher investment returns over the long-term, with less risk (volatility), a more consistent and sustainable income stream, and greater liquidity** relative to its investment in Aurora Energy.

Forsyth Barr's view is that a growth focused portfolio may be most appropriate, with significant exposure to global equities. A passive growth benchmark portfolio has delivered a **historical compound annual return of 9.6% (before fees) since 1970**.

Some may believe that a diversified investment fund would be more volatile than the Council's investment in Aurora Energy. In Forsyth Barr's opinion however, this view is likely to be inaccurate. The Council's investment in Aurora Energy may be perceived to be low volatility, but this is only because the asset is not priced (marked-to market) daily, as is the case with listed assets.

DCHL view

Summary of DCHL's response to concerns raised during public consultation.

1 "The sale will lead to higher lines charges"	• There is no scope for any owner to increase line charges beyond what is allowed by the Commerce Commission, which sets maximum prices and revenues to protect consumers.
2 "Aurora is a strategic asset which DCC must control"	• The regulatory framework also protects the quality of lines services. The regulator has the expertise, scale, resources and responsibility to protect consumer interests. • A Council owner of a single EDB has very limited ability to influence investment decisions and will need to borrow to fund ongoing network growth.
3 "Aurora is a very profitable company and can pay dividends"	• In the long-term, Aurora returns will align with the permitted regulatory return. • The challenge for an owner requiring income is that profits do not translate to cash returns. **Aurora is forecasting negative free cash flows for the foreseeable future, with significant risk of worse outcomes**. • Any dividends in the short- or medium-term will be debt-funded. This will be challenging given the existing debt position of the group.
4 "The sale is a one-off cash gain and benefit will be short-lived"	• Legal, procedural and governance protections can be put in place to protect the capital realised from a sale. • A fund can be structured to provide sustainable and generationally equitable long-term returns, higher than the regulatory return of Aurora, with less risk and volatility.

4. Implications of retaining Aurora

DUNEDIN CITY HOLDINGS LIMITED

Capital investment requirements

If Council chooses to retain Aurora, the company will require significant ongoing investment.

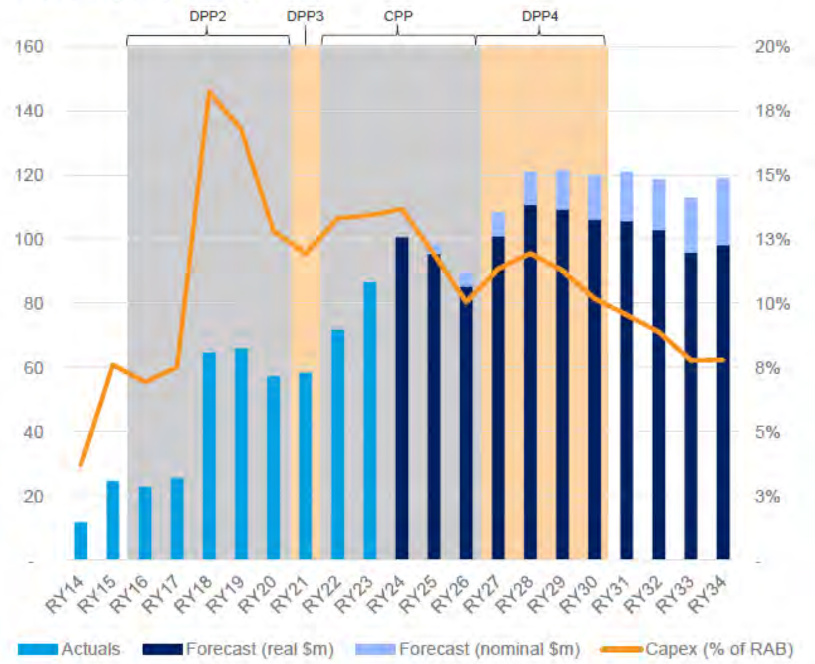
DCHL recognises that this is a significant decision for Council, and we acknowledge the public interest in that decision. If Council decides to retain its shareholding in Aurora Energy, it is important to fully understand the implications of that choice.

If Council wishes to hold Aurora, it must be prepared to **fund the network growth** required. As set out in this paper and prior information provided to Council, all EDB owners must meet the growth demands of the sector, driven by capex inflation, significant capex required to replace ageing assets, decarbonisation and climate change resilience. In addition, the Aurora network must meet the needs of population growth in the Central Otago / Queenstown regions.

Aurora is forecasting **capex of $1.1 billion over FY25 to FY34**. Mafic also noted that there is **significant upside risk** to the base case, especially in respect of capex inflation and decarbonisation capex.

Beyond this, there is significant uncertainty. However, Boston Consulting Group indicated a need for sustained high levels of decarbonisation investment in electricity distribution infrastructure through the 2030s and 2040s in their report *The Future is Electric: A Decarbonisation Roadmap for New Zealand's Electricity Sector*.

Gross capex profile ($m)[1]



Debt requirements

If Council chooses retain Aurora, group debt will increase significantly, putting pressure on credit ratings.

Failing to support Aurora Energy's capital requirements is not an option as it will have implications for service quality and the ability of Aurora Energy to meet customer needs. It could also result in Aurora Energy incurring quality incentive adjustment penalties.

Aurora Energy is forecasting negative free cash flows in the medium-term. In the longer term when demand growth stabilises, and capital investment requirements ease off, Aurora will continue to earn a regulated return on regulated assets but may have headroom to make choices about where it chooses to allocate after-tax free cashflow. e.g. paying dividends, reducing debt, accelerating maintenance or replacement of assets where appropriate. However, we note that the point at which demand growth stabilises is highly uncertain, particularly due to unknown long-run capex requirements to support decarbonisation.

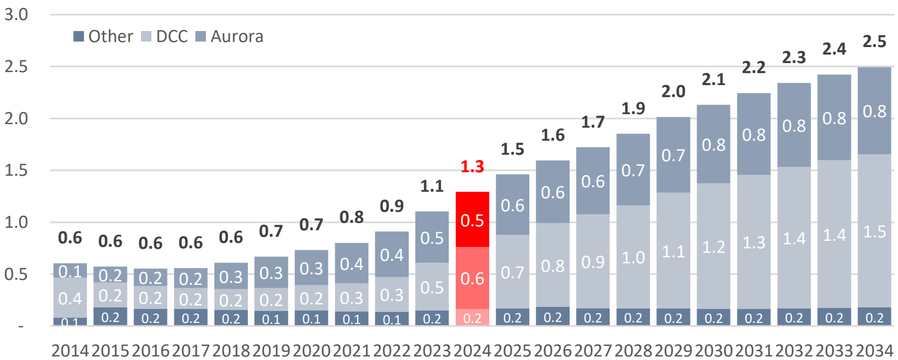
In the short- and medium-term, under all scenarios, Aurora Energy debt is forecast to increase significantly. The base case projects an increase of ~$370m to ~$900m by FY34. Mafic noted that Aurora Energy is already highly leveraged compared with other EDBs.

Since Council does not have access to equity capital, capital must be funded from operational cash flows and increased debt. If Council decides to retain its shareholding in Aurora Energy, it must **accept higher debt**.

Under Council ownership, Aurora Energy borrows from Dunedin City Treasury Limited (DCTL) as part of the DCC group. Aurora Energy debt combined with DCC's increasing debt requirements, which includes core Council infrastructure funding, could increase to a range of $2.3 billion - $2.9 billion by FY34.

Noting S&P's current 'negative outlook', increased group debt to the levels forecast could lead to a S&P credit rating downgrade. Aurora Energy's borrowing requirements could create a drag on Council's credit quality and ability to borrow. The implications of this would be higher borrowing costs and restricting Council's capacity to fund essential infrastructure.

Group debt - KEEP BASE case ($ billion)



Distributions

If Council chooses to retain Aurora, it must accept lower cash distributions from its investments.

If Council decides to retain its shareholding in Aurora Energy, it must accept **lower cash distributions** from its investments for the foreseeable future.

- If Council wishes to restrict growth in group debt, it might wish to forego dividends from Aurora Energy until it is in a position to generate free cash flows to distribute.
- If Council requires dividends from Aurora Energy and accepts that this will be funded by debt, the level of dividends is still expected to be significantly lower than the amount of distributions from a diversified investment fund.

For Council, lower cash distributions in the short- and medium-term will mean **higher rates, lower expenditure on services or higher debt**. Council will have to choose.

DCHL is highly dependent on Aurora Energy, its largest investment, if it is to pay sustainable dividends to DCC. The other commercial entities in the portfolio are much smaller. In the short- and medium term, dividends from these companies will be applied to fund interest costs on debt structured historically into DCHL, with little or no surplus available to distribute.

In the long-term, Aurora Energy is expected to deliver the regulated rate of return. This is expected to be lower than the return from a diversified investment portfolio with a growth profile.

In contrast, DCHL modelling suggests that a diversified investment fund would deliver cash distributions in excess of $300m in the 9 years from FY26 to FY34.

Portfolio considerations

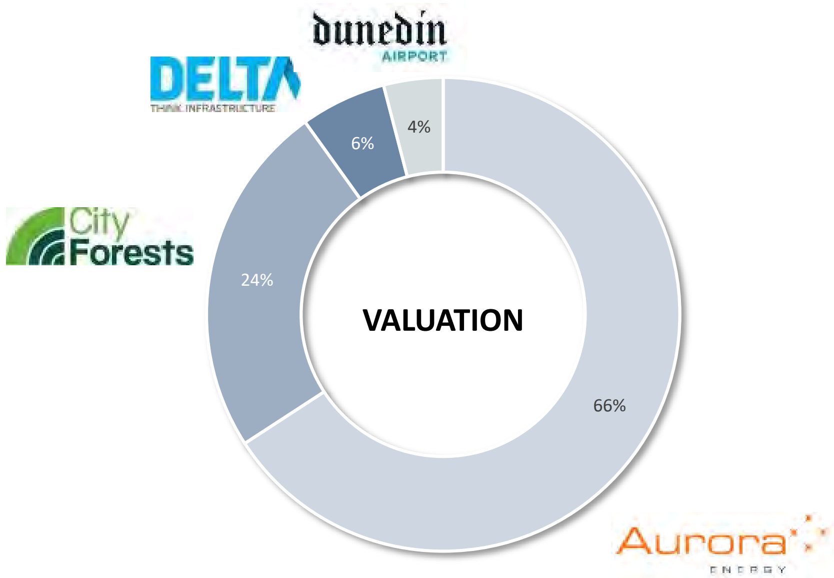
If Council chooses to retain Aurora, the portfolio will remain undiversified, illiquid and over-weighted to capital-intensive infrastructure.

In its Letter of Expectation of 2 February 2023, DCC asked DCHL to "*provide the DCC with strategic options for consideration (including consideration as to the future composition and direction of the portfolio) that allows the DCC to consider the implications for the DCC as shareholder with a particular focus on dividends/return on investment from DCHL*".

DCHL has presented its analysis that the current portfolio is undiversified, illiquid and over-weighted to capital-intensive infrastructure. There is high concentration risk, especially geographically, which creates exposure to major natural events such as earthquake.

DCHL has been clear in its recommendation that, if Council requires a different outcome, it needs a different asset mix. If Council decides to retain its shareholding in Aurora Energy, it will have **no other options to materially reshape the portfolio and achieve different outcomes**.

Council's other commercial investments are not large enough to make a material difference to the portfolio outcomes. The portfolio is already over-weighted to Aurora Energy – concentration risk will become even more pronounced as earnings are reinvested in the company.



Implications of retaining Aurora

Summary of implications of retaining Aurora assessed against DCC's investment objectives

Investment considerations		Comments
DISTRIBUTIONS Cash income to the shareholder	✗	Limited (if any) distributions in short-term. Modest distributions are possible in the medium-term but will need to be debt-funded.
CAPITAL GROWTH Growth in value of investments	✓	Strong capital growth based on a regulated return profile, as earnings are reinvested in distribution network.
CAPITAL REQUIREMENTS Need for capital expenditure	✗	Elevated capital investment programme across the next 10 years and possibly longer, subject to growth and decarbonisation capex requirements.
GROUP DEBT POSITION Impact on DCC group debt	✗	Group debt expected to increase from $1.3 billion in 2024 to $2.3 - $2.9 billion over the next 10 years. Increased group debt to the levels forecast could lead to a S&P credit rating downgrade, increasing future funding costs.
LIQUIDITY Ability to turn into cash when needed	✗	Privately held asset with long lead times to sell or sell down.
RISK PROFILE Uncertainty of returns	✗	Undiversified. Single asset risk, with exposure to one industry and one geographic region.
MARKET VALUE PREMIUM Additional value priced in by investors	✗	Attractive market premium available now – future outcome is uncertain and will only be realised if Aurora is sold.

DCC would forego an opportunity to realise value from the sale, reduce group debt and reinvest the net proceeds in an asset which is likely to generate a higher return over the long-term. If Aurora is retained, DCHL will not be in a position to achieve most of the objectives set out in DCC's revised Investment Framework.

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The impact of regulations on Aurora's line charging and investment

Toby Stevenson and Matthew Williamson
30 July 2024

Contents

Glossary

Abbreviation	Stands for
AMP	Asset Management Plan
BBAR	Building Blocks Allowable Revenue
CAPEX	Capital expenditure
CPI	Consumer Price Index
CPP	Customised price-quality path
DCC	Dunedin City Council
DCHL	Dunedin City Holdings Limited
DPP	Default price-quality path
EDB	Electricity Distribution Business
EV	Electric Vehicle
ID	Information Disclosure
IM	Input Methodologies
MAR	Maximum Allowable Revenue
NPAT	Net Profit After Tax
NPV	Net present Value
OPEX	Operating Expenditure
RAB	Regulated Asset Base
SAIDI	System Average Interruption Duration Index
SAIFI	System Average Interruption Frequency Index
TCSD	Term Credit Spread Differential
WACC	Weighted Average Cost of Capital

Executive summary

In March 2024 Dunedin City Council (DCC) published a consultation document seeking feedback on preferences for one of two options: Sale of Aurora Energy or Keep Aurora Energy

Aurora Energy is a regulated Electricity Distribution Business (EDB). A number of submitters, some of whom appeared at hearings in front of Council in May 2024, referred to possible approaches a different owner than DCC might take to consumer interests which raises the question of how effective regulation is.

We have been asked to address three questions that go to the level of protection regulations provide to electricity consumers. Our answers were presented at a workshop in July 2024. This report is a written form of that presentation.

We have not been asked to form a view on the merits of the consultation question. The three questions we were asked, and the high-level answers, follow.

Question 1: What is the scope for Aurora to **raise lines prices** across the network, **rebalance lines charges** amongst consumer groups, **defer maintenance** to save cost, or **underinvest** under the current regulatory framework? If there is scope, would a different owner take advantage of that latitude?

1. Revenue recoverable through lines charges is capped by the Commission's approach under Part 4 of the Commerce Act and the regulations apply to all (non-exempt) EDB owners.

2. Lines charges cannot be increased more than allowed by the Commission irrespective of who the owner is.

3. Aurora's allocation of lines charges amongst consumer groups including sub-networks is transparent and consistent with Electricity Authority guidelines and oversight. There is minimal scope for cross subsidisation between consumer groups.

4. Service quality standards are factored into the process of determining the revenue allowances. The asset management plan (AMP) content, Information Disclosure requirements and director signoff of the AMP are an integral part of the workings of the quality part of the regulatory framework. No owner wants to take the risk of failing to meet their quality standards.

5. Consumers are equally protected from adverse outcomes in both the price and quality of lines services they receive, regardless of who owner of the EDB is.

Question 2: How enduring is the **regulatory framework** in Part 4 of the Commerce Act?

1. The stated aim of Part 4 of the Commerce Act is **to promote outcomes consistent with those produced by competitive markets**, including providing incentives to invest, innovate and make efficiency gains, while requiring suppliers to share gains with consumers and to limit excessive profits.

2. It is hard to see the circumstances whereby the fundamental premise of the stated aim is undermined by a future government.

3. Most parties' policies released ahead of the 2023 general election had provisions to increase reliance on competition, or equivalent, to achieve better outcomes for consumers, not diminish it.

Question 3: What is the likelihood that the community would be better off or worse off **if Aurora was owned by a party other than DCC/DCHL**?

This question is answered in part, by the actions prompted by New Zealand's decarbonisation goal. Supply of renewable energy will need to rise to meet demand and the level of fossil fuels available to ensure secure supply will fall. At a distribution network level demand will rise, especially from EV charging, and the patterns of EV charging will change the way networks are managed. Increasing installation of rooftop solar generation will also change the way networks are managed. Distribution business will have to be more resilient than usual over coming years. In order to best manage Aurora through this period the owner of Aurora may benefit from some of the following attributes:

1. Long term investment horizons allowing a flexible dividend policy.
2. Understanding the challenges facing EDBs with decarbonisation.
3. Able to deal with uncertainty and risk.
4. Access to capital, specifically cost-effective debt.
5. Comfortable with debt-to-equity ratios that are consistent with Commission's regulated cost of capital over each regulatory period.
6. Experience with regulated businesses.
7. Synergies with other similar businesses esp. other regulated network businesses.
8. Economies of scale.

In the longer term when demand growth stabilises, and capital investment requirements ease off, Aurora will continue to earn a regulated return on regulated assets but with the headroom to make choices about where it chooses to allocate after-tax free cashflow. i.e. paying dividends, reducing debt, accelerating maintenance or replacement of assets where appropriate.

1. Introduction

Electricity consumers are protected under price and quality regulation whoever the owner of an Electricity Distribution Business (EDB) is. The possibility that consumers are worse off price wise or service quality wise under a different owner is not an argument against Aurora having a different owner.

There may be variations between EDB owners on, for example, the reputational risk they are prepared to take on by lowering quality standards or the degree to which they press the EDB for dividends during this period of high investment. However, the price-quality regulations and the Commission's monitoring regime will ensure that consumers interests are not compromised regardless of who an EDB's owner is.

For recovery of the allowable costs of running a network i.e. lines charges, and the treatment of different consumer groups within the resulting maximum allowable revenue, consumers would not feel much if any difference between two different owners of the EDB. On the service quality side, the Commission's monitoring regime has improved over time. It is unlikely now that the Aurora network would be allowed to get to the state it was in 2016. The regime for protecting consumers has been refined and tightened since Aurora found itself in the position it found itself in 2016. I understand that what happened at Aurora in 2016 has informed the way the Commission have evolved the monitoring and investigation functions.

For this written report I have rechecked the basis of a number of observations I made at the 1 July workshop. I stand behind all of my comments and in this written report have taken the opportunity to spell out a few points in more detail.

2. Brief – Three questions

We have been asked to address three issues that were the subject of a number of submissions during DCC's consultation on the possible sale of Aurora Energy:

1. What is the scope for Aurora to **raise lines prices** across the network, or **rebalance lines charges** amongst consumer groups or **defer maintenance** to save cost or **underinvest** under the current regulatory framework? If there is scope, would a different owner take advantage of that latitude?
2. How enduring is the **regulatory framework** in Part 4 of the Commerce Act?
3. What is the likelihood that the community would be better off or worse off **if Aurora was owned by a party other than DCC/DCHL**?

3. Question 1 – An EDB owner's latitude to raise prices or compromise quality

What is the scope for Aurora to **raise lines prices** across the network, or **rebalance lines charges** amongst consumer groups or **defer maintenance** to save cost or **underinvest** under the current regulatory framework?

- There is no scope for Aurora to raise lines charges beyond what is allowed by the Commerce Commission under its application of part 4 of the Commerce Act.
- The scope for Aurora to rebalance lines charges amongst consumer groups, including amongst sub-networks, is confined to a judgement on the allocation of costs between consumer groups as allowed by the Electricity Authority's distribution pricing principles.[1] The implication is that were Aurora to raise prices in one consumer group they would have to lower them in another.
- The scope to defer maintenance or underinvest is limited by the transparency of the information disclosure requirements, improvements to the monitoring regime over the years, director liability under Schedule 17 of the information disclosure requirements, the reputational risk of failures on the network and the risk of a fine for a breach. I note that any fine for a breach would come out of net profit after tax (NPAT), i.e. its not OPEX, which adds to the disincentive.

3.1 The regulatory framework

The regulatory framework is based around the work of two independent agencies each with a statutory responsibility focused on the long-term interests of consumers:

- The Commerce Commission protects consumers against extraction of monopoly rents by sectors with little or no competition including EDBs. This is achieved through the application of regulations governing price and quality under Part 4 of the Commerce Act. These regulations aim to ensure consumer interests are promoted regardless of ownership.
- The Electricity Authority's distribution pricing principles and active reform programme protect against cross subsidy of lines charges between consumer groups. This is consistent with the reliability and economic efficiency limbs of their statutory objective.

Default price path

EDBs have been subject to a **default price-quality path** (DPP) since 2009.

A DPP imposes maximum allowed prices <u>and</u> minimum service standards. The main components of a DPP are:

- the maximum prices & revenues allowed at the start of the regulatory period.

[1] Electricity Authority 2019 Distribution pricing principles See here

- the annual maximum rate at which prices can increase – this is expressed in the form of 'CPI-X', i.e. prices can increase by the rate of Consumer Price Index (CPI) less a prescribed percent or 'X-factor'.
- the minimum service quality standards that must be met.

Customised Price Path

- Electricity Distribution Businesses (EDBs) may apply to the Commission for a **customised price-quality path** (CPP) that better reflects their specific circumstances for a finite period.
- Under a CPP the regulator approves bespoke allowances for what an electricity network business can invest, the consequential charges to its customers, and minimum service levels over a specified period. It comes with a higher level of scrutiny for the duration, and EDBs on a CPP revert to a DPP when the term concludes.
- In 2020 Aurora applied for a CPP. Their Asset Management Plan (AMP) supporting the application focused on additional investment required to reduce risk, and improve network safety and reliability, following years of under-investment and deferred maintenance. The CPP, which runs from 2021 to 2026, gives Aurora the ability to recover additional costs through line charges for the purposes of fixing, upgrading and maintaining its network.

3.2 Workings of service quality standards

Quality and reliability standards set by the Commission reduce the risk that EDBs seek to increase profits by cutting costs and compromising quality. In December 2016, DCHL commissioned a report on the state of the Aurora network from Deloitte who found:

> An under investment on asset inspections/condition monitoring, planned maintenance and asset replacement over the last 25 – 30 years.

This is the root cause of where Aurora finds itself today. The current Aurora board and management are in the process of delivering a safe and reliable network.

The disclosure regime is about shining a light on:

- What should happen with quality,
- What is actually happening with quality, and;
- Responding to any divergence in a timely fashion.

The regulatory framework has evolved such that a decline in quality standards would be picked up more quickly than was the case in 2016. The Commission sets quality performance targets for each EDB based on close scrutiny of Asset Management Plans and an understanding of maintenance requirements for assets at whatever stage of the life cycle assets are at. Independent reports are used to verify what is happening on a network as required.

The performance of all EDBs is monitored based on the targets and the Commission's expectations of performance across all EDBs. Performance is disclosed publicly.

Inside the Commission a monitoring team keeps track of each EDB's performance and uses a series of escalations if data shows that something might be amiss. Escalation might just be conversations and letters and may lead to investigations. Investigations can lead to a finding of a breach and fines.

Aurora found itself in this position as a result of its historic failings. The Otago Daily Times reported 28 March 2020:

> Aurora Energy was ordered to pay almost $5 million for breaching its network quality standards with an excessive level of power outages from 2016 through 2019.
>
> Commission deputy chairwoman Sue Begg said Aurora did not adequately respond to recommendations stemming from the commission's 2014 warning to it for contravening its quality standards in the 2012 assessment period.
>
> ''Aurora's previous management and board were well aware of the deteriorating state of its network but failed to take action,'' Ms Begg said.

Performance targets are set for:

- System Average Interruption Duration Index (SAIDI). This describes the minutes of non-momentary electric interruptions, per year, the average customer experienced.
- System Average Interruption Frequency Index (SAIFI). This describes the number of non-momentary electric interruptions, per year, the average customer experienced.

Aurora reports on its targets and its performance against targets in the annual report as shown in Figure 1.

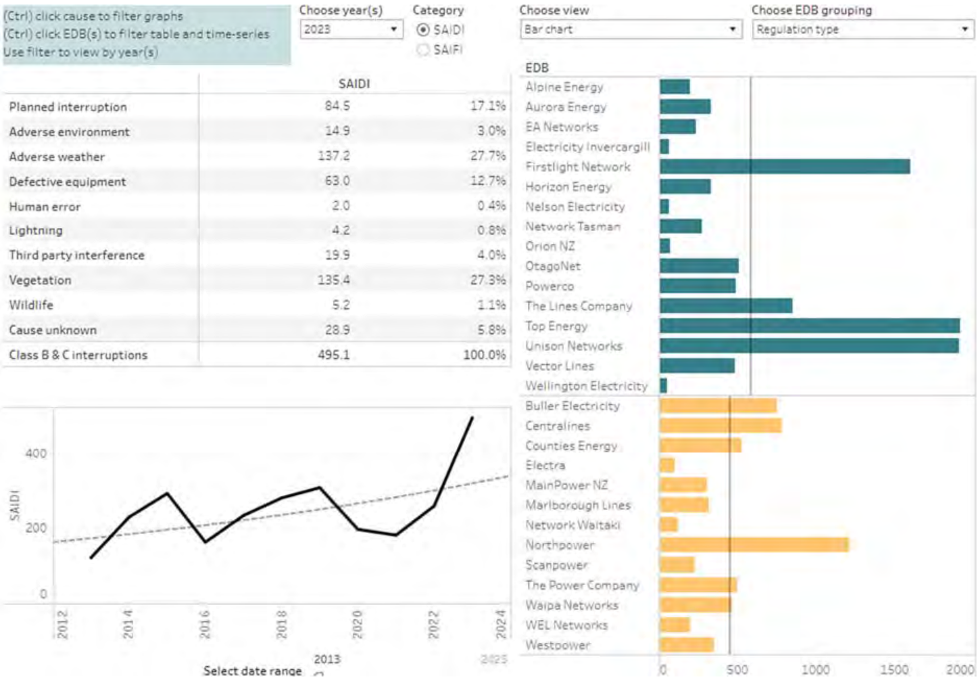
Figure 1 Reliability Performance Targets (Statement of Intent Targets – Period Ended 31 March 2023)[2]

SAIDI			
Class B Interruptions (Planned)	≤ 195.96 minutes	Achieved	110.34 minutes
Class C Interruptions (Unplanned)	≤ 124.94 minutes	Achieved	106.49* minutes
SAIFI			
Class B Interruptions (Planned)	≤ 1.11	Achieved	0.60 interruptions
Class C Interruptions (Unplanned)	≤ 2.07	Achieved	1.75* minutes

The Commerce Commission reports progress for all EDBs against SAIDI and SAIFI. Aurora's statistics are reported by the Commission and shown in Figure 2 and Figure 3 by cause and in comparison with all other EDBs.

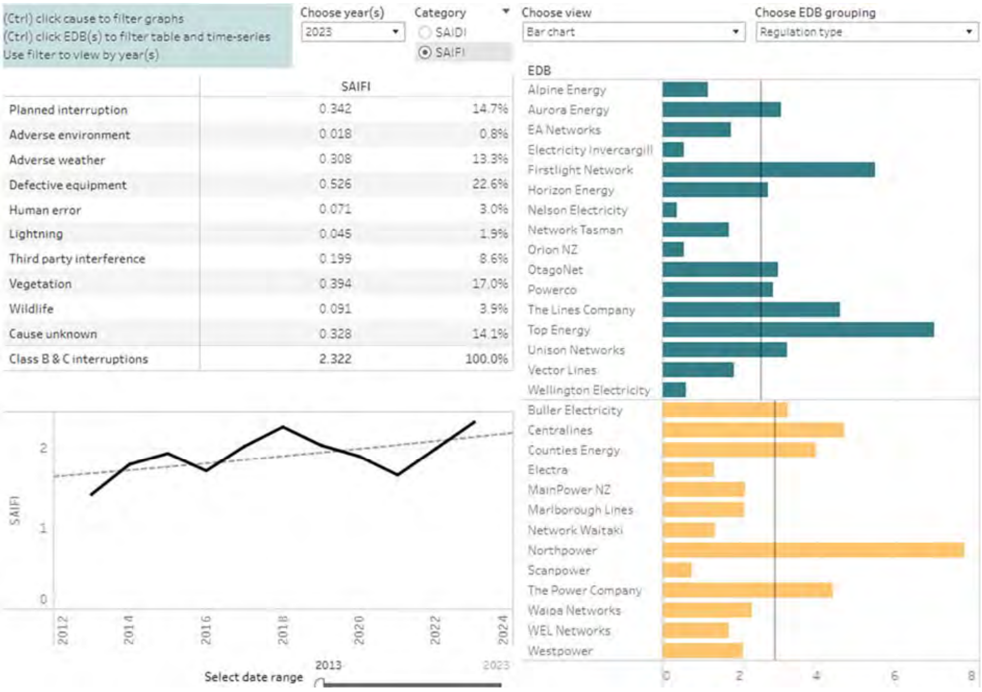
[2] Note: Class C SAIDI and SAIFI are expressed as normalised figures. The Commerce Commission's price-quality framework allows for the effect of extreme events to be removed, resulting in normalised figures that are compared against target. The raw results for Class C SAIDI and SAIFI were 156.3 minutes and 2.48 interruptions respectively.

Figure 2 Reliability by cause - Aurora Energy SAIDI[3]



[3] See Commerce Commission's NZ electricity distributor data and metrics page: here

Figure 3 Reliability by cause - Aurora Energy SAIFI[4]



The Commission has recently published an open letter on Aurora Energy's mid-period performance under its customised price-quality path [5]

1. The Commerce Commission (the Commission) welcomes the disclosure of two reports evaluating Aurora Energy Limited (Aurora)'s performance at the midpoint of its five-year customised price-quality path (CPP). We are publishing this letter under section 53B(2)(b) of the Commerce Act 1986, which requires us to publish a summary and analysis of information disclosed by regulated suppliers, including Aurora, so that stakeholders can better understand the performance of those suppliers.

2. The expert evaluations were completed by Energy Networks Consulting (Energy Networks) and Farrierswier and can be found here. Energy Networks' report evaluated Aurora's performance in areas associated with asset management and Farrierswier evaluated Aurora's customer engagement.

3. Encouragingly, the evaluations found that Aurora has performed reasonably well across the evaluated practice areas. Some positive examples from the expert evaluations found that Aurora:

[4] ibid

[5] Commerce Commission Open letter on Aurora Energy's mid-period performance under its customised price-quality path 21 May 2024

- had made substantial improvements to its safety practices;
- had improved its asset management practices;
- maintained a good level of engagement consistent with the CPP process and good electricity industry practice; and
- used a wide range of forums to engage with customers.

4. However, Energy Networks' evaluation considered that Aurora could improve its network reliability because its unplanned outages remained high during Aurora's time on the CPP so far. We also drew attention to Aurora's network reliability issues in our recent fact sheet on Aurora's progress under its CPP.

It would be incredible for either a new owner or the existing owner to want to compromise on quality with a view to increasing profitability given the level of scrutiny that comes with the disclosure regime and Aurora's history. Under Schedule 17 of the information disclosure requirements directors are liable that information provided to the Commission in all material respects complies with the Commission's information disclosure determination, that prospective financial or non-financial information included in the accompanying information has been measured on a basis consistent with regulatory requirements or recognised industry standards and that forecasts are based on objective and reasonable assumptions which both align the EDB's corporate vision and strategy and are documented in retained records. Further, there are reputational risks with failures on the network and there is the risk of a fine for a breach. Any fine from a breach comes out of net profit after tax (NPAT), i.e. it's not treated as allowable regulatory OPEX, which adds to the disincentive.

3.3 Workings of price regulation

Price regulation is based around revenue limits and in the case of Aurora's CPP, a cap on annual revenue increases. EDBs can recover what the Commission consider are efficient operating costs and a regulated return on regulated assets to deliver the required quality by way of a revenue limit which is described in the Commission's default price-quality paths for electricity distribution businesses. The overall approach is described as follows: [6]

> A revenue path is the set of annual revenues an EDB is allowed to earn over the regulatory period. It has two main parts:
>
> - 'forecast net allowable revenue' (which allows for the smoothed recovery of building blocks allowable revenue (BBAR)),
> - pass-through and recoverable costs.
>
> Pass-through and recoverable costs (other than those giving effect to regulatory incentive mechanisms) are generally outside of a supplier's control, for example, Transpower costs, local body rates.
>
> If a supplier keeps its opex and capex lower than our forecasts, it can keep some of its savings. This creates an incentive to be efficient. This applies to both opex and capex.

The allowable revenue is developed through the building blocks approach as shown below in Figure 4. The building blocks approach adds up the components of an EDB's forecast costs and sets revenue limits equal to them. It starts with an updated regulated asset base (RAB) at the beginning of the DPP or CPP period. A regulated return on that investment based on what the Commerce Commission views as appropriate for that business is applied to the RAB. The projected return on investments is added to the projected costs of an efficient EDB over the regulatory period.

The Commission notes: [7]

> The limit on revenue provides incentives to focus on controllable costs. Profitability depends on the extent to which EDBs control costs. Actual costs may differ from forecasts for a variety of reasons, but the incentive to increase profits helps to create an incentive for EDBs to find efficiencies that result in reduced costs.
>
> There is a risk that EDBs may find these cost savings by reducing investment or maintenance. Quality standards play an important role in reducing the risk of this occurring.

The DPP has to specify revenue limits for each EDB for each year of the regulatory period The revenue limits are set net of pass-through costs and recoverable costs. The two main components of these revenue limits are:

- the 'starting price' allowed in the first year of the regulatory period.

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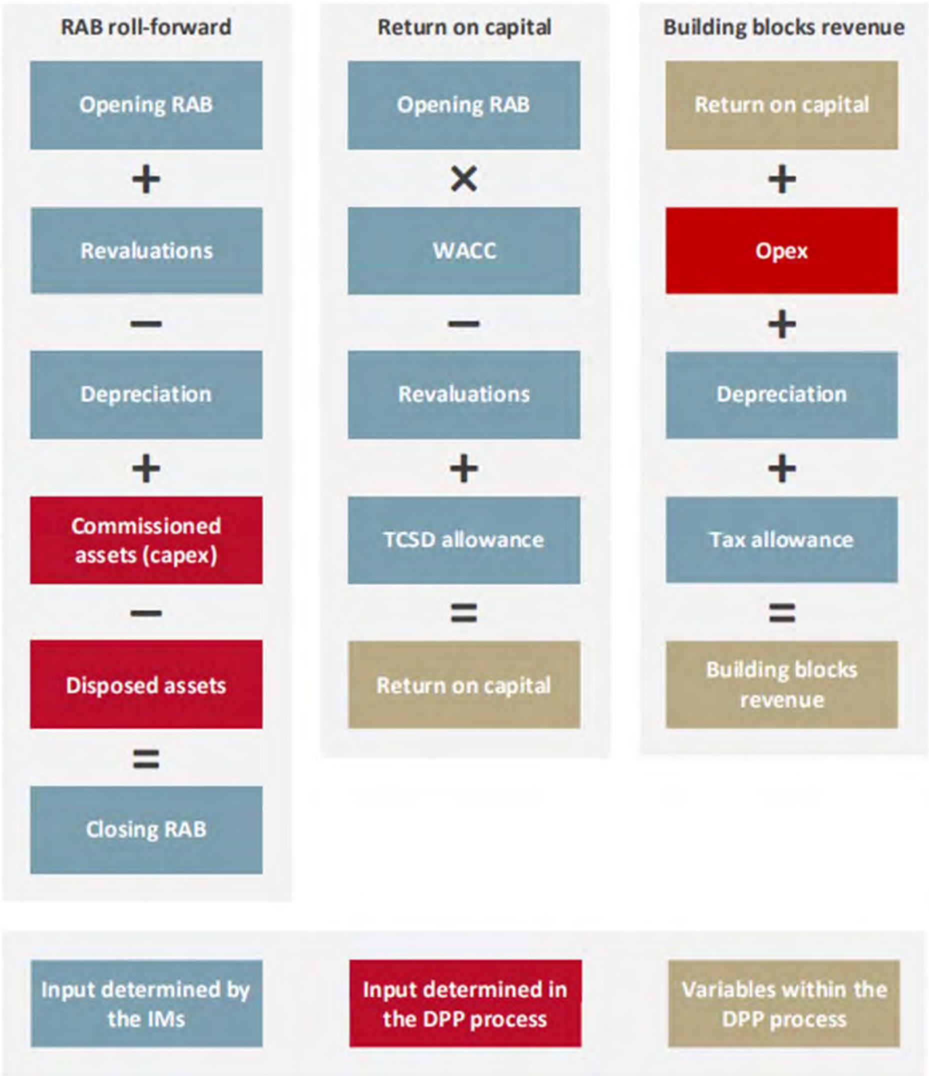
[6] Commerce Commission Default price-quality paths for electricity distribution businesses from 1 April 2025 Issues paper 2 November 2023
[7] ibid.

- the 'rate of change in price', relative to the CPI, that is allowed in later parts of the regulatory period.

Figure 4 How the Commission calculates BBAR[8]



The starting prices the Commission sets for EDBs are specified in terms of maximum allowable revenue (MAR), which is an amount net of pass-through costs and recoverable costs. The MAR amount is calculated through two processes:

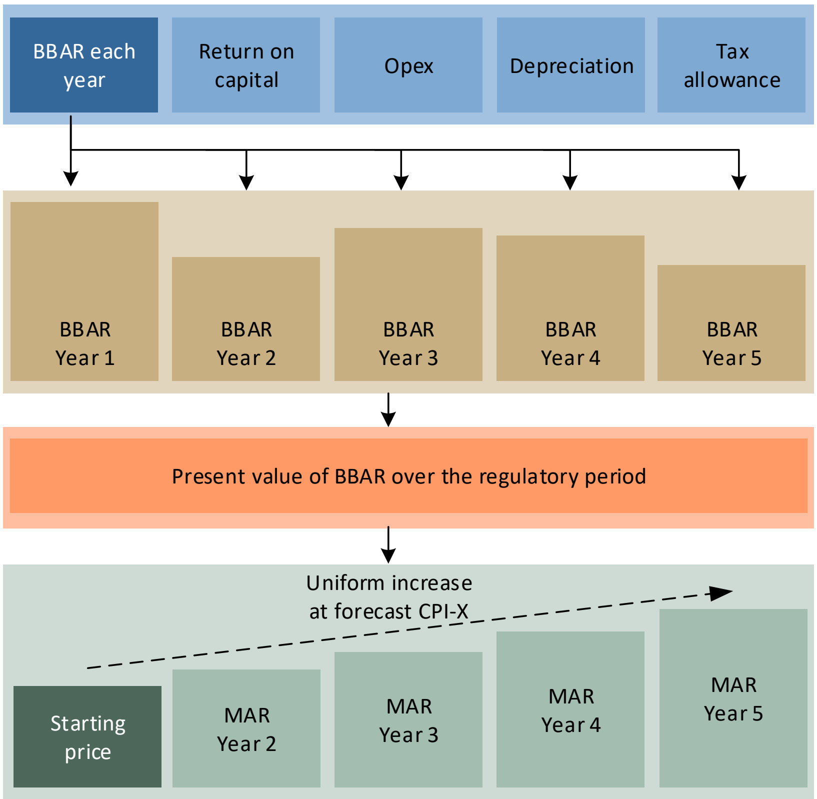
- Determining a BBAR for each year of the regulatory period as shown in Figure 4.

[8] Ibid.

- Smoothing each of the BBAR amounts over the regulatory periods by forecast CPI and any applicable X-factor in present value terms. This represents the yearly changes to the revenue limit that are allowed over the regulatory period. This process is shown in Figure 5.

When the BBAR is smoothed into annual MAR figures through applying forecast CPI and the X-factor, the present value of BBAR and MAR is kept constant.

Figure 5 From annual building blocks allowable revenue to annual maximum allowable revenue [9]

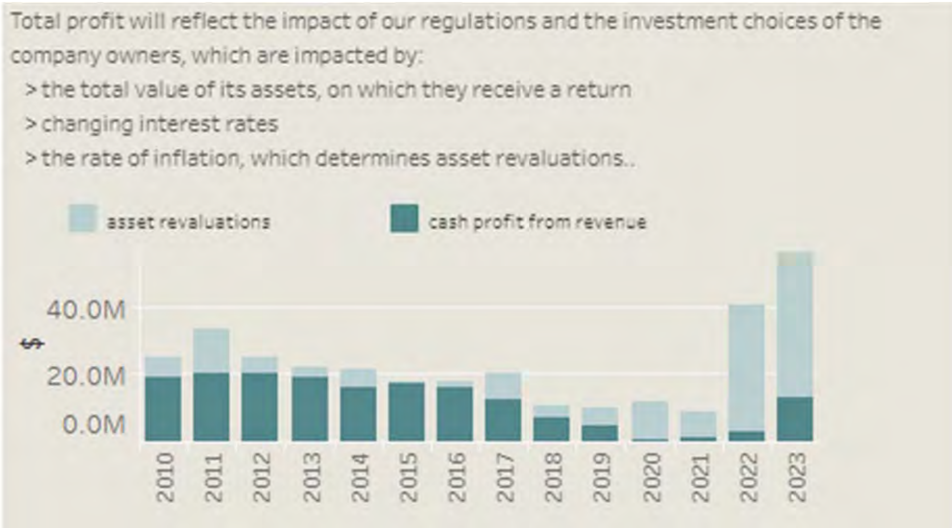


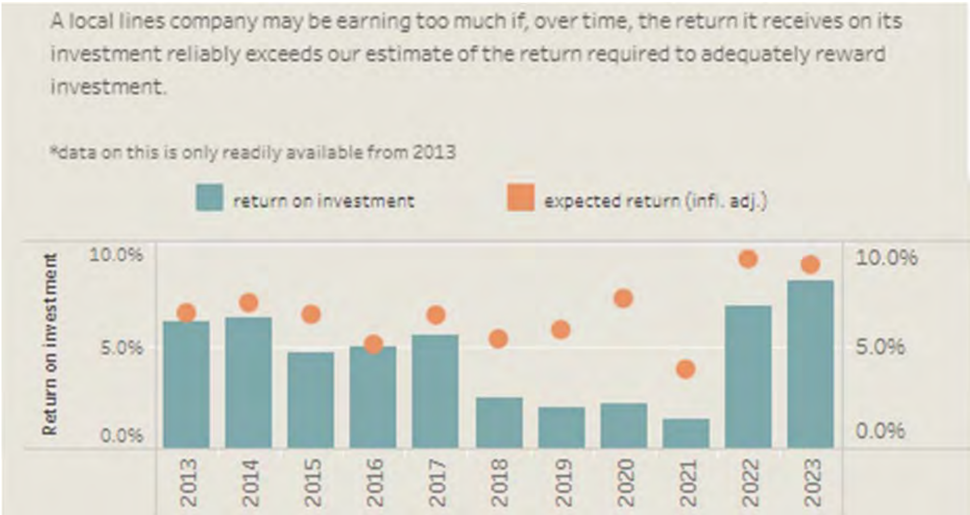
The limit on the smoothed increase in the MAR created by the CPI – X and revenue cap restraints on prices leads to some revenue being recovered in later years. This deferred revenue mechanism is discussed in the following section.

There is no scope for either a new owner or the existing owner to set prices outside the Commission's DPP or CPP process. The Commission monitors and comments on each EDB's return on investment against expected returns publicly as shown in Figure 6. In Aurora's case the Commission reports total profits were "not generally excessive"

[9] ibid

Figure 6 Aurora's historical profit and reported return on investment compared to the Commission's expectation of Aurora's return [10]





Deferred revenue

- Deferred revenue (revenue deferred to reduce the timing of price impact on consumers) arises from the deferred recovery of costs and regulated returns on capital that have been allowed by

[10] See Commerce Commission's NZ electricity distributor data and metrics page: here

the Commerce Commission when the MAR is calculated, but which are not recoverable in the year the costs and capital investments are incurred.

- The Commission's deferral of an estimated $69 mil of revenue to cap the rate at which allowable revenue could be recovered (and to smooth the pricing impact on consumers) was well documented in the Commerce Commission's 2021 final decision on Aurora Energy's proposal for a CPP.
- Aurora accounts for deferred revenue in their financial management and reporting – see note 3 of Aurora's 2023 annual report:[11]

  > The Commerce Commission's Customised Price-Quality Path Determination for Aurora Energy included a 10% limit on the annual increase in line charge revenue in order to reduce the price impact on consumers. Combined with the impact of volume driven revenue variances the total deferred revenue for year ended 31 March 2023 is $39.315 million (2022: $13.417 million). This deferred revenue will be recovered from consumers in future financial years.

- The input methodologies provide for the deferred revenue plus "any related time value of money adjustment made in accordance with a **DPP determination** or **CPP determination**."[12] It would not be correct to say deferred revenue earns interest. It is correct to say that the regulations provide for the net present value (NPV) at the time revenue is deferred to be protected so no time value of money is lost when it is recovered. If this was not the case, then on the simplifying assumption that all actual values are equal to the projected values at the start of the CPP or DPP, the EDB would not meet it's cost of capital.
- It is also correct to say that when the revenue that is deferred is received in later years it is recorded and disclosed as both financial and regulatory income, and is subject to income tax in the year it is received.

3.4 Aurora pricing approach

The Electricity Authority has a framework for EDB pricing methodologies aimed at ensuring tariffs are cost reflective and that one group of consumers does not subsidise another. Aurora's pricing methodology reflects those requirements. To illustrate, Aurora allocates its lines charges amongst consumer groups as shown in Figure 7 Schematic of A.

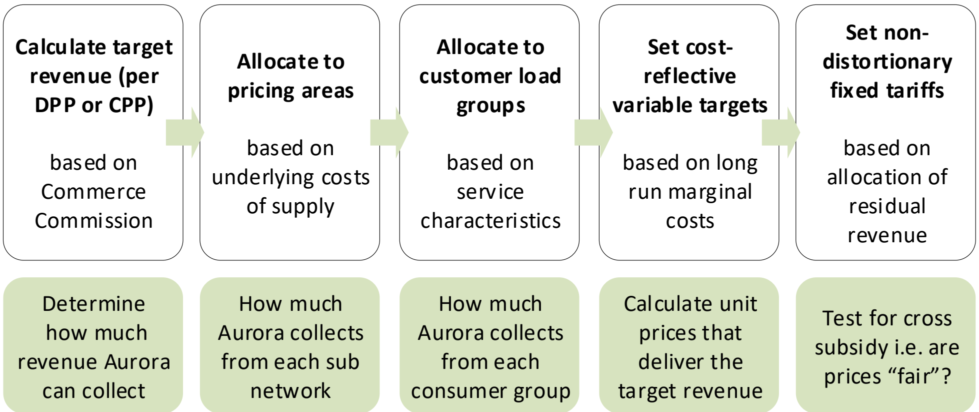
The breakdown of recoverable costs amongst consumer groups and sub-networks begins with the MAR as shown on the left-hand panel in the diagram. The second step is allocating MAR amongst the sub-networks based on the underlying costs of supply. Given that the MAR covers all three sub-networks any reallocation of costs in one sub-network area has to have a corresponding shift to the other sub-network areas. This is why we say a different owner couldn't simply raise prices in Dunedin to make more profit. If they did so they would have to lower cost recovery in the other sub-networks accordingly.

[11] Aurora Annual Report 2023

[12] Commerce Commission Input Methodologies Section 3.1.3(13)(k) 23 April 2024

The next step is to allocate costs in each sub-network between consumer groups. Here is the scope for cross subsidisation between domestic and commercial or industrial consumers. The tension here is to ensure that the costs assigned to each consumer group truly reflect the costs of providing the service to them. Finally, once recoverable costs are so allocated each EDB has to develop tariffs that don't over recover or under recover costs for the period. That does happen from time to time and when it is detected the offending EDB is required to put it right.

Figure 7 Schematic of Aurora's approach to assiging prices to sub-networks and consumer groups.



The Authority monitors EDB performance on their pricing approach scoring them against the following criteria:

- The EDB's unique circumstances.
- Adherence to the Authority's Distribution Pricing Principles.
- The overall strategy for distribution pricing.
- The pricing roadmap expected to deliver cost reflective and fair pricing for all parts of the network and all consumers.

In their 2023 report on distribution pricing the Authority notes:[13]

> Consistent with 2021, Wellington Electricity and Aurora continue to receive the highest overall score. These distributors demonstrated leading practice on several criteria and a consistent improvement compared to 2021.

This section shows Aurora's approach to pricing and, in particular, that it recognises the unique challenges in the three sub-networks. The scope for a different owner to arrive at slightly different allocation of costs amongst consumers is minor. There is no scope for a new owner to raise prices for some consumers without a corresponding reduction of prices for other consumers.

[13] Electricity Authority Distribution pricing scorecards 2023 Information paper 10 October 2023

4. Question 2 – The reliability of the regulatory framework

How enduring is the **regulatory framework** in Part 4 of the Commerce Act?

- The stated aim of Part 4 of the Commerce Act is **to promote outcomes consistent with those produced by competitive markets**, including providing incentives to invest, innovate and make efficiency gains, while requiring suppliers to share gains with consumers and to limit excessive profits.
- It is hard to see the circumstances where undermining the fundamental premise of the stated aim is prioritised by a future government.
- Most parties' policies released ahead of the 2023 general election had provisions to increase reliance on competition to achieve better outcomes for consumers, not diminish it.

How stable is the regulatory framework?

- The purpose of the Commerce Act is to promote competition in markets for the long-term benefit of consumers within New Zealand. (s1A)
- The Act establishes the independent Commerce Commission which plays a role in ensuring New Zealand's markets are competitive, consumers interests protected, and **sectors with little or no competition are appropriately regulated**.
- The Electricity Authority's statutory objective requires it to deliver competition, reliability and economic efficiency for the long-term interest of consumers.
- Both of these regimes have been strengthened since they were introduced and continue to be strengthened.
- Softening the promotion of competition in markets or regulation of sectors with little or no competition would be a major shift in government policy. The regulatory framework has not been softened in any way by successive governments to date.
- The prospect of unwinding the promotion of competition or regulation of sectors with little or no competition has not featured as policy for any political party to date. A review of all political parties' policy statements released ahead of the 2023 general election shows that most parties were looking to promoting benefits of competition (or equivalent for regulated sectors). For example, there were proposals to address the lack of competition in the grocery industry, fuel, banking and building products.

5. Question 3 – Attributes required of Aurora's owner

What is the likelihood that the community would be better off or worse off **if Aurora was owned by a party other than DCC/DCHL**?

- Consumers are well protected by the regulatory regime and that protection is not owner dependent.
- Every EDB in New Zealand faces the challenges of the high investment required to accommodate electrification which is, in turn, a consequence of New Zealand's legislated decarbonisation goal.
- In addition, Aurora is dealing with fixing, upgrading and maintaining its network after years of under maintenance and under investment.
- Aurora's owner will have to be more resilient and far sighted in the coming years than would normally the case. If DCC/DCHL doesn't have the resilience required to get through the coming years the electricity consumers on the Aurora network could, potentially, be worse off.

Attributes for EDB owners under price-quality regulation with the decarbonisation challenge

I can only answer for the community as power consumers. I cannot comment on whether the community would be better off or worse off from any other perspective.

The answer to this question lies, in part, on the speed and extent of New Zealand's transition to a low carbon economy. In 2017 electricity demand growth was modest and investment in new generation was keeping up with growth. Some generation came from fossil fuels but New Zealand was being supplied by ~85% renewable generation.

The incoming Government set out about decarbonising the economy by passing an Act legislating a target of net zero carbon by 2050 and establishing an independent Climate Change Commission whose role is to set the carbon budgets that would have to be met to get to zero carbon by 2050.

The implication of this shift was that amongst the major initiatives aimed at achieving the target would be higher levels of renewable electricity and, with that low carbon energy source, high levels of electrification in a number of sectors notably transport and industrial heat processes.

The twin effects of higher demand, i.e. increased supply, and lower use of fossil fuels combine to create a major challenge for energy supply, distribution and transmission. For the distribution sector Boston Consulting wrote:[14]

> In all pathways there is a clear need for a significant scaling up of transmission and distribution infrastructure investment to at least $30 billion in the 2020s.

It is unsurprising then to read in Aurora's Statement of Intent: which says: [15]

[14] Boston Consulting Group THE FUTURE IS ELECTRIC A Decarbonisation Roadmap for New Zealand's Electricity Sector 17 December 2023

[15] Aurora Energy Statement of Intent for the year ending 30 June 2024

> As a regulated business, Aurora Energy has a responsibility to its customers to provide safe, reliable electricity infrastructure. To maintain a reliable network and cater for growth, we are planning to invest in the order of $800 million in the network over the next decade to be funded by increased revenue, increased borrowings and reduced dividends.

So, the answer to this question can be viewed through two time frames.

Aurora's upcoming investment requirements come on top of the investment already made as part of the restoration of the network under the CPP. That being the case during the coming years the owner of Aurora will have to be more resilient and far sighted than would normally be the case.

The owner of Aurora during this phase would benefit from some or all of the following attributes:

1. Long term investment horizons allowing a flexible dividend policy.
2. Understanding the challenges facing EDBs with electrification and decarbonisation.
3. Able to deal with uncertainty and risk.
4. Access to capital, specifically cost-effective debt.
5. Comfortable with debt-to-equity ratios that are consistent with Commission's regulated cost of capital over each regulatory period.
6. Experience with regulated businesses.
7. Synergies with other similar businesses esp. other regulated network businesses.
8. Economies of scale.

In the longer term when demand growth stabilises, and capital investment requirements ease off, Aurora will continue to earn a regulated return on regulated assets but with the headroom to make choices about where it chooses to allocate after-tax free cashflow. i.e. paying dividends, reducing debt, accelerating maintenance or replacement of assets where appropriate.

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independence, integrity and objectivity

Aurora Energy Limited

Mafic Partners response to public consultation

September 2024

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Partners in infrastructure

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Contents

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1

Introduction

Mafic scope

This report provides an independent view on the financial aspects raised by respondents to the public consultation process for the potential sale of Aurora Energy Limited (**Aurora Energy**)

- Mafic Partners Limited (**Mafic**) has been appointed by Dunedin City Holdings Limited (**DCHL**) to provide an independent view on the financial aspects of the public consultation in relation to the potential sale of Aurora Energy
- This presentation covers the following key categories:

Capital requirements	• Summary of Aurora Energy's capex forecast and key drivers over the next 10 years • Benchmarking of capex against electricity distribution business (**EDB**) peers
Profitability and cashflow generation	• Overview of the regulatory framework and its impact on Aurora Energy returns • Explanation of the link / delink between Aurora Energy's profitability and shareholder cashflows
Debt levels and capacity	• Summary of the key credit metrics driving Aurora Energy's / Dunedin City Council's (**DCC**) ability to borrow • Summary of Aurora Energy financial risk, including benchmarking against EDB peers • Implications of forecast capital requirements on leverage / credit metrics going forward
Sale considerations	• Key financial considerations of sale versus retain • Evaluation of sale options
Post 2034 implications	• A high-level estimate of the financials (Aurora Energy and DCC) post 2034

Base case forecast

This presentation utilises forecasts supplied by Aurora Energy and utilises the latest estimates of council debt requirements

Aurora Energy's base case

- Mafic was supplied a financial model from Aurora Energy in June 2024
- This reflects the latest opex and capex metrics disclosed by Aurora Energy in its 2024 asset management plan (**AMP**)
- A regulatory weighted average cost of capital (**WACC**) of 7.37% is applied for default price path four (**DPP4**)
  - This is in line with the latest estimate (May 2024) disclosed by the Commerce Commission (**ComCom**)
- We've assumed dividends are paid from financial year (**FY**) 2027 onwards
  - Dividends are set at 40% of net profit after tax (**NPAT**)
  - Note: This has been included to understand the financial metrics under a modest resumption to dividends. Aurora Energy has not made a formal statement on resumption to dividends
- Whilst the numbers presented are based on the most up to date published expenditure forecasts, Aurora Energy has signalled further upward pressure on expenditure, which would flow through to greater capital needs

DCC financials

- In July 2024, Mafic prepared indicative DCC level debt metrics based on public information at the time
  - This output has been included in appendix D for completeness
- Since preparation of the July 2024 report, DCC has undertaken its own review of wider debt / capital requirements, potential DCC rate increases and applied a revised Aurora scenario
- This review has resulted in three revised DCC financial scenarios. Our DCC level financial analysis has been updated to reflect this

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2

Capital requirements

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Capital requirements

Key observations

Capital expenditure drivers

- Aurora Energy has experienced a period of significant capex to address past issues
- While these issues have been addressed, Aurora Energy is expected to remain in an environment of elevated capex driven by:
  - Capex inflation
  - High growth Central Otago/Queenstown catchments
  - Capex required to replace ageing assets
  - Decarbonisation and climate change resilience

Benchmarking

- Aurora Energy is forecasting capex of $1.1b over FY25 – FY34
  - **This is in line with peers, normalised for size**
- We note there is upside risk to the base case in relation to decarbonisation capex, as flagged in the Aurora Energy AMP, and ongoing capex inflation pressures

Capital requirements

Key observations

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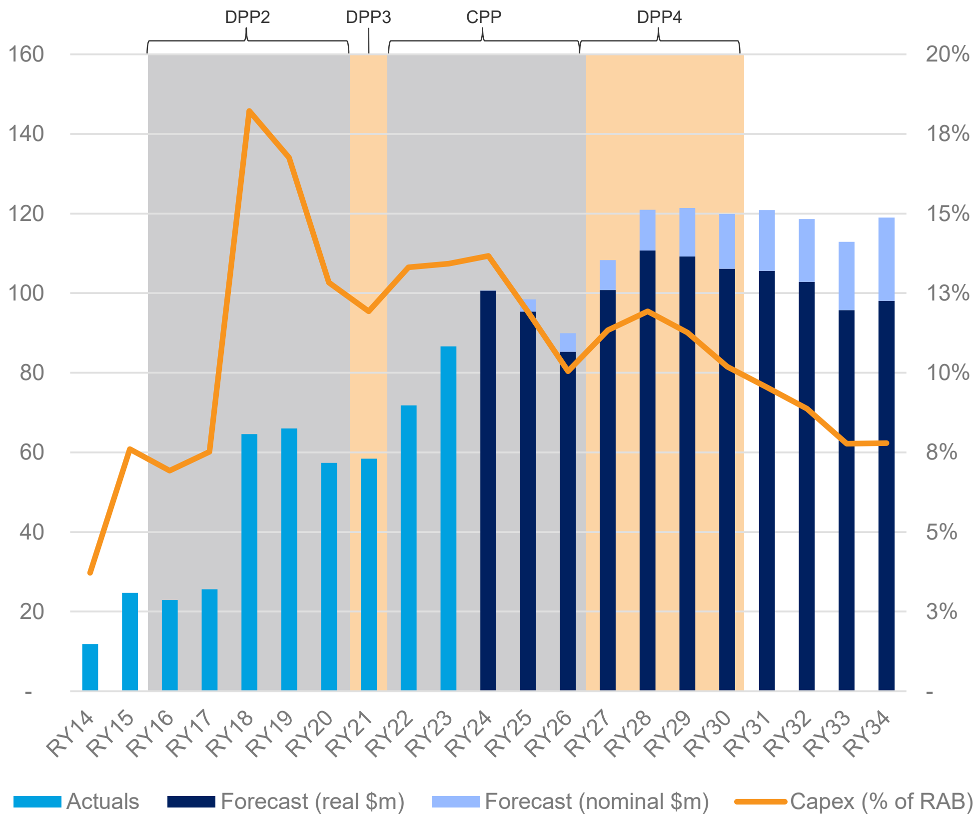
Aurora Energy is forecasting capex to remain elevated over the next ten years, which is underpinned by several long-term capex drivers

Gross capex profile ($m)[1]



Capex drivers

- ✓ Capex inflation
- ✓ Significant capex required to replace ageing assets
- ✓ High growth Central Otago/Queenstown catchments
- ✓ Decarbonisation and climate change resilience

Key observations

$1.1b[2] — **10Y capex (nominal, gross of customer contributions)**
Forecast over RY25 – RY34

70% — **5Y capex as % of regulatory asset base (RAB)**
Nominal as % of RY23 RAB

1,400[3] — **New connections**
Annual forecast per annum

1. Based on regulatory year end (March). Gross of customer contributions. 2. Customer contributions FY25 – FY34 are $144m. 3. Aurora Energy 2024 Asset Management Plan

Key: Below peer average; Slightly below peer average; In line with peer average; Above peer average

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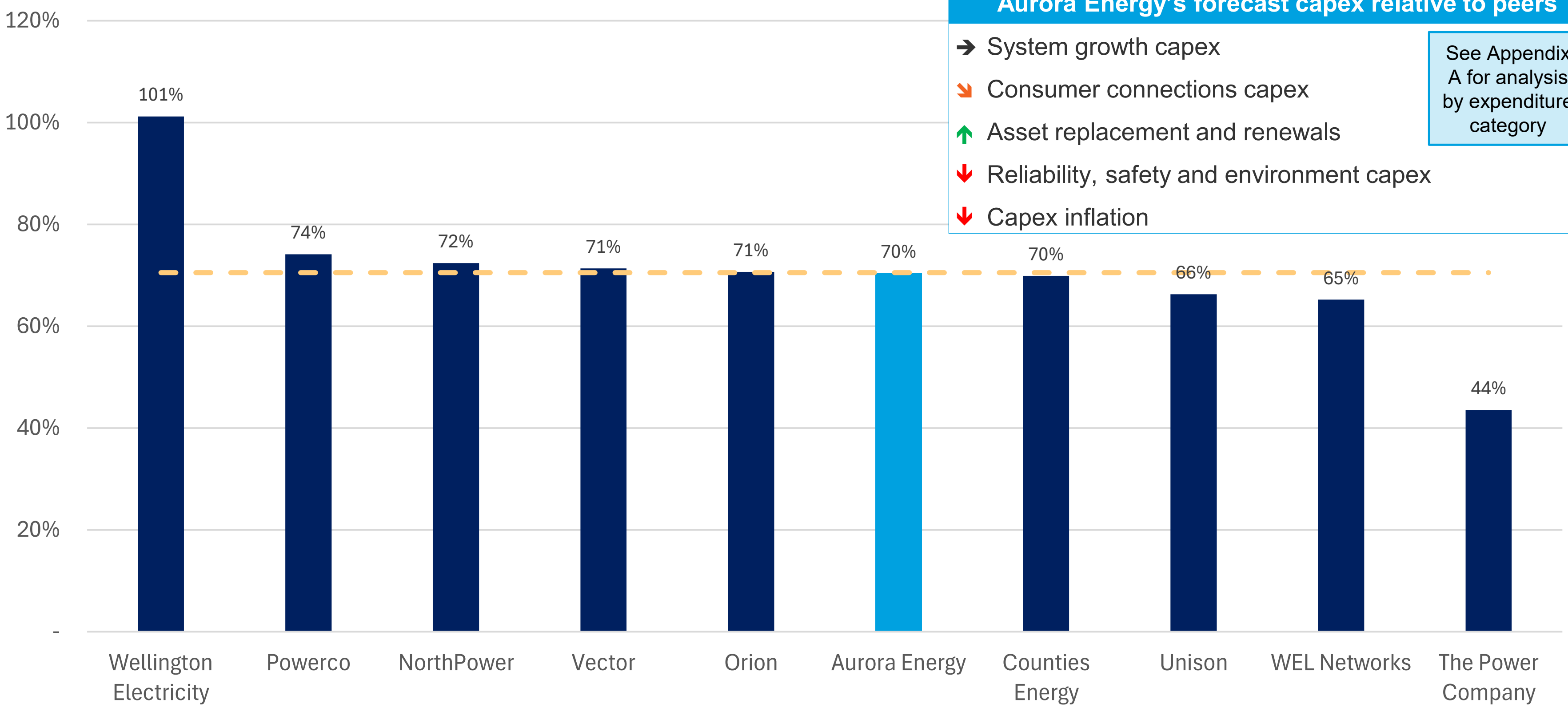
Capital requirements

Benchmarking against peers

Aurora Energy's base case capex is not dissimilar to its peers and a reasonable base for assessing cashflow and debt requirements

Five-year forecast capex (nominal) as a % of RY23 RAB[1]



Aurora Energy's forecast capex relative to peers

- System growth capex (in line with peer average)
- Consumer connections capex (slightly below peer average)
- Asset replacement and renewals (above peer average)
- Reliability, safety and environment capex (below peer average)
- Capex inflation (below peer average)

See Appendix A for analysis by expenditure category

1. Table presents for the ten latest EDBs (based on the RY23 regulated asset base (RAB)), capex sourced from the latest asset management plans (2024). Capex is for the period RY24 – RY28.

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Capital requirements

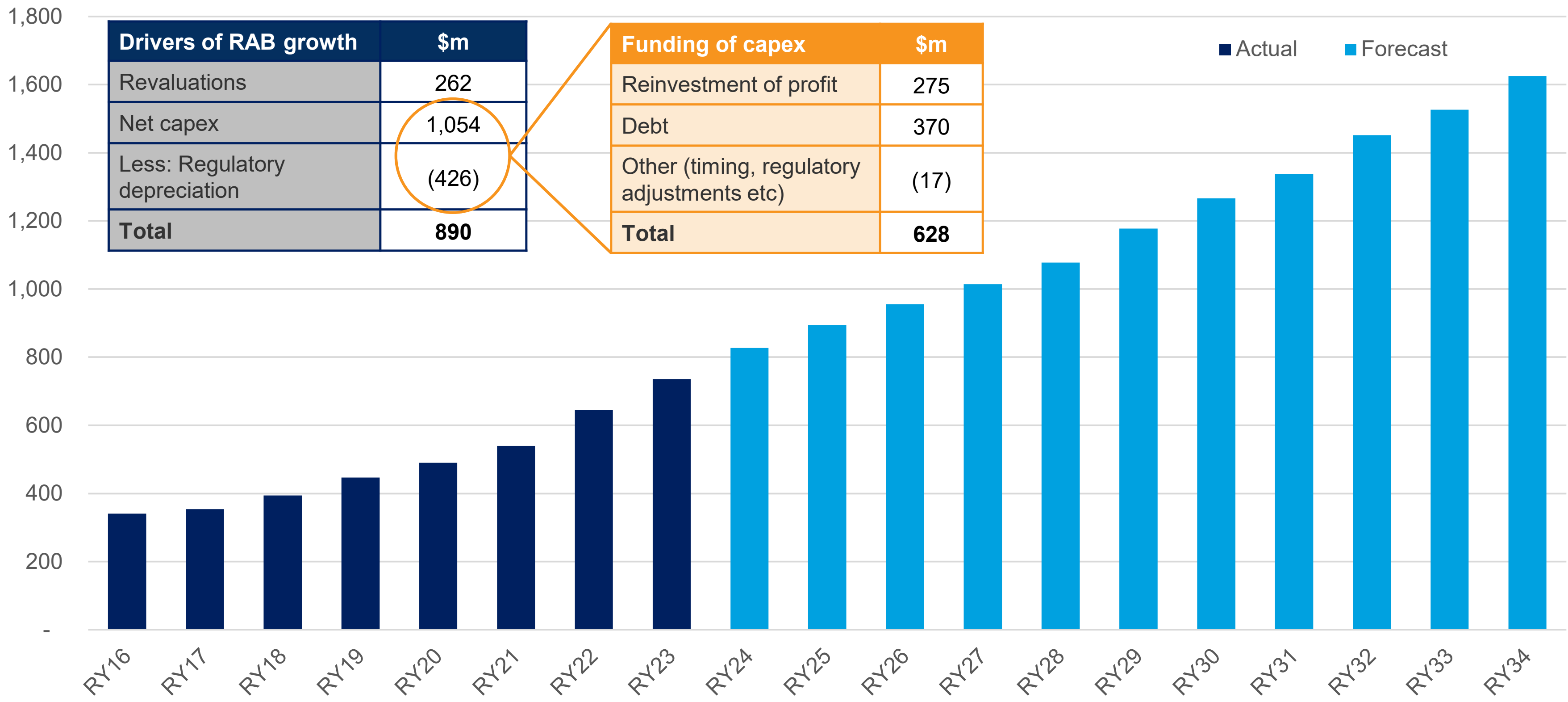
RAB profile

Aurora Energy's asset base is forecast to grow to ~$1.6b by RY34. The growth in RAB is driven by non-cash returns (revaluations) and capex requirements

RAB profile (Nominal $m)

Drivers of RAB growth	$m
Revaluations	262
Net capex	1,054
Less: Regulatory depreciation	(426)
Total	**890**

Funding of capex	$m
Reinvestment of profit	275
Debt	370
Other (timing, regulatory adjustments etc)	(17)
Total	**628**



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3

Profitability and cashflow generation

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Profitability and cashflow generation

Key observations

Aurora Energy return on assets

- Return on assets is determined by regulatory return – forecast DPP4 return is ~7.4%[1]
- The regulatory regime is such that actual returns should average the regulatory return in the long-run. However certain factors can impact returns
  - There are several adjustments (e.g. capex overspend and financial incentives/penalties[2]) that have a negative value impact to shareholders[3]
  - Historically Aurora Energy has under-performed the regulatory return (RY13 – 21)
- In the short-term forecast, Aurora Energy's return on assets is above the regulatory return, driven by:
  - A positive financial penalties adjustment[2], arising from Aurora's current customised price path (**CPP**)
  - Realisation of deferred revenues (arising from ComCom revenue smoothing)
  - **<u>These are included in the forecast and would be incorporated by acquirers when determining value</u>**

Shareholder cashflows

- Regulatory returns can differ from shareholder cashflows. This is a function of regulatory design and company specific factors
- Over the forecast period, these differences are driving significant negative free cashflows for Aurora Energy
  - Base case free cash flow is **negative $220m** over FY25 – FY34 (before any dividends)
  - Dividends will further increase outflows
- Given DCC does not have access to equity capital, these cash outflows need to be funded through additional DCHL debt

1. Based on the ComCom's latest estimate for DPP4. 2. These relate to Incremental Rolling Incentive Scheme and quality incentive adjustments. 3. We note capex overspend is normalized in subsequent default price path periods. However, they have a negative net present value due to the time value of money. By contrast, the Incremental Rolling Incentive Scheme has a permanent and one-off impact to EDB cashflows

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Profitability and cashflow generation

Regulatory return

As defined by the ComCom, EDB's generate an asset return in line with the regulatory return. This is calculated every five years and is primarily driven by the risk-free interest rate

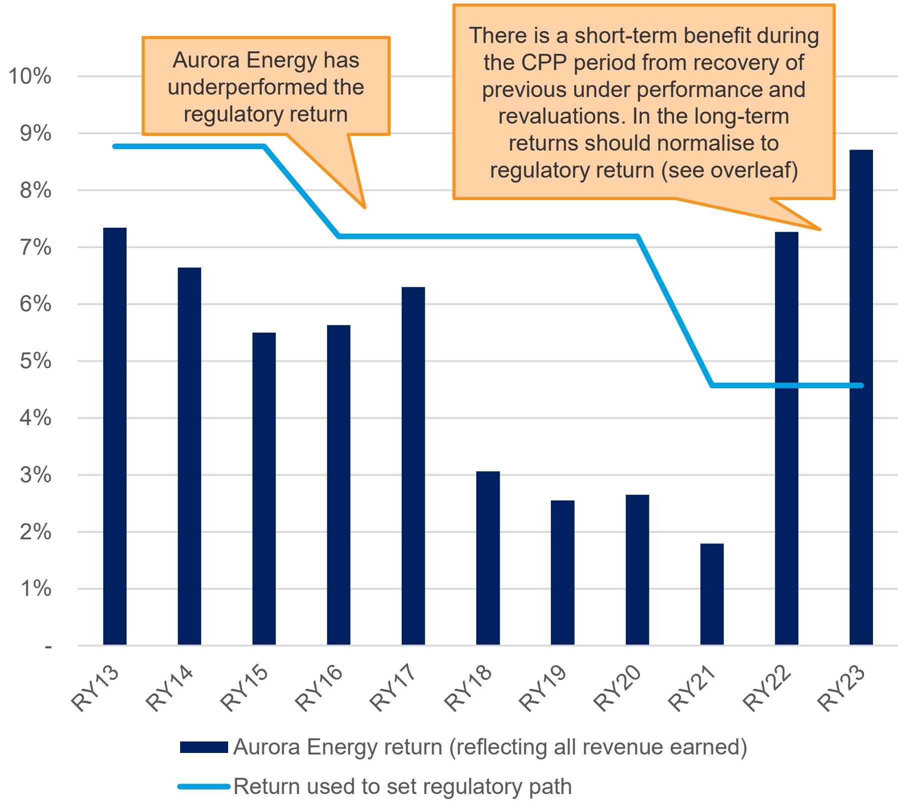
Return on assets is determined by the regulatory return

- The regulatory regime is designed to enable EDBs to generate returns in line with the regulatory return
  - The regulatory return is set every five years
  - A key driver is risk-free rate (NZ Government bond rate)
- DPP3 return: **4.6%**
- Forecast DPP4 return: **~7.4%**[1]

However, EDB returns can differ to the regulatory return

- Key drivers of deviation include[2]
  - Capex and opex overspend / underspend
  - Financial and quality penalties / incentives[3]
  - Wash ups
- Regulatory changes can also impact returns in the long-term

Aurora Energy return on assets vs regulatory return



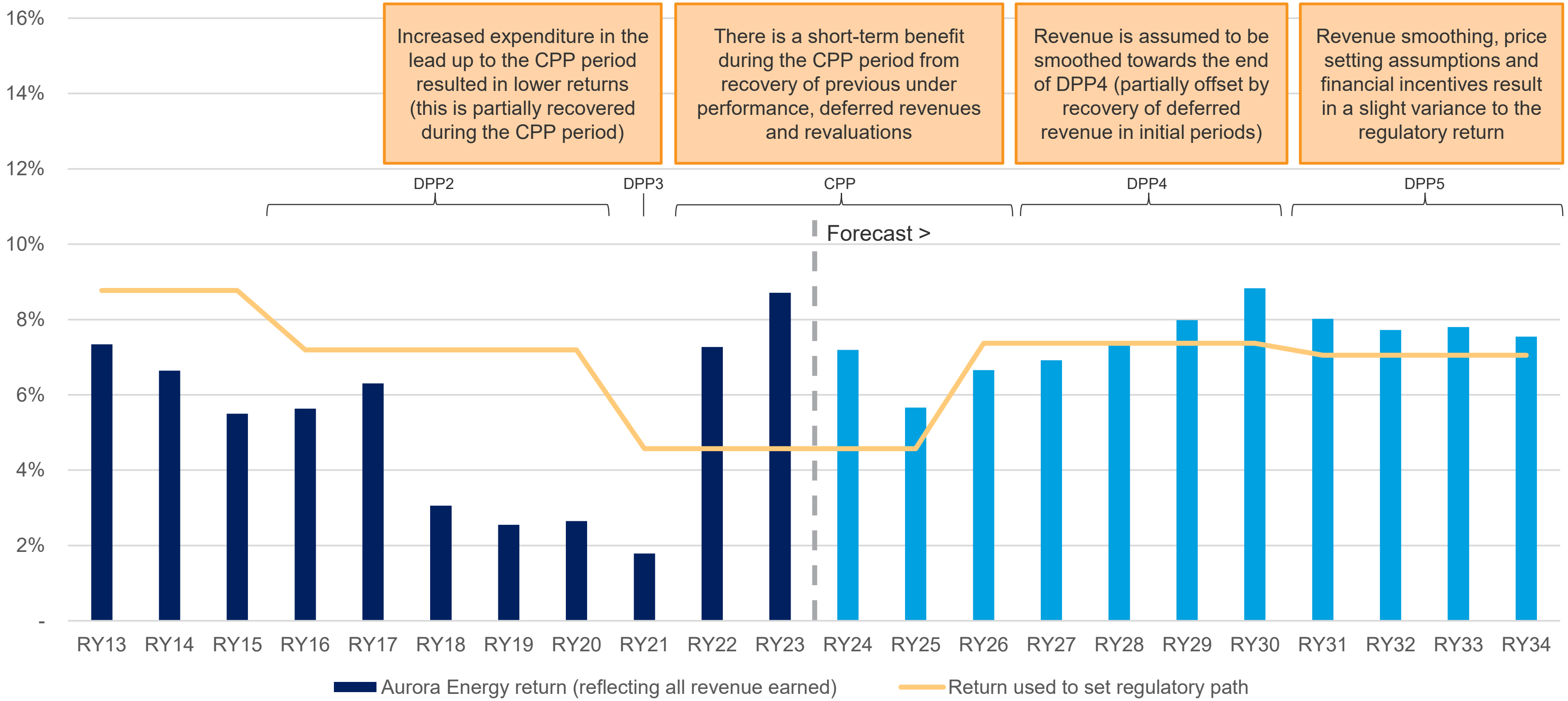
1. The regulatory return for the next DPP (DPP4) will be determined in September/October 2024. The ComCom's latest estimate for DPP4 is 7.4% which has been applied in the forecast. 2. Note there are other drivers of deviations such as regulatory vs actual gearing, actual versus default price path depreciation, actual inflation and other financial incentives. For simplicity, we've presented the key drivers of temporary deviations to regulatory return. 3. These relate to the Incremental Rolling Incentive Scheme and quality incentive adjustments

Profitability and cashflow generation

Return on assets

In the short-term, actual returns can differ from the regulatory returns due to a range of factors. However over the long-term, actual returns should revert to regulatory return levels

Aurora Energy return on assets vs regulatory return



The regulatory return is a measure of profit and is distinct to free cash flows (which are forecast to remain negative). This is discussed in subsequent slides

Profitability and cashflow generation

Regulatory return and shareholder cashflows

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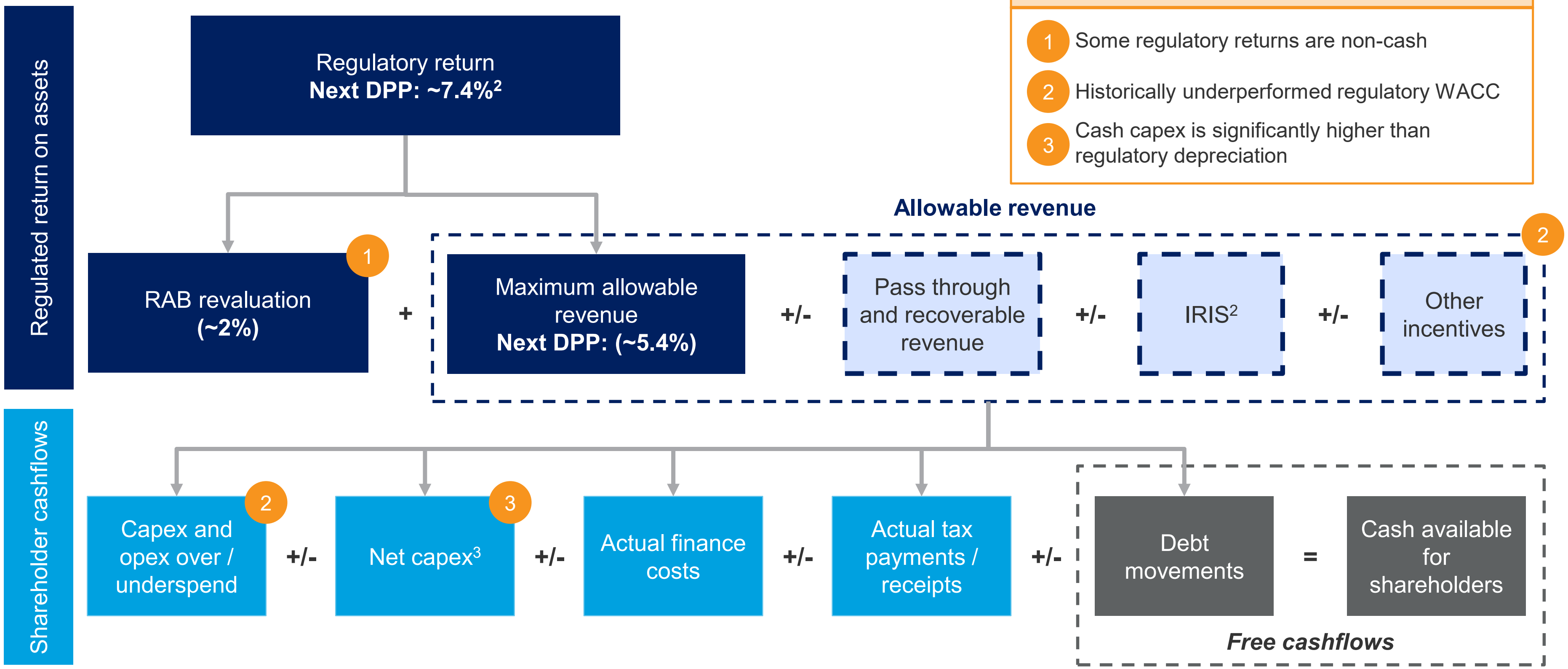
There are a number of factors that impact shareholder cashflows for a regulated business. A schematic showing the link between regulatory returns and shareholder cashflows is shown below. Two key factors impacting Aurora are discussed overleaf

High level schematic linking regulatory returns to shareholder cashflows[1]

Why is Aurora generating negative free cashflows?

1. Some regulatory returns are non-cash
2. Historically underperformed regulatory WACC
3. Cash capex is significantly higher than regulatory depreciation



1. Note: This is a simplified schematic showing average returns. Some factors such as current gearing, inflation, working capital, regulatory vs income tax have been ignored for this purpose. 2. Based on ComCom's estimate of the WACC for the regulatory period RY26 – 30. The final WACC will be determined in October 20242025 3. Defined as capex less regulatory depreciation. The regulatory regime provides a recovery of depreciation. Therefore there is a net cash outflow where capex exceeds depreciation (during periods of high capex) and net cash inflow where capex is less than depreciation (during period of low capex). 2. Incremental rolling incentive schemes (IRIS)

Profitability and cashflow generation

Regulatory return and shareholder cashflows

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<u>However, a regulatory return does not always translate to positive shareholder cashflows</u>

Aurora Energy is expected to incur significant negative free cash flows over the forecast period

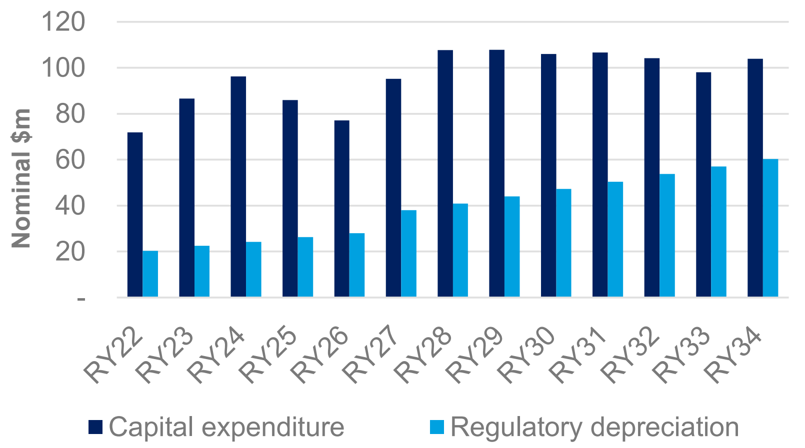
1 Some regulatory returns are non-cash

Regulatory return
Next DPP: ~7.4%[1]

RAB revaluation
(~2%)

Maximum allowable revenue:
(~5.4%)

2 Aurora Energy cash capex is significantly higher than regulatory depreciation allowance



The difference between capex and regulatory depreciation is reflected in free cash flows (see slide 18) and is distinct to the return shown on slides 13 & 14 which is a measure of profit

1. Based on ComCom's estimate of the WACC for the regulatory period RY26 – 30

Profitability and cashflow generation

Revenue and IRIS

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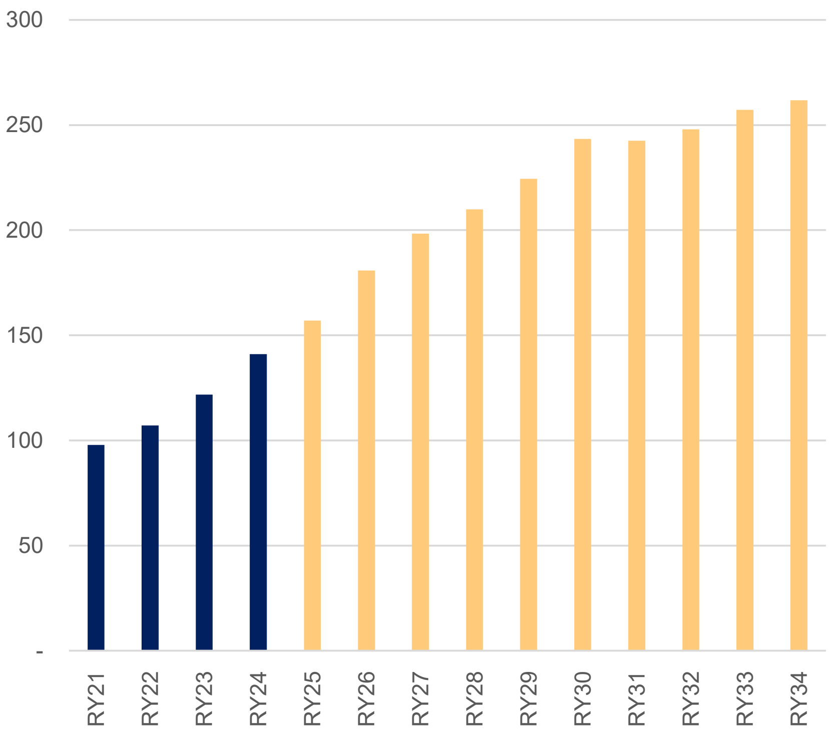
Significant investment prior to and during the CPP period supports higher regulated revenue. However, due to regulation, Aurora revenue increases are capped to 10% per annum. This deferred revenue will be unwound over the forecast period

Allowable revenue (nominal $m)



Deferred revenue

- Aurora Energy's allowable revenue is based on the ComCom's view of the efficient level of costs incurred by Aurora Energy to maintain its network at appropriate service standards
- As part of the CPP determination, the ComCom set a cap on the annual increase in revenue that Aurora Energy is allowed during the CPP period (at 10% per annum)
- This cap delays the recovery of costs. For clarification, we note:
  - **It is NPV neutral:** Any deferred revenue grows by the regulatory return percentage
  - **It is not additional profit:** It is simply a timing impact of when costs (including allowed regulatory returns / profits) are recovered
  - **Deferred revenue will be recovered during the forecast period:** The deferred revenue is included in the base case forecast in this report. As set out below, it is assumed to be fully recovered by 2030

Revenue wash-up – closing balance (nominal $m)

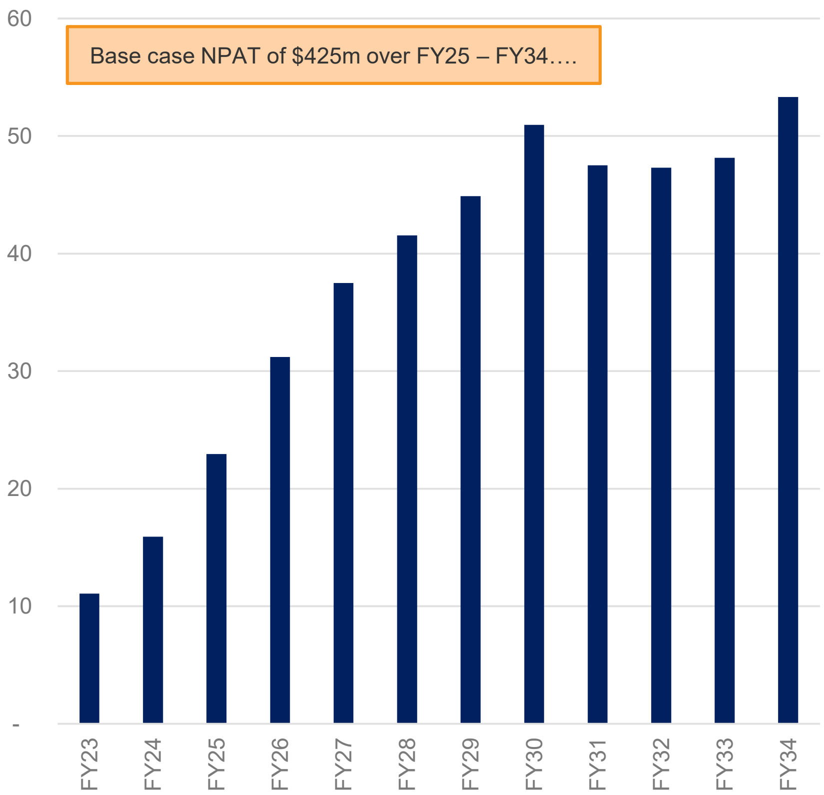
RY23	RY24	RY25	RY26	RY27	RY28	RY29	RY30
(1)	15	26	50	32	14	4	-

Profitability and cashflow generation

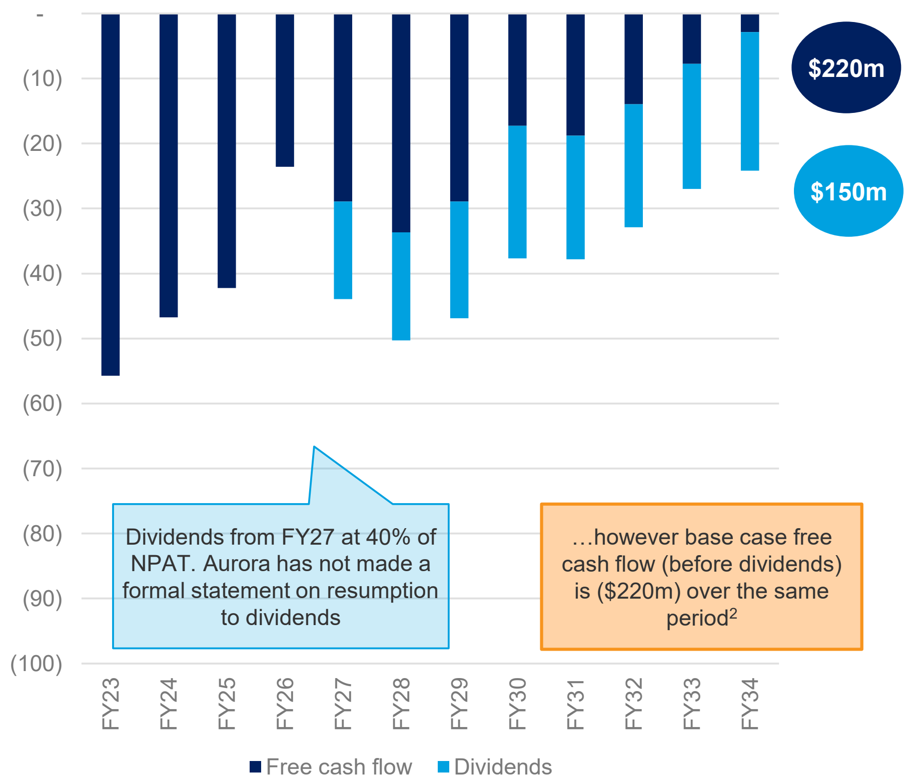
NPAT and free cashflows

Aurora Energy is expected to incur significant negative free cash flows over the forecast period. This will need to be funded via debt or equity

NPAT (nominal $m)



Free cash flows and dividends (nominal $m)[1]



1. Free cash flows are calculated as operating cashflows minus capex. 2. $370m after dividends

4

Debt levels and capacity

Debt levels and capacity

Key observations

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Aurora Energy's credit metrics

- Aurora Energy's ability to borrow is driven by (i) EDB credit metrics and (ii) DCC group credit metrics
- **EDB metrics:** Aurora Energy's leverage is one of the highest of EDB peers
  - Current funds from operations (**FFO**) / debt ratios are in line with an "aggressive" assessment by S&P
  - Ratios are forecast to remain relatively highly leveraged, albeit they improve over the next 10 years
- **DCC group credit metrics:** DCC ownership means council credit metrics are the key constraint
  - EDB's typically have a high debt to revenue (Aurora Energy: ~370%[1]). As such they can have a drag on council credit quality and ability to borrow
  - Based on DCC's latest inputs (provided in September 2024), group level debt to revenue is expected to grow materially and exceeds 240% from FY27/28 (in all scenarios). This would imply an S&P credit rating downgrade
  - This risk is exacerbated by S&P's current "negative outlook" for DCC's credit rating

Aurora Energy capital requirements

- On an absolute basis, Aurora Energy requires significant additional capital from DCC
  - The base case forecast sees Aurora Energy requiring **~$370m** of additional debt over FY25 - FY34 (~$220m excluding any dividends)
  - Combined with DCC's wider debt requirements, this sees total DCC debt increasing to $2.1b by FY31 (from $1.2b as at December 2023)
- Failure to support Aurora Energy's capital requirements will have implications on service quality and the ability of Aurora Energy to meet customer needs
  - It could also result in Aurora Energy incurring quality incentive adjustment penalties

1. As at FY23

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Debt levels and capacity

Aurora Energy's financing constraints

Aurora Energy's ability to borrow is driven by typical EDB financing ratios and DCC credit metrics

Aurora Energy's ability to borrow is driven by:

Aurora Energy credit metrics[1]

S&P primary ratios:
FFO / debt
Debt / EBITDA

Moody's primary ratios:
FFO / net debt
Net debt / RAB
Interest cover

Indicative credit rating	FFO / debt	Debt / EBITDA	Net debt / RAB	Interest cover
bbb- / bb+	<6%	>6x	>90%	1.1 - 1.4x
bbb	6 – 9%	5 – 6x	>75%	1.4 – 2.0x
a-	9 – 13%	4 – 5x	60 – 75%	2.0 – 3.5x
a+/a	13 – 23%	3 – 4x	45 – 60%	3.5 – 5.5x

Takeaway: Highly leveraged financial ratios create heightened financial risk for DCC as a shareholder

DCC credit metrics

S&P primary ratio:
Debt to revenue
(group level)

Internal limit:
Gross debt to revenue
(parent level)

LGFA limit:
Net debt to revenue

We've excluded these as internal limit is parent only and LGFA limit has flexibility to exclude subsidiary debt

Debt / revenue	Impact
>240%	**DCC ratings downgrade**
~200% - 240%	**Risk of DCC ratings downgrade** *Weakening financial risk position could trigger a lower "financial management" assessment. Note this is qualitative assessment. As such the range presented is indicative only and will ultimate be determined by S&P*

Takeaway: Where DCC's debt to revenue (group) trends towards 200%+, it has wider implications on DCC's borrowing capacity and credit rating

1. S&P and Moody's use other financial risk ratios and qualitative metrics to consider overall credit rating. However, we've presented the key metrics for simplicity.

Debt levels and capacity

Aurora Energy's credit metrics

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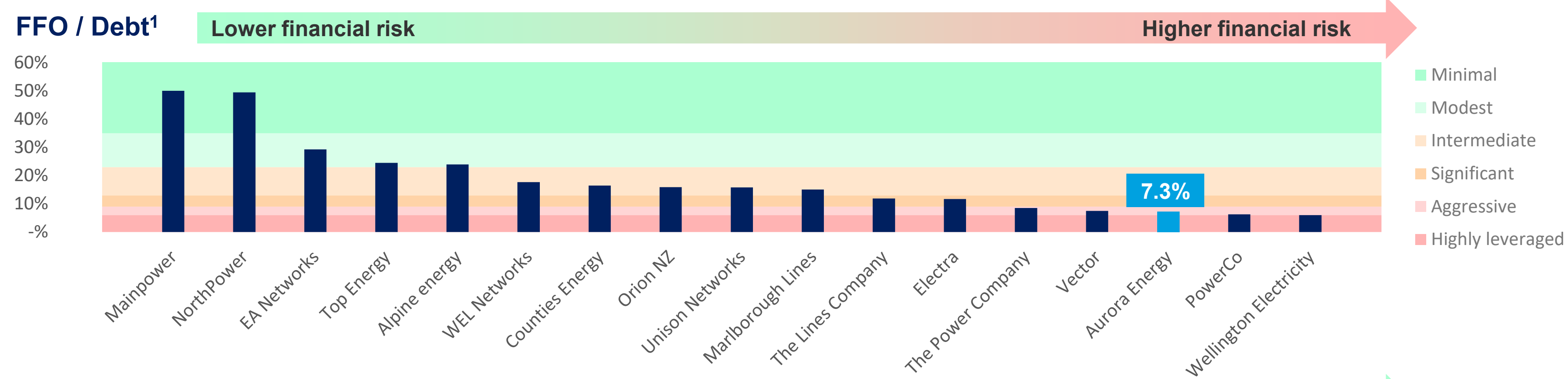
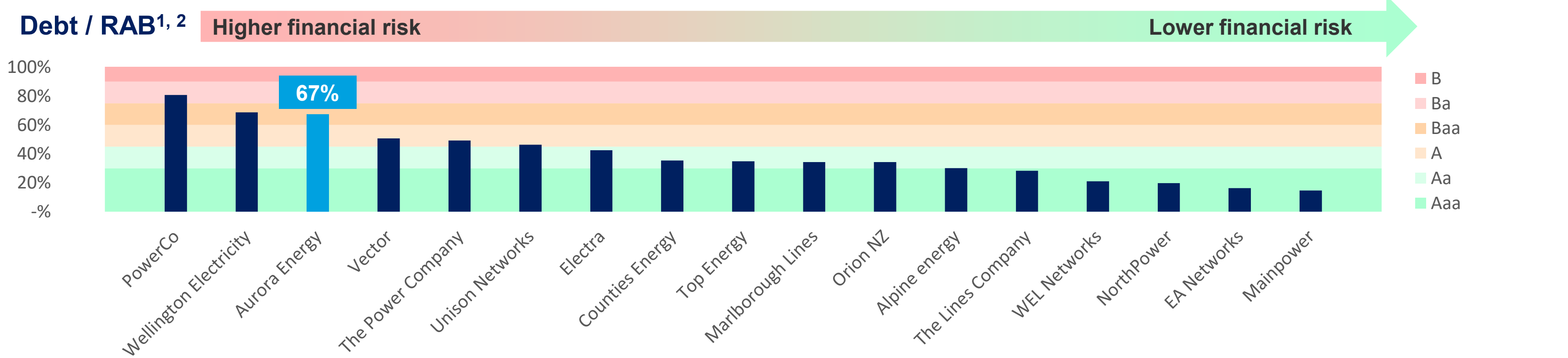
Aurora Energy is one of the most leveraged EDBs. Only privately held EDBs have higher leverage (which is facilitated by the private sector's ability to access capital)





1. The graphs comprise of EDBs with more than $200m of RAB. Metrics are based on the most recently available financial information. FirstLight has been excluded as there is no financial information post acquisition by Igneo. The implied credit rating ranges are indicative only as they don't consider other financial risk and qualitative assessment factors used by S&P / Moodys. 2. Where entities have a material asset base outside of the EDB sector and such information is disclosed (e.g. Vector, PowerCo, Northpower, Top Energy), Mafic has applied debt on a pro-rata basis based on EDB fixed asset and the other segment fixed assets.

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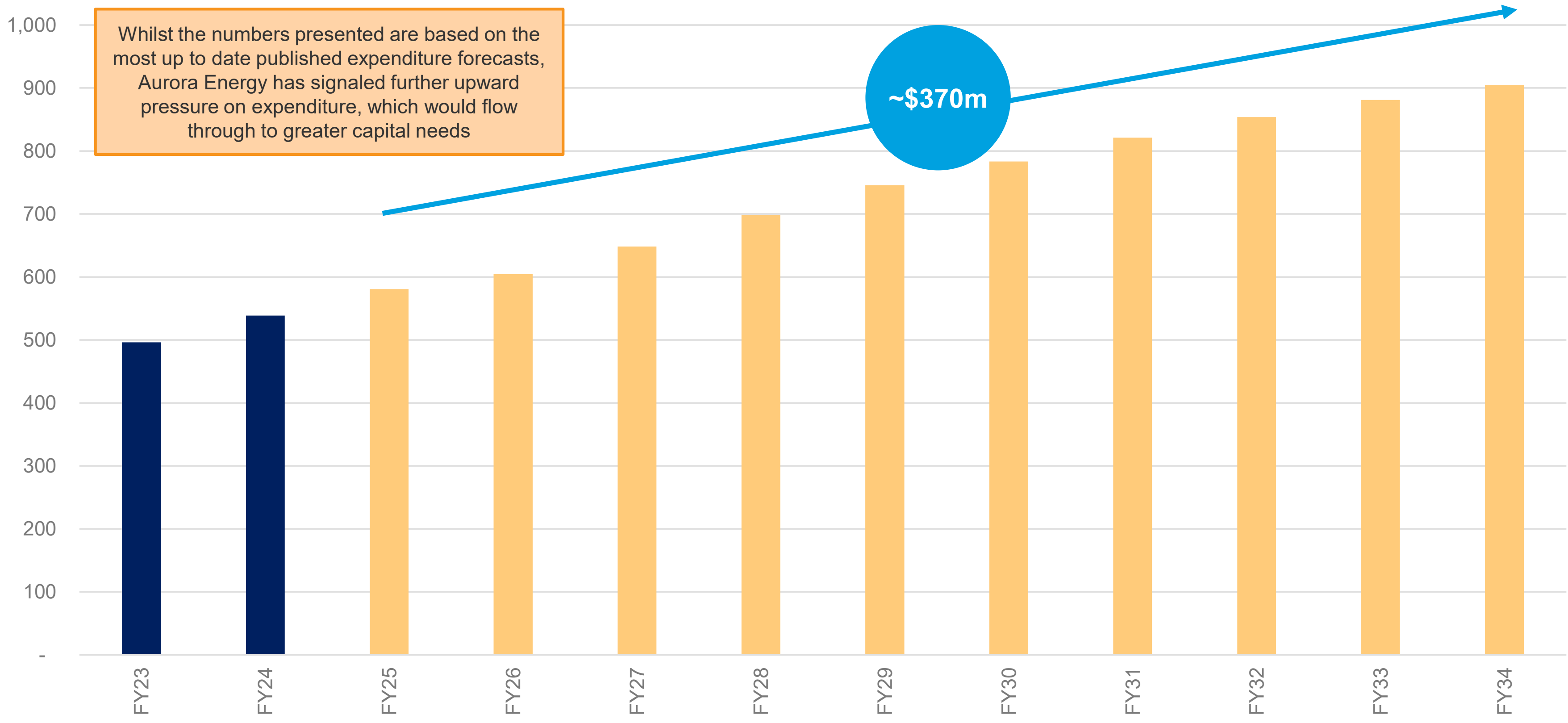
Debt levels and capacity

Base case Aurora debt requirements

Capex requirements are assumed to be funded through debt. This sees debt increasing by ~$370m over the forecast period to ~$900m by FY34

Debt balance (nominal $m)

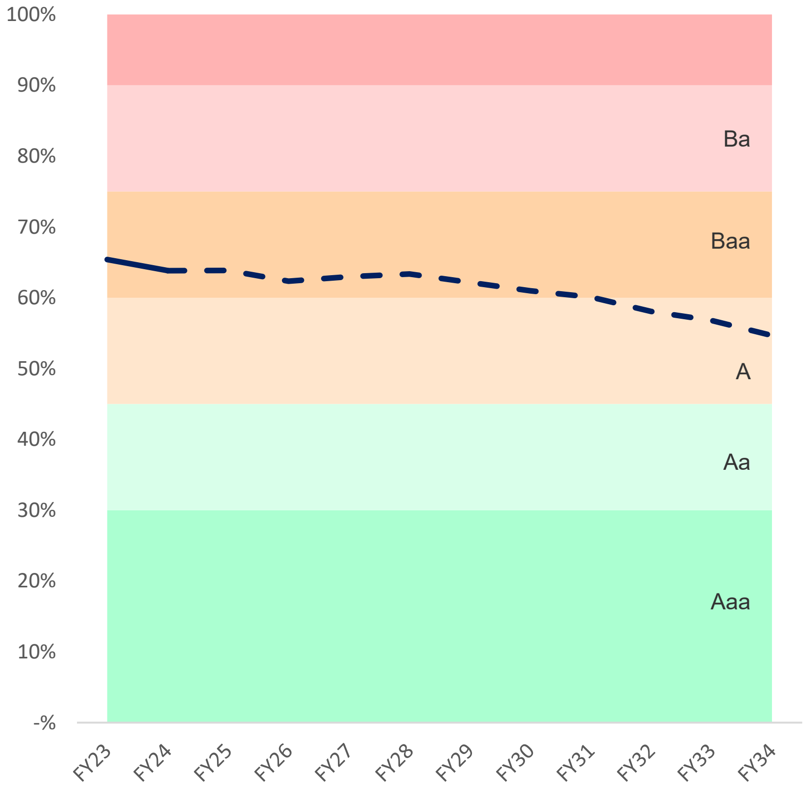


Debt levels and capacity

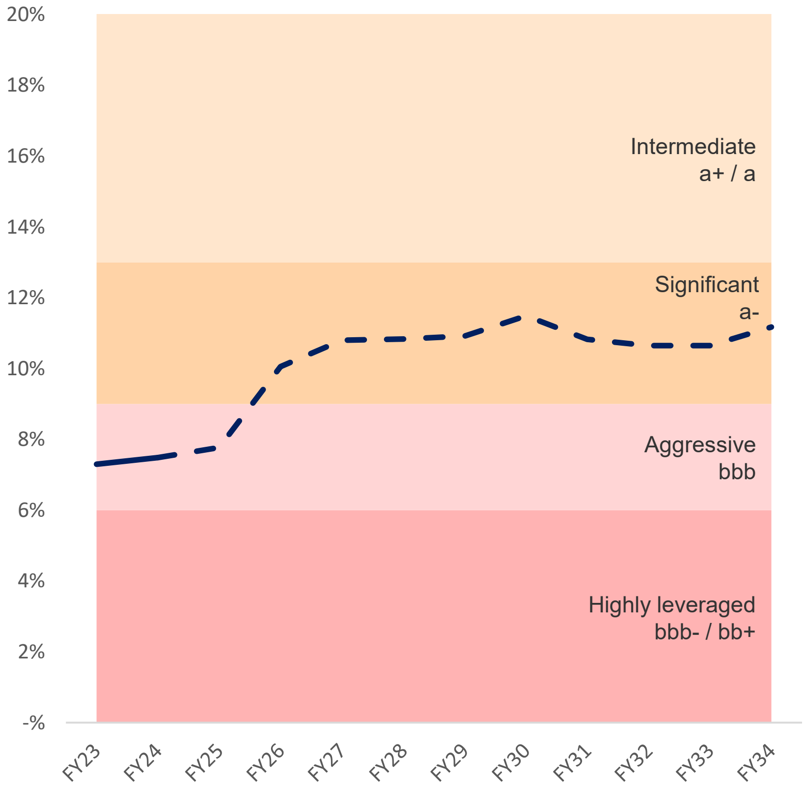
Aurora credit metrics overtime (base case)

On a standalone basis, Aurora Energy's credit metrics should improve overtime, albeit remains relatively highly geared versus peers

Net debt / RAB



FFO / debt[1]



1. FFO is calculated as EBITDA less customer contributions less cash interest less cash tax. Credit ratings shown assume an 'excellent' business risk profile.

Debt levels and capacity

Net debt to RAB scenario analysis

Under the sensitivities, the net debt to RAB remains within the range of 45%-60% in the outer years, except for the low risk-free rate sensitivity.

Net debt / RAB scenarios

	FY23	FY24	FY25	FY26	FY27	FY28	FY29	FY30	FY31	FY32	FY33	FY34
Base case	65.4%	63.8%	63.9%	62.3%	62.9%	63.4%	62.2%	61.0%	60.1%	58.1%	56.8%	54.7%
10% higher capex	65.4%	63.8%	63.9%	62.3%	63.6%	64.4%	63.5%	62.5%	61.8%	59.7%	58.6%	56.6%
10% lower capex	65.4%	63.8%	63.9%	62.4%	62.3%	62.3%	60.9%	59.5%	58.4%	56.4%	54.9%	52.6%
Low risk-free rate (2%)	65.4%	63.8%	63.9%	62.3%	64.4%	66.2%	66.1%	65.9%	65.7%	64.0%	63.2%	61.3%
High risk-free rate (7%)	65.4%	63.8%	63.9%	62.3%	61.8%	61.1%	58.8%	56.5%	54.5%	51.6%	49.5%	46.7%
$15m dividend payout	65.4%	63.8%	63.9%	62.3%	62.9%	63.2%	61.8%	60.2%	59.0%	56.7%	55.2%	52.7%

Key:
Financial risk profile (Moody's)

Aaa
Aa
A
Baa
Ba
Worse than B

Debt levels and capacity

FFO to debt scenario analysis

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Aurora Energy's financial ratios are exposed to increased capex and a lower risk-free rate

FFO / debt[1]

	FY23	FY24	FY25	FY26	FY27	FY28	FY29	FY30	FY31	FY32	FY33	FY34
Base case	7.3%	7.5%	7.8%	10.1%	10.8%	10.8%	10.9%	11.5%	10.8%	10.6%	10.6%	11.2%
10% higher capex	7.3%	7.5%	7.8%	10.1%	10.8%	10.6%	10.5%	11.0%	10.5%	10.2%	10.1%	10.5%
10% lower capex	7.3%	7.5%	7.8%	10.1%	10.7%	11.0%	11.3%	12.0%	11.2%	11.1%	11.2%	12.0%
Low risk-free rate (2%)	7.3%	7.5%	7.8%	10.1%	7.4%	7.3%	7.4%	8.0%	7.9%	7.9%	8.0%	8.5%
High risk-free rate (7%)	7.3%	7.5%	7.8%	10.1%	13.7%	14.0%	14.6%	15.7%	15.5%	15.4%	15.5%	16.5%
$15m dividend payout	7.3%	7.5%	7.8%	10.1%	10.8%	10.9%	11.0%	11.7%	11.1%	11.0%	11.1%	11.7%

Key:
Financial risk profile (S&P[2])

- Minimal (aaa / aa+)
- Modest (aa)
- Intermediate (a+ / a)
- Significant (a-)
- Aggressive (bbb)
- Highly leveraged (bbb / bb+)

Under the Base Case, the FFO to debt remains at the bottom end of peers. However, FFO to debt remains at or above the recommended minimum financial risk range of 6 – 9%, even under downside sensitivities.
We would also flag there is greater financial risk where Aurora Energy experiences a significant reduction to the risk-free rate

1. FFO is calculated as EBITDA less customer contributions less cash interest less cash tax. 2. Credit ratings shown assume an 'excellent' business risk profile.

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DCC credit metrics

Summary inputs

Since preparation of the July 2024 report, DCC has undertaken its own review of wider debt / capital requirements, potential DCC rate increases and applied a revised Aurora scenario. Following this exercise, DCC have prepared three scenarios set out below

DCC scenarios

	DCC parent inputs				DCHL level inputs			
	2026 rates increase	2027+ rates increase	Capex $m (2025-2034)	Opex $m (2025-2034)	Aurora dividends	Aurora scenario	Other DCHL subsidiary inputs	DCHL dividends to DCC
Scenario One	9.95%	5.9%	2,071	4,139	None	+10% capex	See below	$11m in 2026, none thereafter
Scenario Two	9.95%	5.9%	2,318	4,357	None	+10% capex	See below	$11m in 2026, none thereafter
Scenario Three	10.0%	10.0%	2,318	4,290	None	+10% capex	See below	$11m in 2026, none thereafter

DCC's scenarios assume no dividends are paid across the forecast period to FY34. This compares to an assumed 40% of NPAT from FY27 in this report (total Aurora dividends of ~$150m)

Other DCHL subsidiary inputs (excluding Aurora)

$m	FY26	FY27	FY28	FY29	FY30	FY31	FY32	FY33	FY34
DCHL debt	184	162	159	158	156	155	159	163	167
DCHL revenue	182	192	199	207	213	221	225	228	232

Debt levels and capacity

DCC (group) debt to revenue scenario analysis

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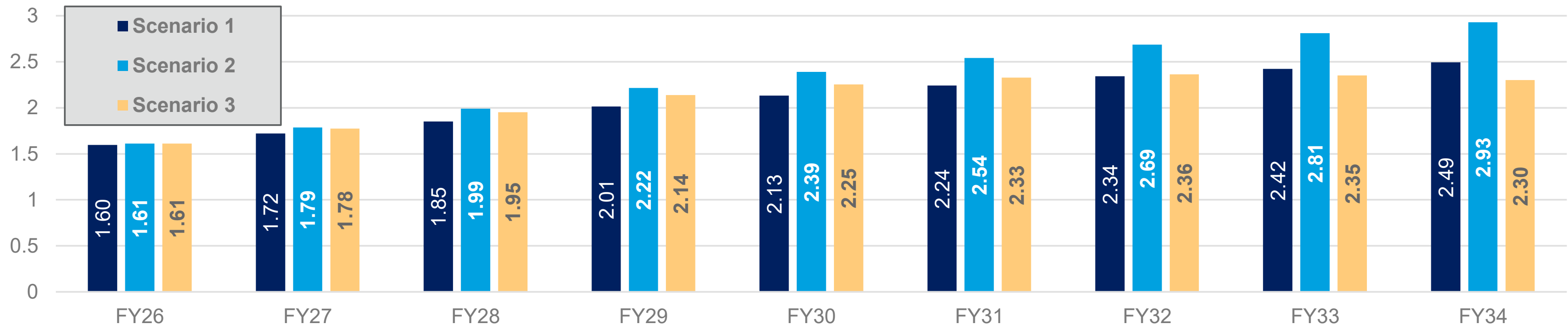
The below output shows the debt profile and credit metrics determined by DCC. DCC have utilised the Aurora inputs presented in this report, adjusting for assumption changes set out on the previous slide

Total debt balance, $m (DCC plus DCHL)



DCC (group) debt to revenue

	FY26	FY27	FY28	FY29	FY30	FY31	FY32	FY33	FY34
DCC scenario one	208%	213%	219%	227%	230%	234%	236%	236%	233%
DCC scenario two	209%	221%	235%	250%	257%	265%	271%	274%	274%
DCC scenario three	209%	217%	224%	231%	229%	226%	218%	205%	189%

Key: Debt burden assessment — Stable rating assessment — Risk of DCC ratings downgrade — DCC rating downgrade

Under all scenarios, debt / revenues trends towards 240% (versus FY23 debt / revenue of 188%). This could place some credit rating downgrade risk as S&P may apply a lower "financial management" assessment to DCC. Under scenario two, debt metrics exceed 240% implying a credit rating downgrade. Scenario 3, which sees 10% rate increases per annum, implies debt stabilising towards ~190% by 2034

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Sale considerations

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Sale versus retain

Below are some key considerations in relation to a retain versus sale of Aurora Energy

Consideration	Retain	Sale	Observations
Valuation	**N/A**	**Recent sales suggest a premium to RAB**	• Investors will utilise a long-term discounted cashflow forecast to value (i.e. they will "see through" short-term matters) • Recent transactions have achieved a premium to RAB, reflecting significant interest in the sector (this may not persist[1])
Debt requirements	**~$370m additional debt for Aurora Energy by FY34[2]**	**Lower DCC debt**	• Implied total DCC debt of $2.1b by FY31 (from $1.2b as at December 2023)
DCC access to debt / credit quality	**Weakening DCC group credit metrics**	**DCC capital structure rightsized. Headroom for future risks**	• Aurora Energy debt metrics are expected to remain highly leveraged relative to peers but appear to improve over time • Risk of DCC credit rating downgrade over time
Dividends	**Dividends are debt funded**	**Sale proceeds can be redirected into cashflow generating assets**	• A diversified portfolio is less vulnerable to severe losses or extended periods of low returns because not all investments will react in the same way to market volatility
Control of EDB infrastructure	**Retained**	**Regulatory framework mitigates risk**	• The regulatory framework incentivises investment (via return on RAB) and performance • Revenue already capped by regulation
Portfolio	**Concentrated**	**Diversified, liquid assets**	• Aurora Energy represents ~54% of DCHL subsidiaries asset base[3]

1. Factors such as investor appetite, cost of capital and regulatory changes could impact future valuations. 2. When compared to FY24. 3. Calculated based on 2023 asset book values of all subsidiaries as disclosed in DCHL's annual report (comprising Aurora Energy, City Forests, Delta, Dunedin Railways, Dunedin Stadium, Dunedin Venues Management and Dunedin International Airport)

Aurora Energy sale options

We have provided a high-level comparison of various sale options against criteria that may be important for DCC / DCHL

Criteria	Status quo (retain)	Minority sale (<50%)	Majority sale (50.1%+)	Full sale (100%)	Central Otago only
Value maximisation: Maximises sale value		Likely passive investors and discount for lack of control	Smaller size will limit appetite from highest value investors. Discount for lack of control	Likely delivers the highest upfront valuation due to control premium and scale	Smaller scale[1] will likely limit to existing marker participants, which may not be highest value
Execution risk Transaction certainty and investor appetite	N/A	Governance rights and minority control will be impediment to attracting interest	Smaller size and lack of control will limit the suite of investors	Expect greater certainty as transaction is free from complexities of governance arrangements with DCHL	Complexities of asset / business / systems separation
DCHL control Governance / voting rights		Control retained; however incoming investor will require governance rights	Reduced control for DCHL (particularly to deliver balance sheet separation)	No residual control of Aurora Energy	No control of Central Otago but Dunedin assets retained
DCC credit quality Impact on DCC credit quality and ability to access debt		Unlikely to deliver balance sheet separation. Limited proceeds	Has potential to deliver balance sheet separation. Will still need to fund share of capital going forward	Delivers significant proceeds to right size DCC's capital structure	Partially reduces debt but also sees a corresponding reduction to revenue and RAB. No balance sheet separation
Value adding ownership Incoming investor can help deliver operating / oversight value to Aurora Energy		Incoming investor can bring governance / oversight, albeit likely to be less experienced, passive investors	Can bring sector experience but will require sufficient control to properly deliver	N/A as Aurora Energy fully sold. Note, ability to add value will be reflected in bidder purchase price	Reduces scale of residual business and, as a result, access to workforce

Attractiveness to criteria: Low Mid High

Partial network sale

A divestment of part of Aurora's network, such as Central Otago, may enable DCC to retain control of residual assets. However, we believe there are some major disadvantages to a partial sale

Consideration	Key implications
Reduced investor set and relative valuation implications	• A partial sale would involve the sale of a smaller network (e.g. Central Otago and Queenstown have a RAB of ~$388m) • The smaller size would likely reduce the investor pool (as many target investors are seeking a larger scale opportunity in New Zealand, commensurate with the total Aurora asset base). This presents a risk to the sale premium to RAB (versus a full sale of Aurora Energy)
A sub-scale residual business may have operational challenges	• The smaller size may have implications on access to quality staff and contractor negotiating power • It may also limit Aurora Energy's ability to deliver quality services in an environment of change (technology changes arising from a "smart grid", managing increasing intermittent generation, increased resiliency arising from climate change demands)
Residual business would face a higher cost base which could have consumer pricing implications	• Aurora Energy's fixed costs base would be spread over fewer customers • This may necessitate a higher allowable revenue per customer to recover these costs
Complexities in splitting the business	• There will be complexities in splitting the two businesses (e.g. recruitment of new head office, transition of IT / systems) • This likely has timing and deliverability implications with respect to a sale
Less meaningful impact on DCC ratios	• The residual business would continue to put upward pressure on DCC group debt / revenue

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Post 2034 forecast

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Post 2034 forecast

Assumptions and capital requirements

Mafic has undertaken high level analysis to illustrate the potential impact beyond 2034, based on the following simplifying assumptions

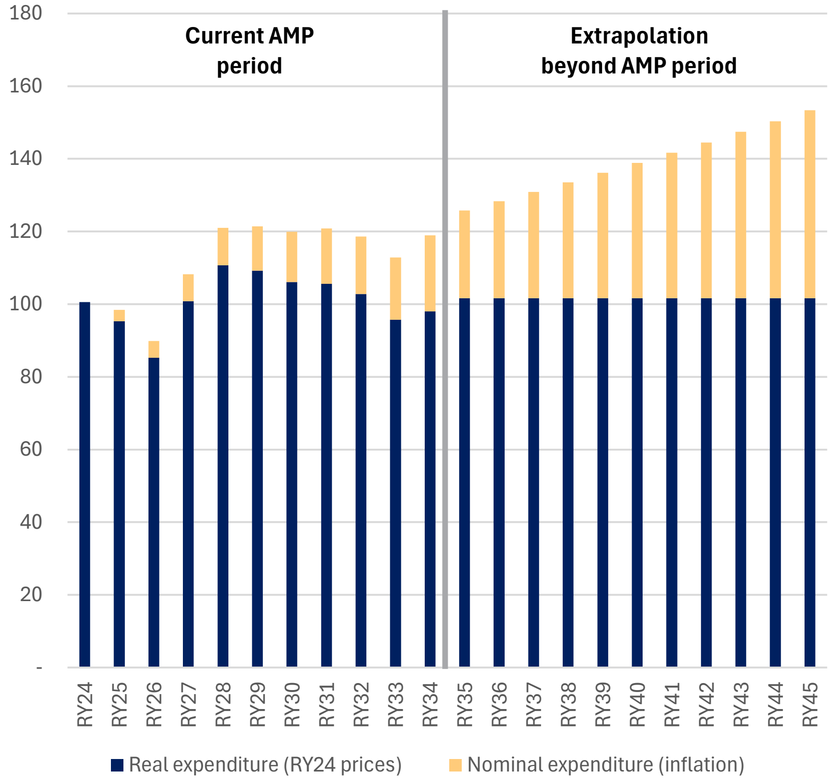
Aurora Energy forecast

- Key assumptions
  - — Risk free rate of 4.2% applied (same as the DPP5 assumption)
  - — Capital expenditure based on RY30-RY34 average (in real terms)
  - — Depreciation based on RY34 ratio (depreciation / opening balance)
  - — Operating expenditures increase with inflation (2% per annum)
  - — Borrowing costs of 5.3% (consistent with the regulatory return assumptions)
  - — Dividends are set at 40% of NPAT
- Assumptions applied prior to FY34 are outlined on page 5

DCC financials

- DCC level debt and revenue have been extrapolated beyond FY31 assuming:
  - — Operating revenues increase with inflation (2% per annum)
  - — Debt levels increase with inflation (2% per annum)
- Assumptions applied prior to FY31 are outlined on page 5

Gross capex profile ($m)[1]



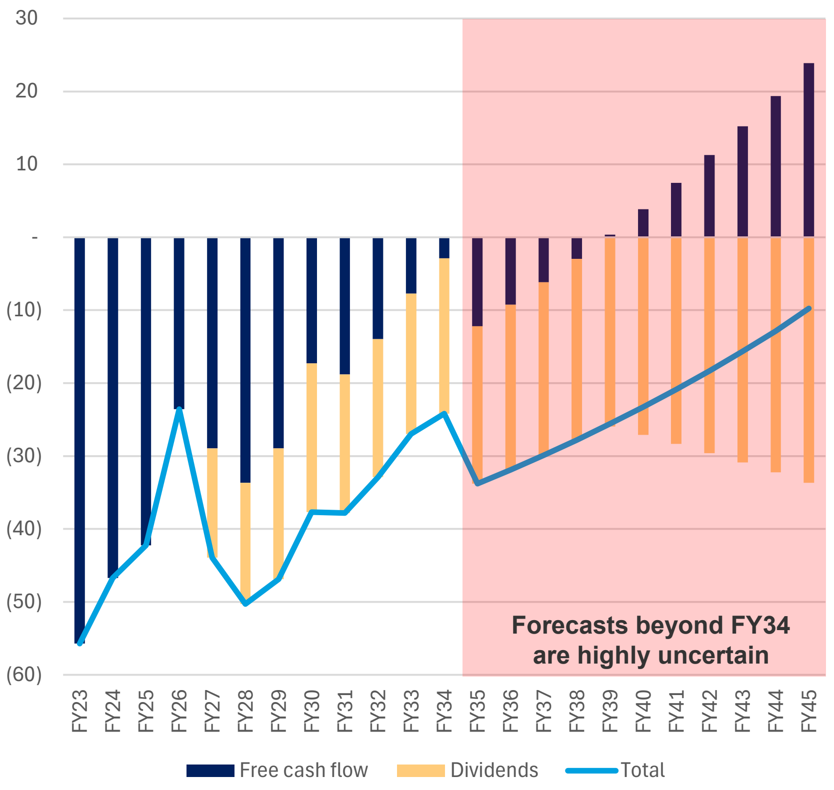
1. Based on regulatory year end (March). Gross of customer contributions.

Post 2034 forecast

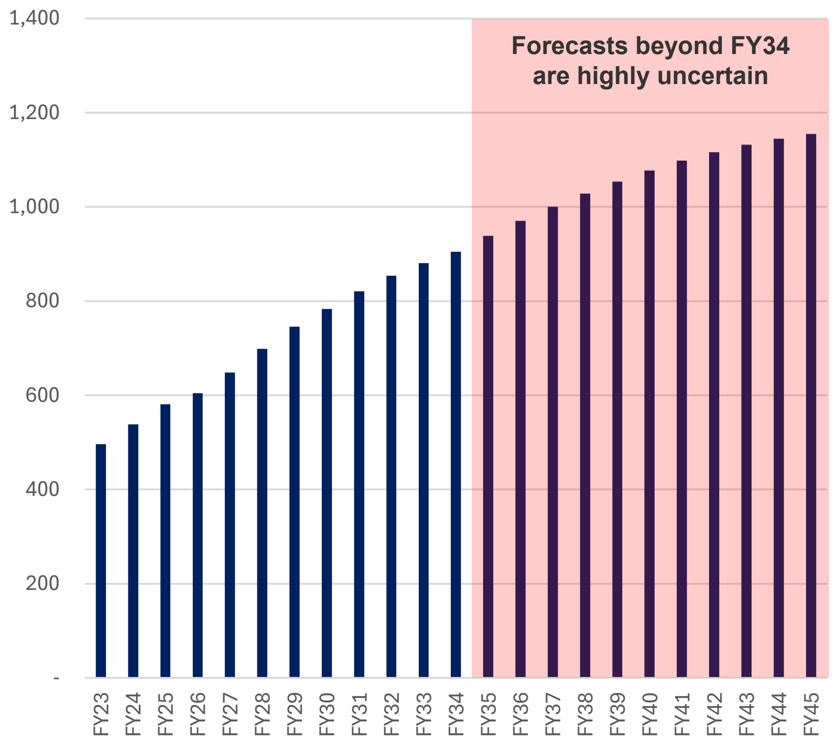
Cashflow generation and debt

Free cash flows (before distributions) are positive from 2040, albeit there is considerable uncertainty that far out. Distributions continue to be debt funded out to FY45, with debt levels growing to ~$1.2b

Free cash flows and dividends (nominal $m)[1]



Debt balance (nominal $m)



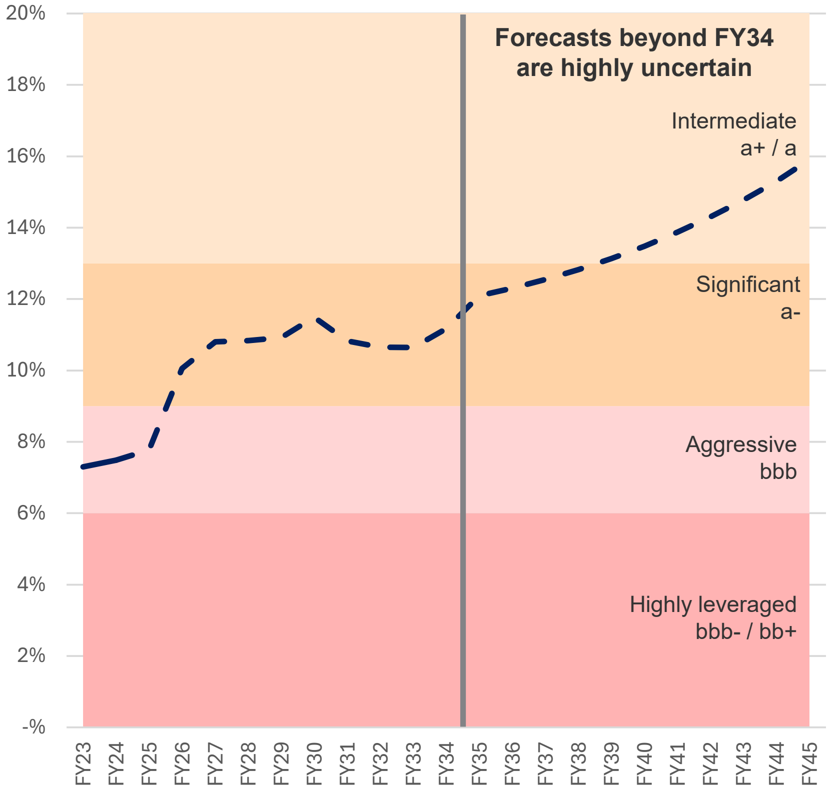
1. Free cash flows are calculated as operating cashflows minus capex.

Post 2034 forecast

Aurora credit metrics overtime

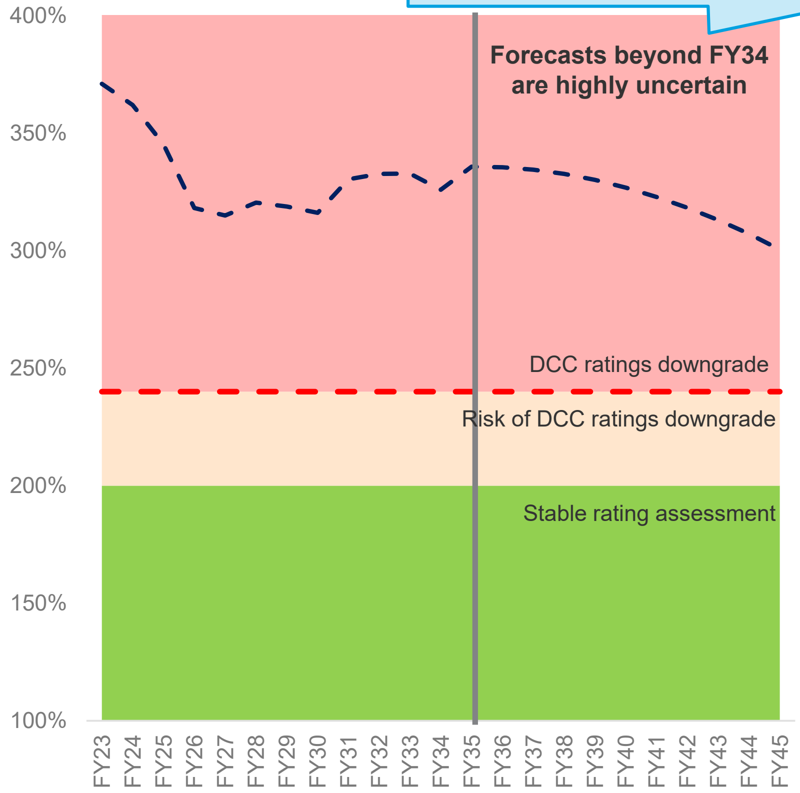
We have undertaken a high level forecast of Aurora credit metrics beyond 2034. While EDB credit metrics improve overtime, its debt / revenue will continue to have a drag on DCC group level debt metrics

FFO / debt[1]



Aurora debt / revenue

Aurora's debt / revenue will continue to have a drag on council credit metrics, with Aurpra debt / revenue exceeding 300% over the forecast



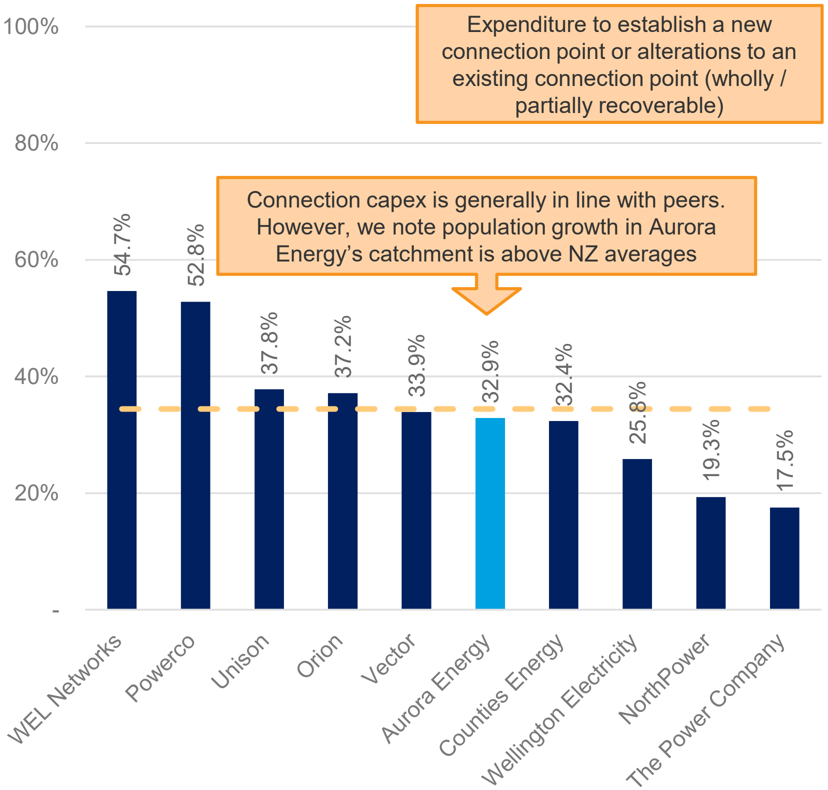
1. FFO is calculated as EBITDA less customer contributions less cash interest less cash tax. Credit ratings shown assume an 'excellent' business risk profile.

A
APPENDIX
Capex benchmarking

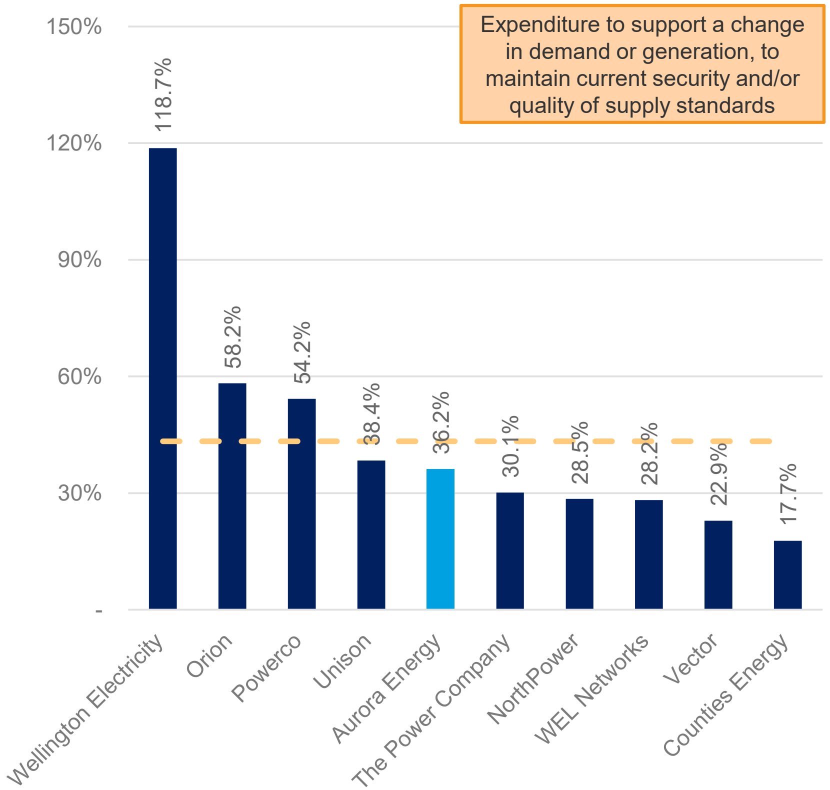
Capex benchmarking (1 of 3)

Aurora Energy's forecast expenditure on consumer connections and system growth is below the average for its peers

Consumer connection capex[1]
(RY24-RY34 nominal expenditure as a % of RY23 RAB)



System growth capex[1]
(RY24-RY34 nominal expenditure as a % of RY23 RAB)

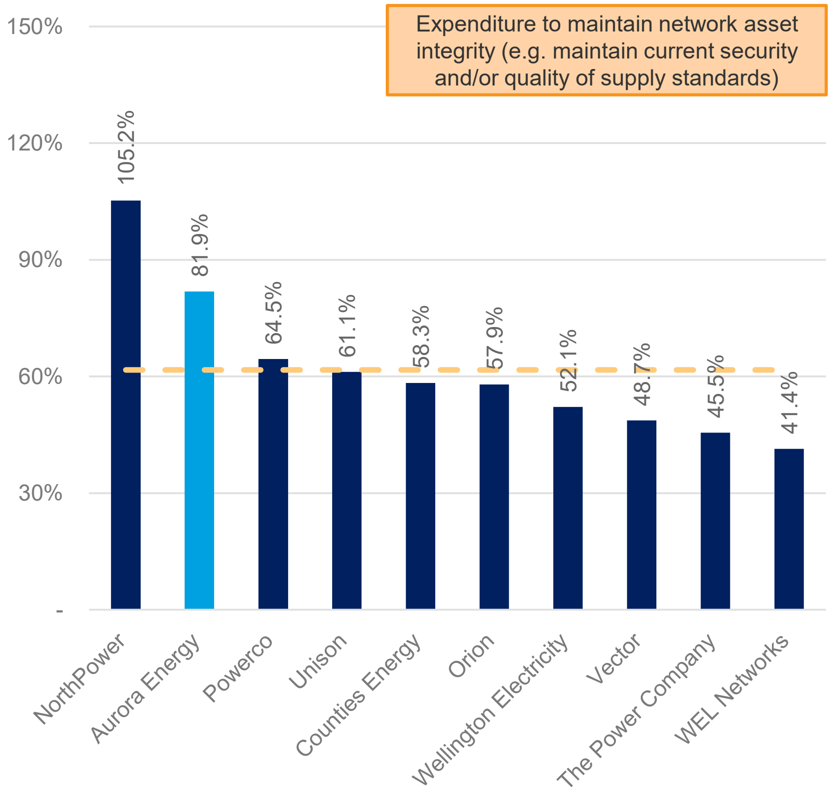


1. Based on latest Asset Management Plans of 10 largest EDBs (by RAB)

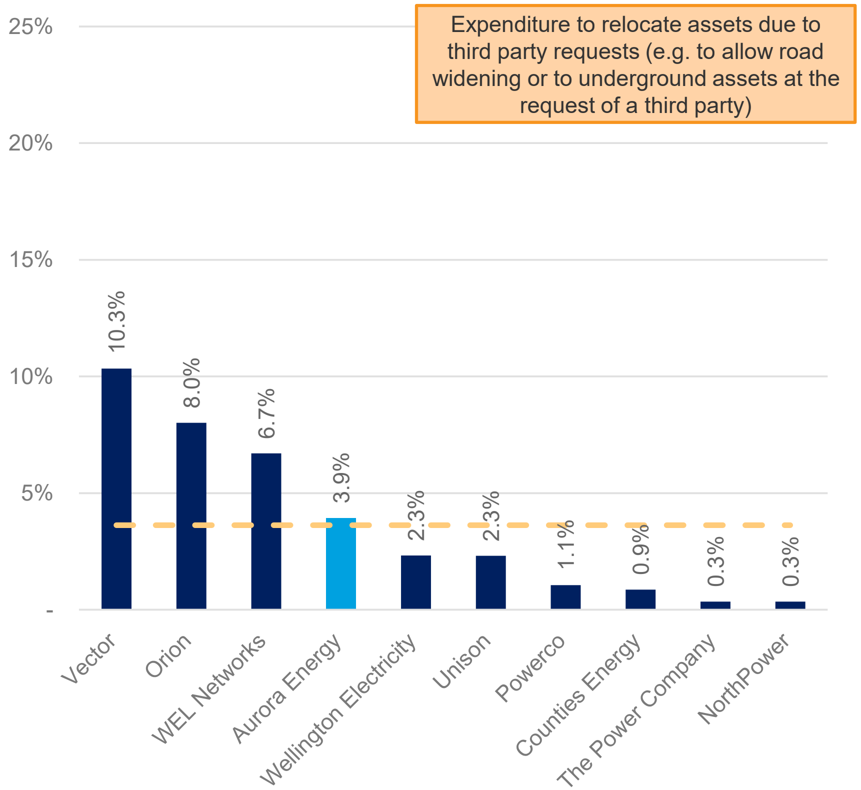
Capex benchmarking (2 of 3)

Aurora Energy's forecast expenditure on asset replacement and relocations is above the average for its peers

Asset replacement and renewal capex[1]
(RY24-RY34 nominal expenditure as a % of RY23 RAB)



Asset relocations capex[1]
(RY24-RY34 nominal expenditure as a % of RY23 RAB)

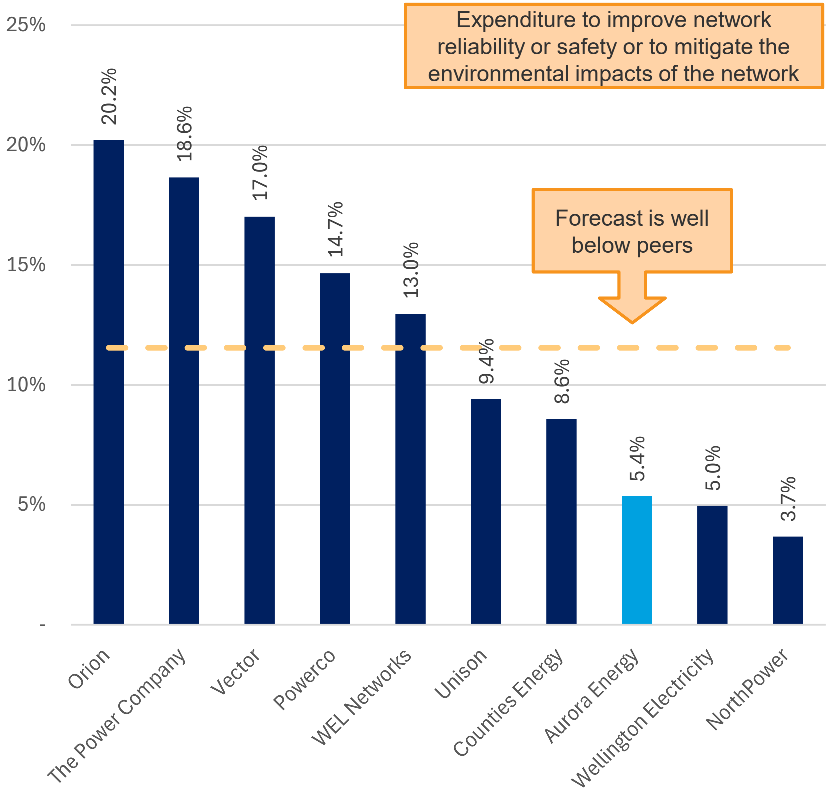


1. Based on latest Asset Management Plans of 10 largest EDBs (by RAB)

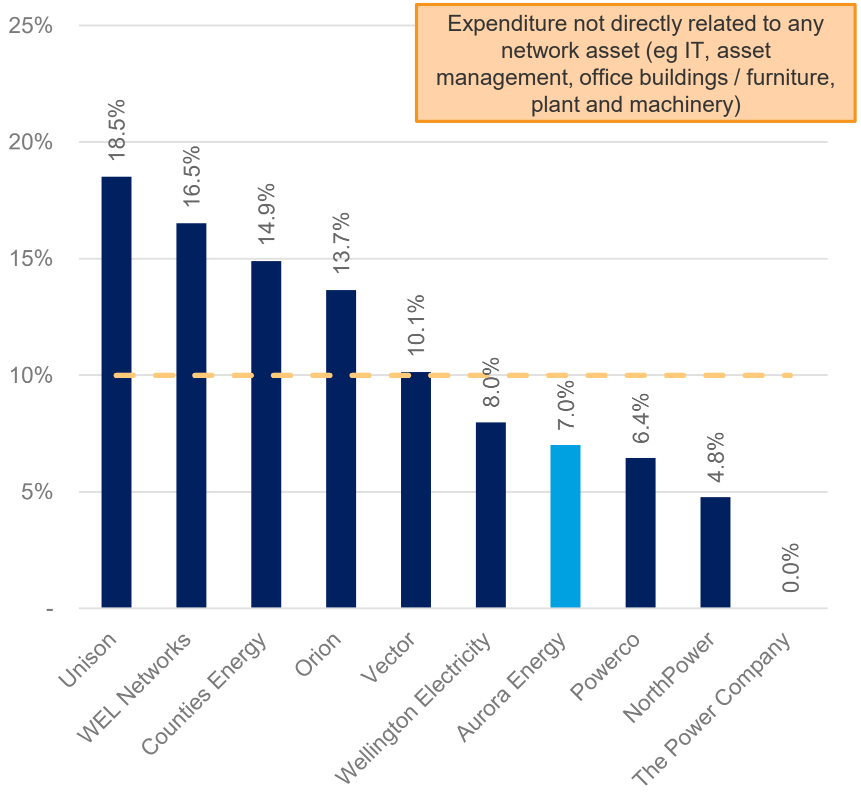
Capex benchmarking (3 of 3)

Aurora Energy's forecast expenditure on reliability and non-network is below the average for its peers

Reliability, safety and environment capex[1]
(RY24-RY34 nominal expenditure as a % of RY23 RAB)



Non-network assets capex[1]
(RY24-RY34 nominal expenditure as a % of RY23 RAB)



1. Based on latest Asset Management Plans of 10 largest EDBs (by RAB)

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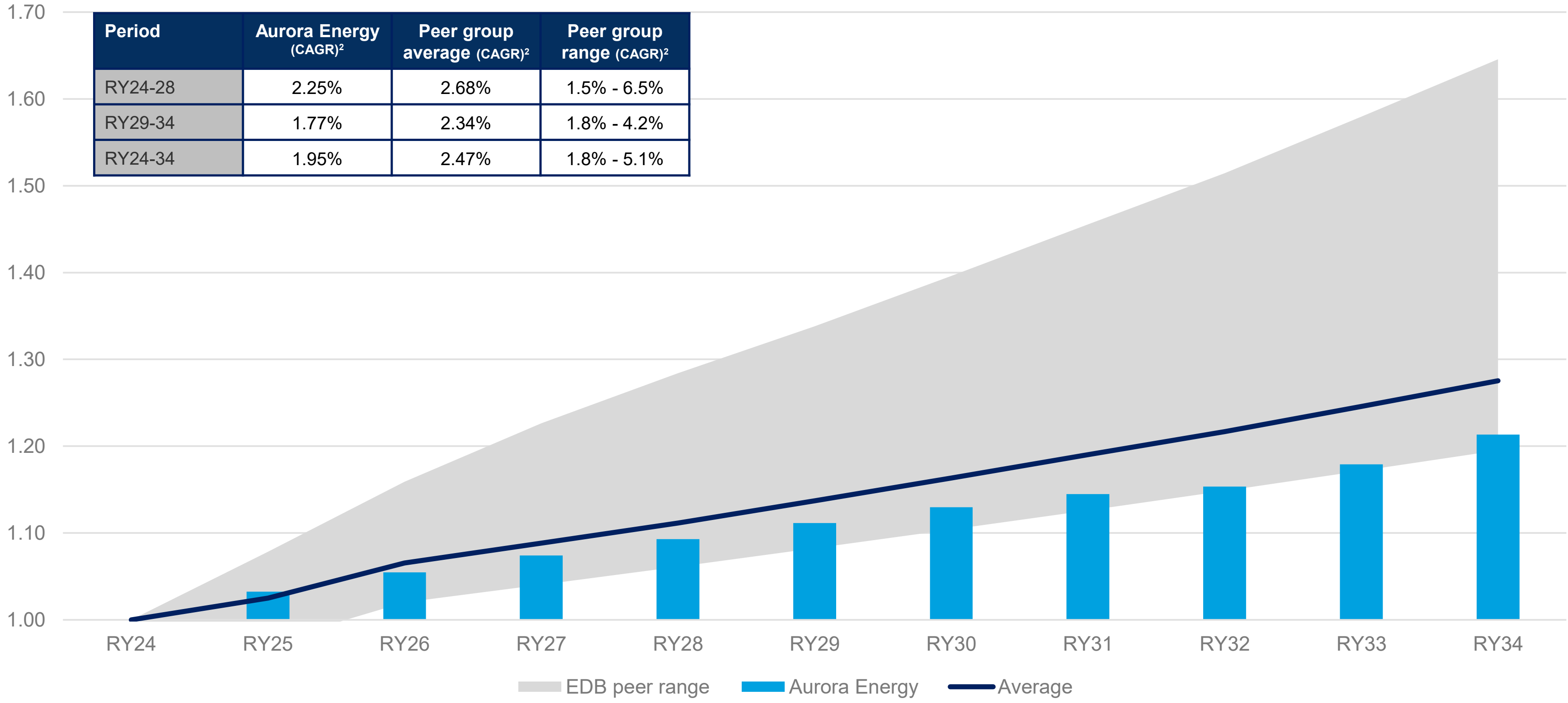
Capex inflation benchmarking

Cost inflation is a key driver of capex spend. Aurora Energy's price growth assumption is below peers

Capital expenditure inflation[1]

Period	Aurora Energy (CAGR)[2]	Peer group average (CAGR)[2]	Peer group range (CAGR)[2]
RY24-28	2.25%	2.68%	1.5% - 6.5%
RY29-34	1.77%	2.34%	1.8% - 4.2%
RY24-34	1.95%	2.47%	1.8% - 5.1%



1. Based on latest Asset Management Plans of 10 largest EDBs (by RAB). 2. Compounded annual growth rate (CAGR)

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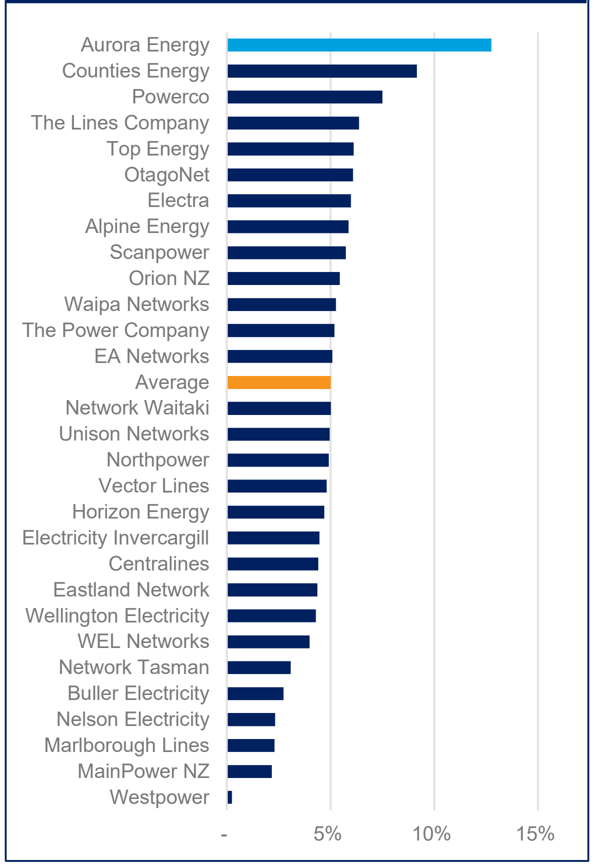
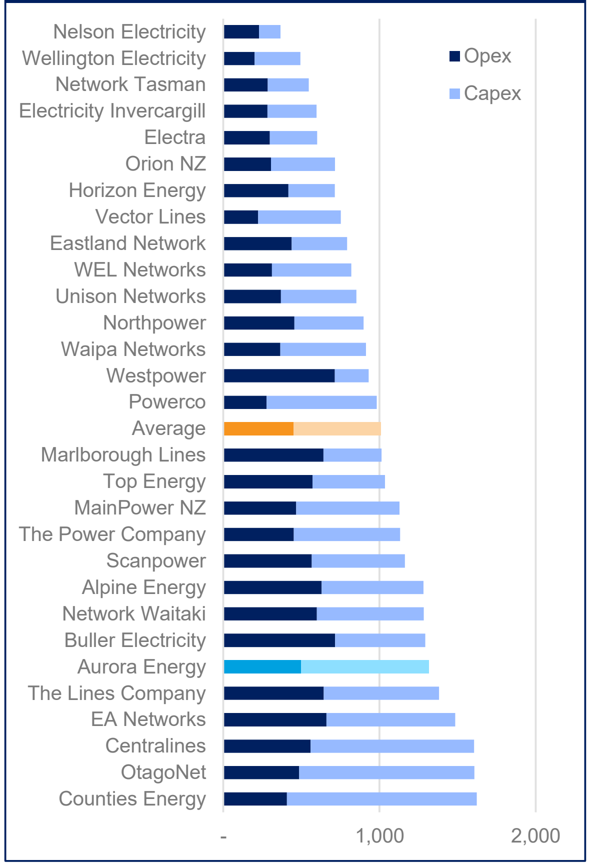
Capex and cost base benchmarking

Aurora has experienced the highest RAB CAGR in recent years

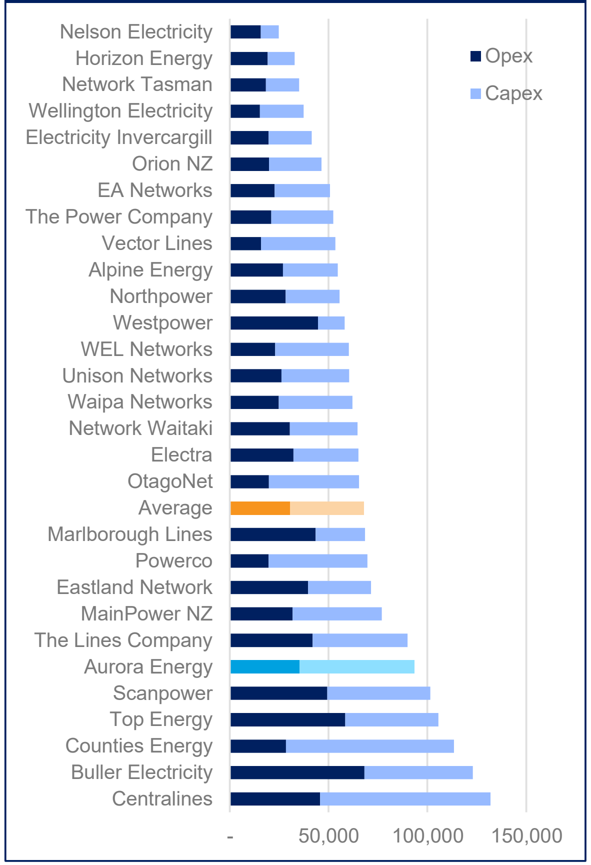
RAB CAGR (last 5 years)[1]



Opex and capex efficiency ($/connection)[2]



Opex and capex efficiency ($/GWh of generation)[2]



1. Source: Commerce Commission. For the period 2018 – 2022. 2. Source: Commerce Commission. Average annual opex/capex over 2021 and 2022

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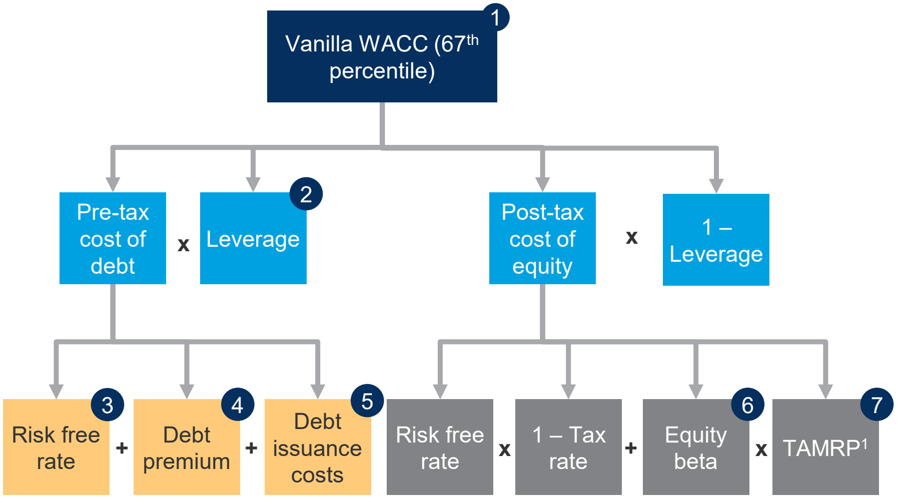
B
APPENDIX
Profitability and shareholder returns

Breakdown of regulatory WACC

The calculation of regulatory WACC is defined by the ComCom (summarised below)

Components of regulatory WACC



1. Calculated as mid-point WACC + 0.385 x standard error (standard error is 0.0108)
2. Notional leverage of 41% is applied
3. NZ government bond rates during the price path period (i.e. 5 years)
4. Based on margins on corporate bonds with an S&P credit rating of BBB+
5. Annual debt costs 0.20% per annum
6. 0.61 assumed based on long-term empirical evidence
7. 7% assumed based on long-term empirical evidence

Regulatory WACC

DPP price path	DPP2	DPP3	DPP4[2]	DPP5[3]
Period	**RY16 - 20**	**RY21 – 25**	**RY26 – 30**	**RY31 – 35**
Risk free rate	4.09%	1.12%	4.53%	4.21%
Equity Beta	0.61	0.60	0.61	0.61
TAMRP	7.00%	7.00%	7.00%	7.00%
Debt premium (incl. issuance costs)	2.00%	1.80%	1.59%	1.47%
Leverage	44%	42%	41%	41%
Tax	28%	28%	28%	28%
Vanilla WACC (mid-point)	6.72%	4.13%	6.95%	6.64%
Vanilla WACC (67th percentile)	**7.19%**	**4.57%**	**7.37%**	**7.05%**

1. Tax adjusted market risk premium. 2. The regulatory WACC for DPP4 will be determined in September/October 2024. The ComCom's estimate for the next DPP is 7.37% which has been applied in the forecast. 3. The base case forecast assumes a 7.05% regulatory WACC for DPP5.

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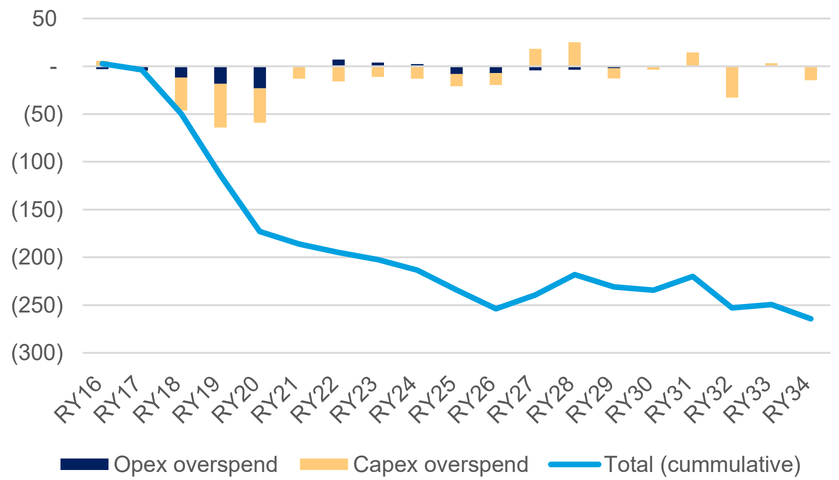
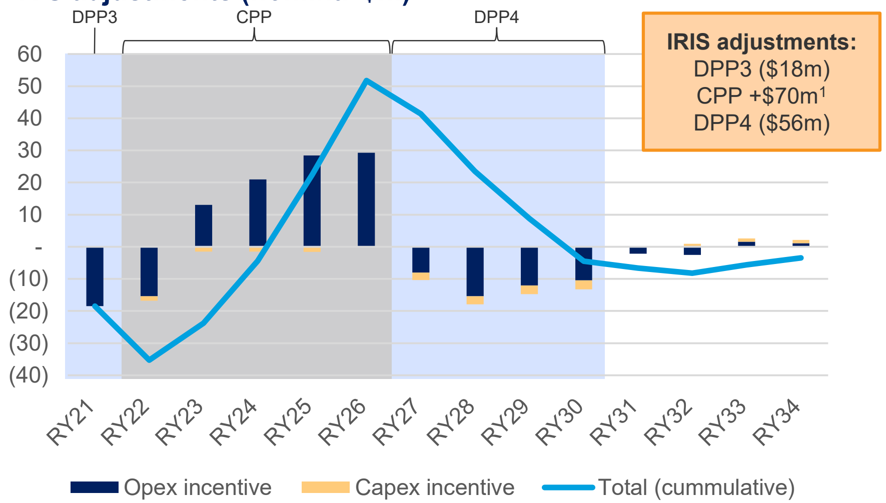
Overspend and IRIS penalties

From a net present value perspective, capex and opex over / under spend and IRIS penalties have a permanent impact on EDB's in line with the incentive rate (23.5% for the CPP period)

Capex and opex over / under spend (nominal $m)



IRIS adjustments (nominal $m)[1]



Capex and opex over / under spend	IRIS adjustments
• While the regulatory regime is designed to allow EDBs to recover costs over the long-term (less incentive rates applied to over / under spend), short term cash flow impacts can be material • Capex and opex over / under spend is not reflected in regulated revenue allowances until the subsequent regulatory period • The EDB therefore doesn't generate a regulatory return during the DPP period, creating a short-term cash flow impact (which can be material)	• The IRIS mechanism works by sharing a proportion of over / under spend between the EDB and consumers over time • IRIS adjustments have a permanent cashflow impact (ie adjustments are not offset in future periods) • IRIS adjustments are designed to bring the overall recovery of opex and capex over / under spend in line with the incentive rate (when taking into consideration the over / under spend and future revenue impacts)

1. The positive opex IRIS adjustment during the CPP may appear counterintuitive considering Aurora Energy overspent its allowance during DPP2 and the one year of DPP3. However, this removes potentially perverse incentives when moving onto a CPP as during the DPP periods prior to the CPP, Aurora Energy will have borne a greater proportion of overspends than was intended under the Input Methodologies (Ims), and so is able to recover some of this expenditure back from consumers during the CPP period.

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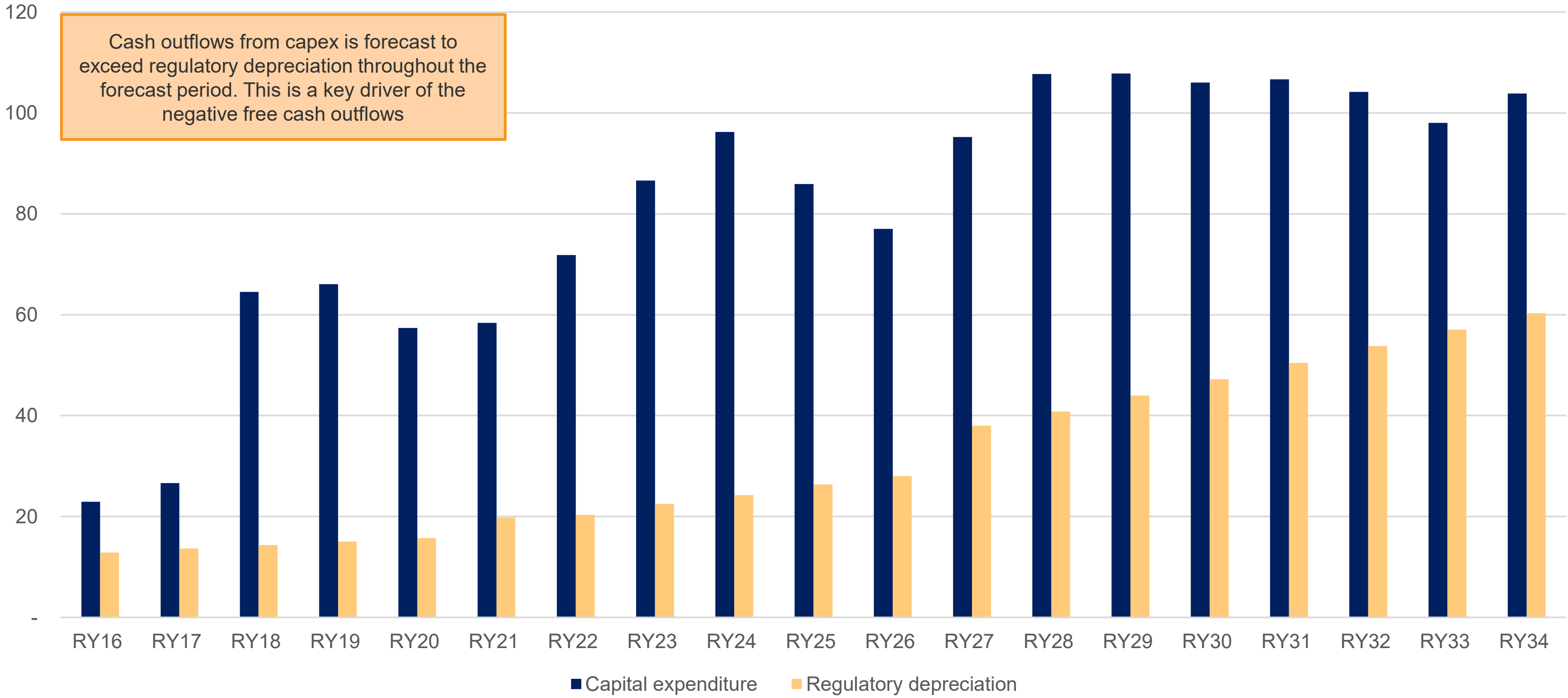
Depreciation vs capex

Due to Aurora Energy's recent period of high capex, capex outflows are expected to materially exceed regulatory depreciation. This is a key driver of the disconnect between profitability and shareholder cashflows

Regulatory depreciation versus cash capex (nominal $m)

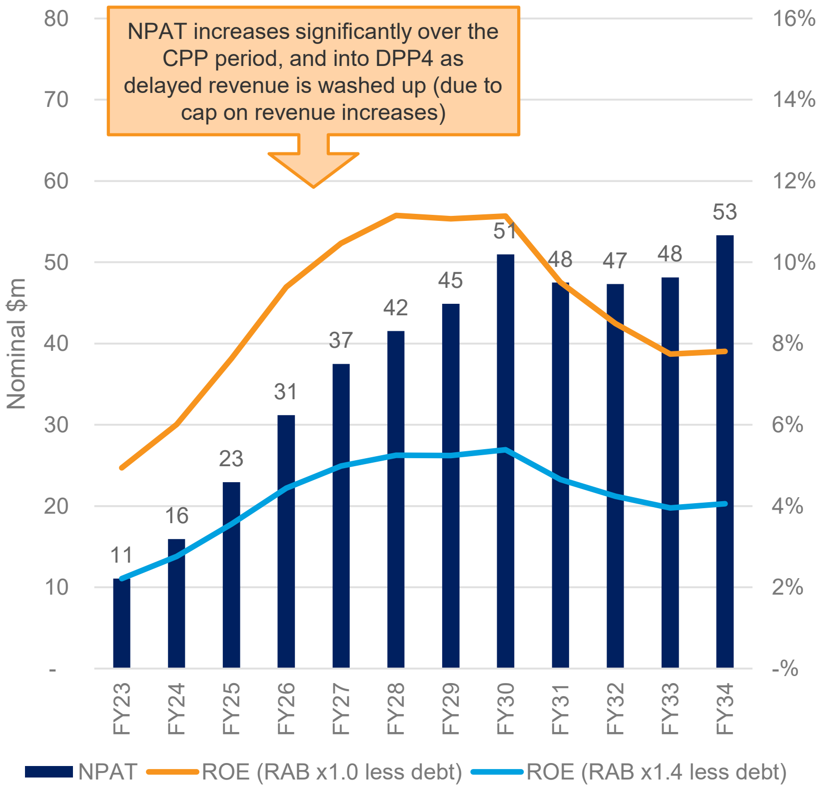


The difference between capex and regulatory depreciation is reflected in free cash flows and is distinct to the return shown on slides 13 & 14 which is a measure of profit

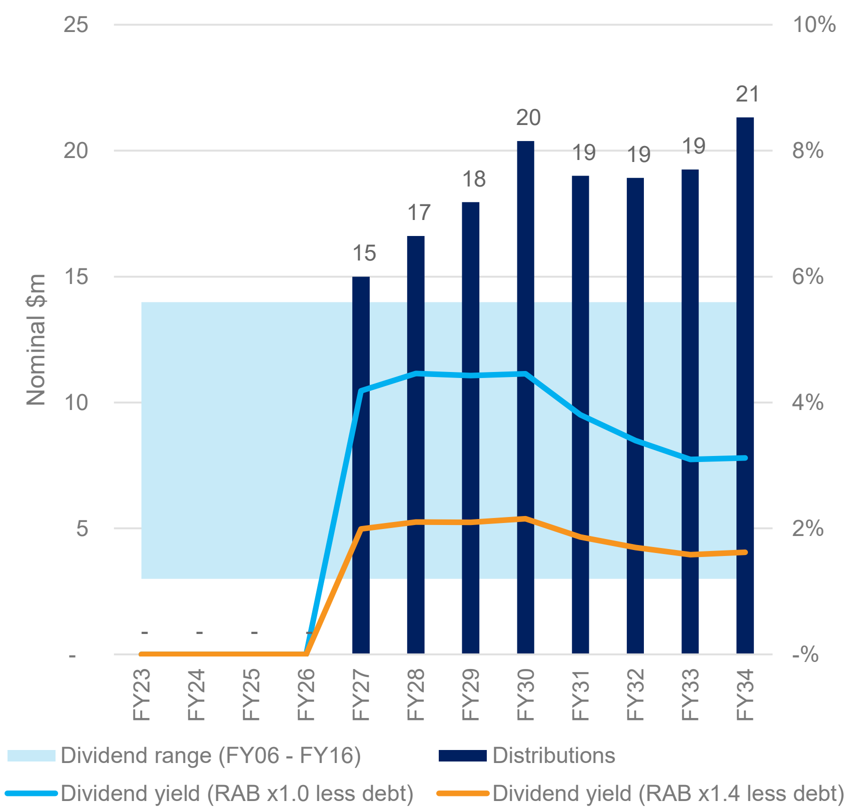
Shareholder returns

The base case assumes dividends resume in FY27 and amount to 40% of NPAT

NPAT and return on equity (ROE)[1]



Dividends[2]



1. Return on equity is calculated as NPAT divided by RAB minus debt. 2. Dividend yield is calculated as dividend divided by RAB minus debt.

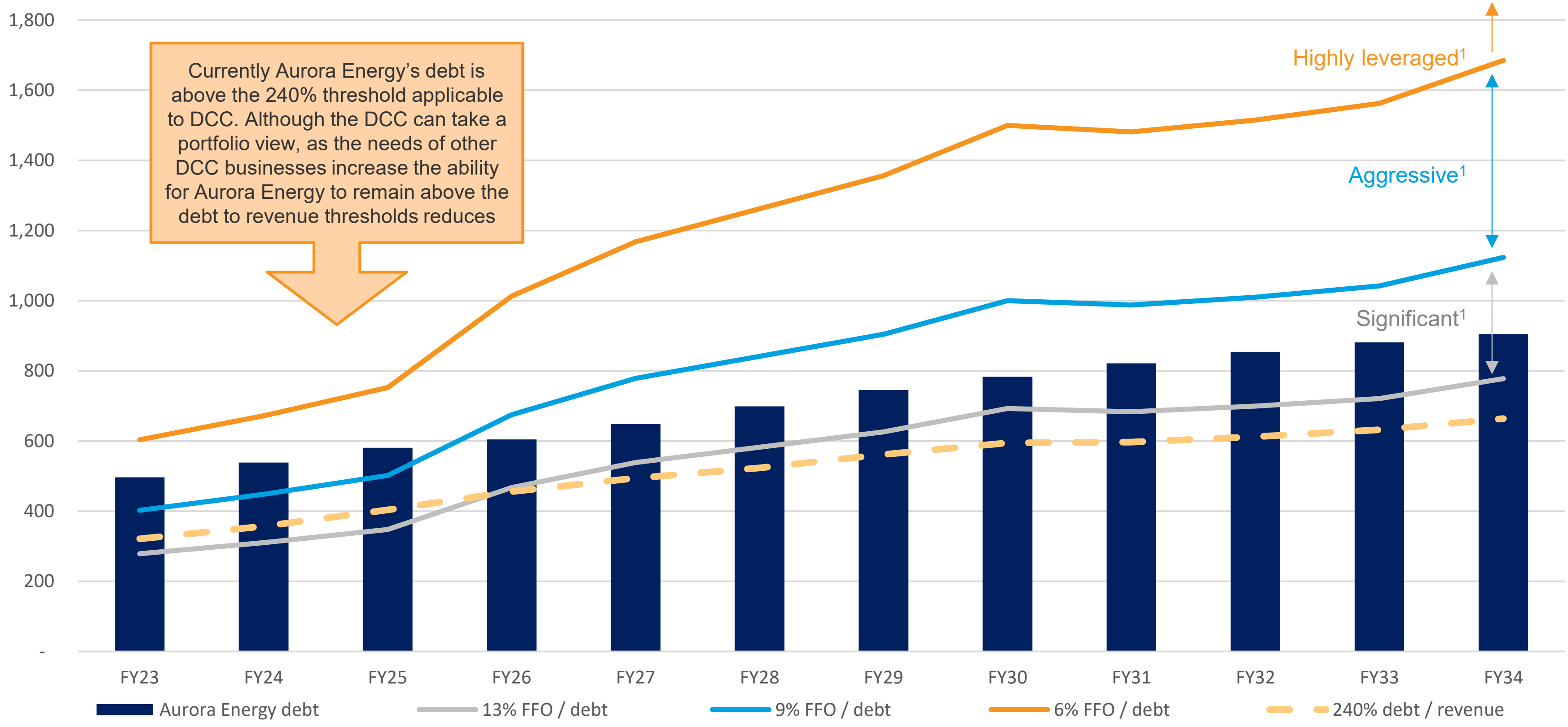
C
APPENDIX
Debt and credit metrics

Financial risk

Aurora Energy borrowing capacity

Thresholds specific to Aurora Energy provide greater headroom than the DCC's underlying S&P credit rating thresholds

Aurora Energy borrowing capacity (nominal $m)[2]

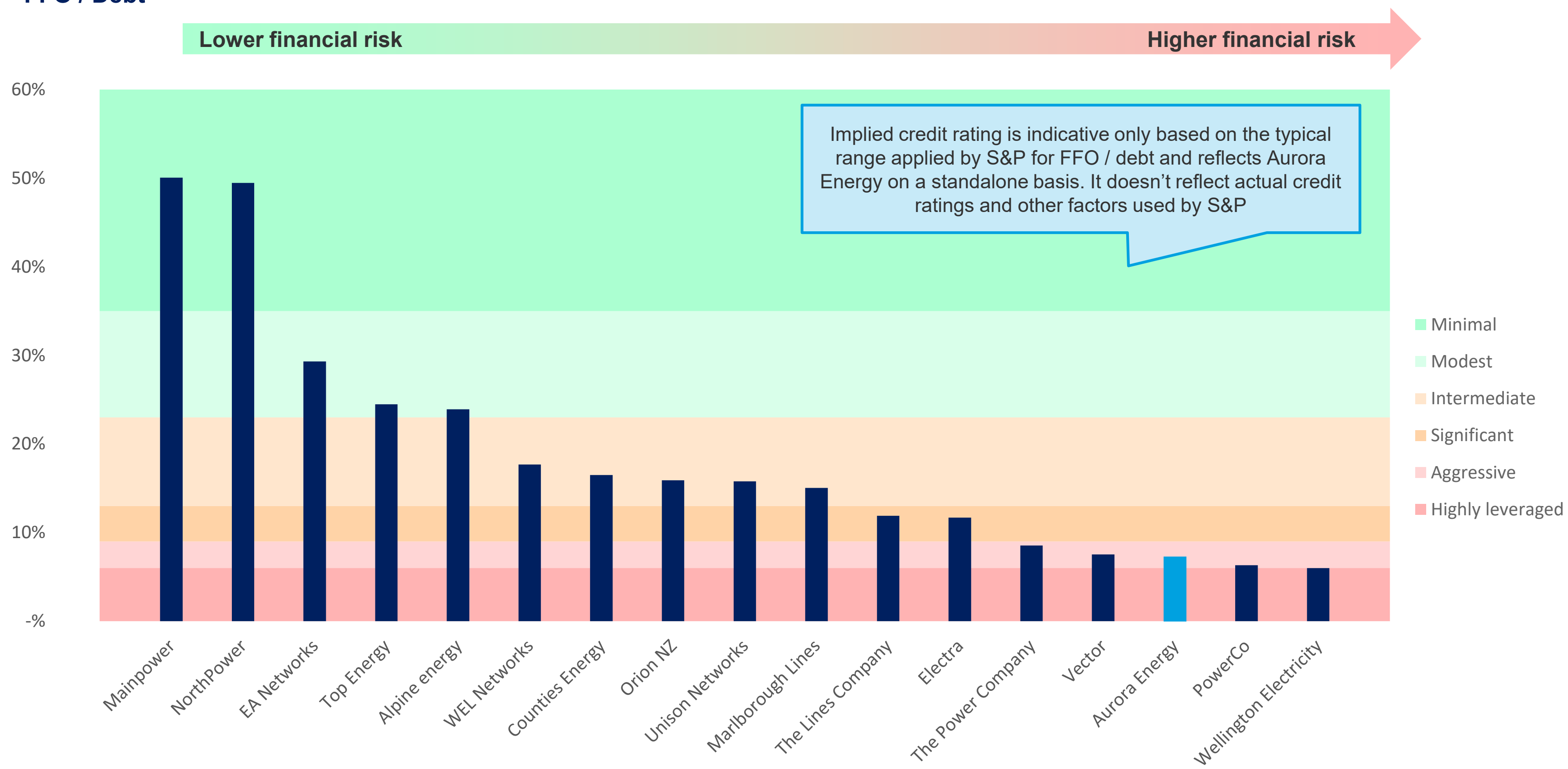


1. S&P Global Ratings, Cash Flow/Leverage Analysis Ratios – Low Volatility.
2. The DCC (group) debt forecast sourced from DCTL. Operating revenue forecast sourced from S&P (FY24 – FY25) and extrapolated based on the DCC LTP and Aurora Energy forecast.

EDB credit metrics

Current EDB FFO to debt levels are summarised below

FFO / Debt[1,2]

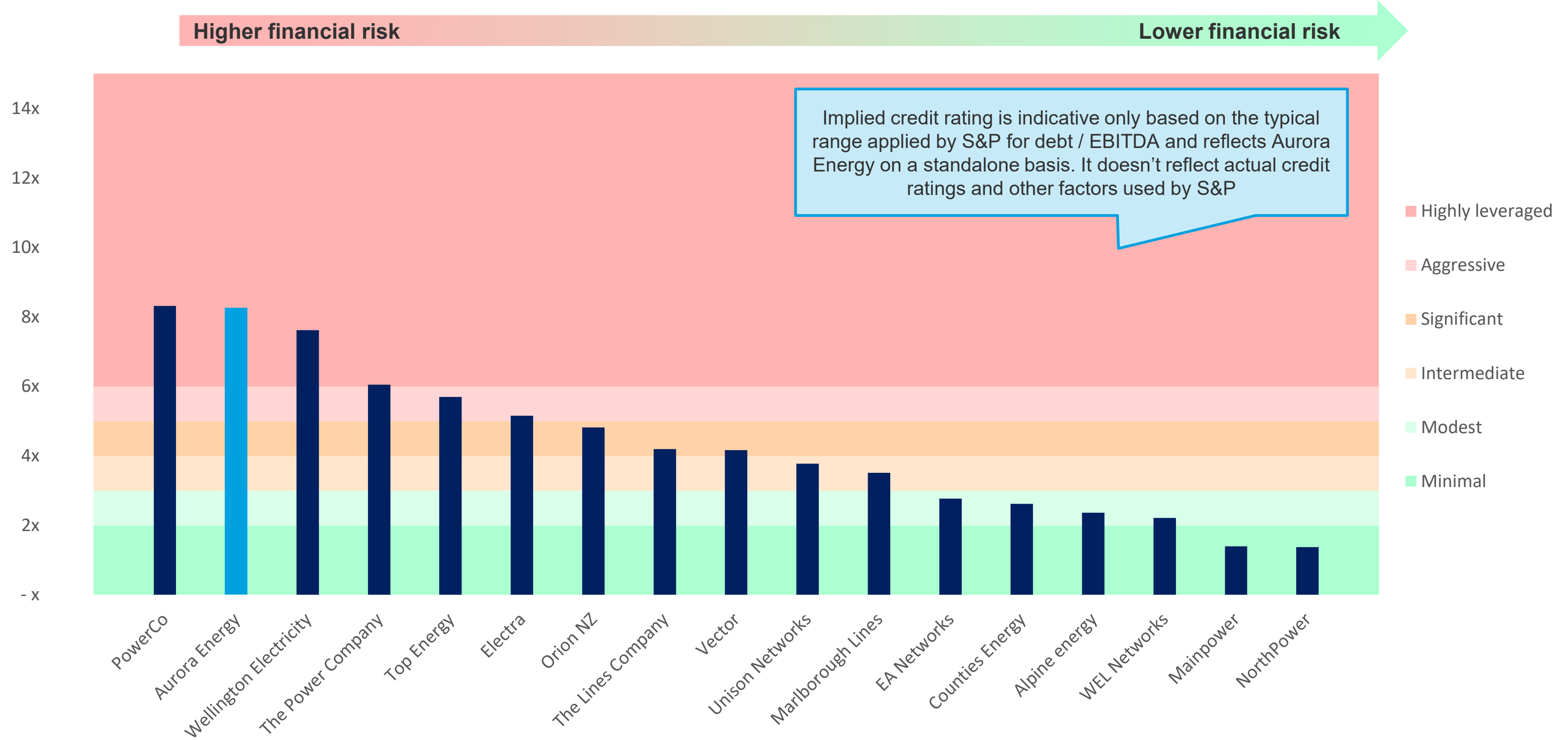


1. The graphs comprise of EDBs with more than $200m of RAB. Metrics are based on the most recently available financial information. FirstLight has been excluded as there is no financial information post acquisition by Igneo. The implied credit rating ranges are indicative only as they don't consider other financial risk and qualitative assessment factors used by S&P / Moodys.

EDB credit metrics

Current EDB net debt to EBITDA levels are summarised below

Net Debt / EBITDA[1,2]

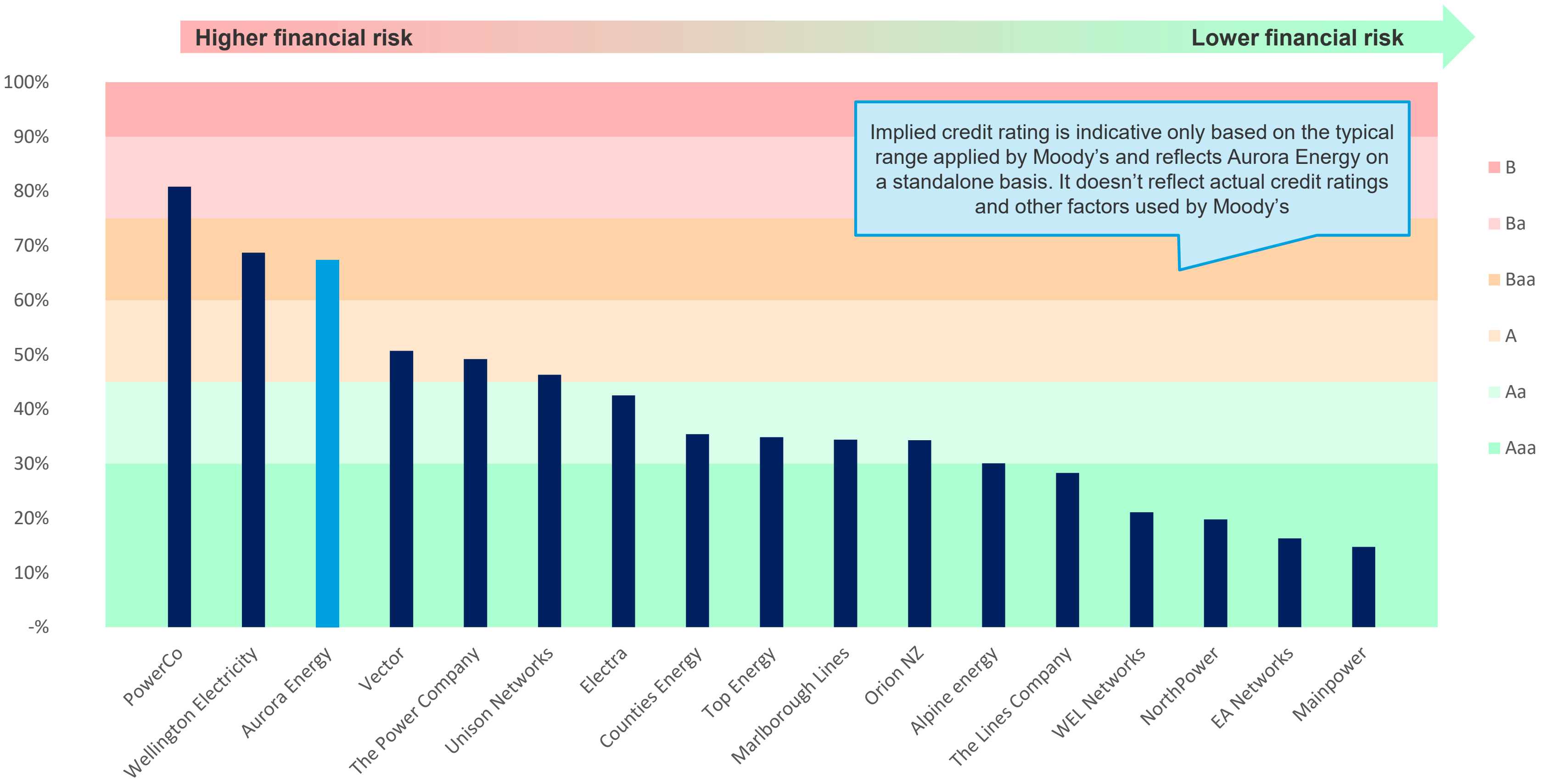


1. The graphs comprise of EDBs with more than $200m of RAB. Metrics are based on the most recently available financial information. FirstLight has been excluded as there is no financial information post acquisition by Igneo. The implied credit rating ranges are indicative only as they don't consider other financial risk and qualitative assessment factors used by S&P / Moodys. 2. Where entities have a material asset base outside of the EDB sector and such information is disclosed (e.g. Vector, PowerCo, Northpower, Top Energy), Mafic has applied debt on a pro-rata basis based on EDB fixed asset and the other segment fixed assets.

EDB credit metrics

Current EDB debt to RAB levels are summarised below

Debt / RAB[1,2]



1. The graphs comprise of EDBs with more than $200m of RAB. Metrics are based on the most recently available financial information. FirstLight has been excluded as there is no financial information post acquisition by Igneo. The implied credit rating ranges are indicative only as they don't consider other financial risk and qualitative assessment factors used by S&P / Moodys. 2. Where entities have a material asset base outside of the EDB sector and such information is disclosed (e.g. Vector, PowerCo, Northpower, Top Energy), Mafic has applied debt on a pro-rata basis based on EDB fixed asset and the other segment fixed assets.

D
APPENDIX
July 2024 DCC (group) credit metrics

Base case forecast

The July 2024 DCC credit metrics used public information at the time. These are summarised below

DCC financials

- DCC level debt and revenue has been estimated based on the latest public information
- DCC group debt (other than Aurora) is determined as follows:
  - FY24 - FY27: sourced from the Dunedin City Treasury 2025 Statement of Intent
  - Thereafter: debt movements are based on the increases set out in the 2021-31 Long Term Plan (**LTP**)
- DCC group revenues (other than Aurora) are determined as follows:
  - FY24 – 25: DCC's most recent Annual Plan
  - Thereafter: DCC group revenues increase at the revenue growth rate set out in the 2021-31 LTP

mafic

Debt levels and capacity

DCC (group) debt to revenue scenario analysis

DCC's debt / revenues are exposed to a lower risk-free rate (which reduces Aurora Energy revenues). Beyond Aurora Energy, DCC is also exposed to one-off debt requirements that might arise in other subsidiaries or increases to council expenditures

DCC (group) debt to revenue[1]

	FY23	FY24	FY25	FY26	FY27	FY28	FY29	FY30	FY31
Base case	188%	202%	211%	219%	223%	225%	225%	224%	227%
10% higher capex	188%	202%	211%	219%	222%	226%	227%	227%	230%
10% lower capex	188%	202%	211%	219%	223%	224%	223%	221%	223%
Low risk-free rate (2%)	188%	202%	211%	219%	229%	234%	236%	237%	241%
High risk-free rate (7%)	188%	202%	211%	219%	217%	217%	215%	211%	212%
$15m dividend payout[2]	188%	202%	211%	219%	223%	224%	224%	223%	225%
DCC incremental debt requirements	188%	202%	211%	219%	223%	225%	225%	224%	227%

This scenario assumes DCC requires an additional $200m debt above base case (incurred in FY27)

Key: Debt burden assessment
- Stable rating assessment (green)
- Risk of DCC ratings downgrade (orange)
- DCC rating downgrade (red)

Under the Base Case, we start to see debt / revenue push up closer to 240% in the early 2030s. While debt / revenue is not forecast to exceed 240%, this could place some credit rating downgrade risk as S&P may apply a lower "financial management" assessment to DCC. Further, given the trend upwards and the absolute debt level increase, we see a risk that DCC may self-impose financing limits well ahead of this debt / revenue level.

1. The debt to revenue metric is based on debt to FY27 from DCTL's Statement of Intent and revenue to FY25 from DCC's annual plan. Thereafter forecast debt and revenue are extrapolated using 2021-31 LTP forecasts. 2. Applied from FY27 onwards


Council Investment Strategies and Implications - July 2024
183.102
154.178
TX1 Insight

Table of Contents

Executive Summary

Issues

Councils across New Zealand are looking to optimise balance sheets as they lock in 10-year long term plans accompanied by 30-year infrastructure strategies.

Councils' requirements for regular cashflows combined with limited borrowing headroom come at a time when many of their legacy income-generating assets require significant capital investment over the next 10 to 20 years, limiting their ability to pay dividends.

Active portfolio management and potential divestments have formed a key narrative in Council community consultation processes the length of the country with councils looking to manage a range of emerging risks and opportunities including balance sheet capacity, risk concentration, self insurance and cashflow requirements.

Models

There are a range of council investment models in place across New Zealand with New Plymouth District Council's (NPDC) Perpetual Investment Fund considered one of the more mature examples in the sector following 20 years of evolution.

Elements of the NPDC perpetual investment fund:

- CCO – fully independent board - PIF Guardians
- Fully Outsourced Agent - Mercer
- Diversified portfolio based on statement of investment policy and objectives
- Structure underpins NPDC's AA+ credit rating
- Sustainable dividend policy requires a super majority (>75% vote) of council to change
- Act of Parliament protects the capital base and geofences benefits in perpetuity
- Fund provides a level of self insurance

Community implications of Council divestments

New Plymouth District Council sold its stake in Powerco in 2004 which led to a full takeover of the company by Australian business Prime Infrastructure.

The impact of ownership change on Powerco's performance from a customer and community perspective has been positive with international investors bringing their expertise and capital to continuously drive improvements in an organisation that has a long history of being well run.

Key positive outcomes following the sale:

- Increase in staff numbers
- $100m capital injection 2010
- >$30 invested in New Plymouth offices and control-rooms
- CPP investment of $1.27b 2018-2023
- Industry leading environmental and social governance
- International expertise
- Community sponsorship and engagement
- Improved customer experience
- Stable network performance
- Increased network investment

Proposals

Five Councils including Dunedin City Council have been working through potential changes to their investment strategies over the past 18 months.

A range of proposals have been considered from active portfolio management, asset leases, diversification, divestments and the establishment of perpetual investment funds.

The table below summarises these investment strategy reviews and their current status with details of the various projects outlined in the body of this report.

Project	Proposal	Current Status
Auckland Council / Auckland Airport	2023 Airport share sale to pay down debt	Partial sale approved $836m ✓
Auckland Council / Auckland Airport	2024 Airport shares to perpetual investment fund	Share sale and fund approved ✓
Auckland Council / Ports of Auckland	2024 Port lease to perpetual investment fund	Lease declined dividends increased ✗
Bay of Plenty Regional Council Toi Moana	2024 Port share sale to diversify investments	Partial sell down to 28% ✓
Christchurch City Council	2024 Active Portfolio Management within CCHL	Proposal declined prior to consultation ✗
Absolutely Positively Wellington City Council	2024 Airport share sale to perpetual investment fund	Proposal progressing to test the market ✓

Conclusions

Decision-makers across the country have been assessing the risks and potential benefits of a range of active portfolio management and divestment options.

Decisions largely revolve around spread of risk, availability of free cashflow to equity, debt levels at both subsidiary and group level, insurance implications, the definition of strategic investments and the financial implications of retaining the status quo.

Several of the proposals include provision for perpetual investment funds to be designed in a way that provides a level of self-insurance, reducing external insurance premiums, providing coverage for significant natural events and more predictable, regular cash flows aligned to local government revenue and finance policies and planning requirements.

There are a range of structural, policy and legislative options employed across New Zealand which enable Councils to safeguard their investment portfolios, regardless of composition, and ensure the benefits of those investments continue to flow back to their local communities in perpetuity

20 Years from Powerco to PIF

Introduction

There are a range of council investment models in place across New Zealand with New Plymouth District Council's (NPDC) Perpetual Investment Fund considered one of the more mature examples in the sector following 20 years of evolution.

Establishment

NPDC's Perpetual Investment Fund (PIF) was established on 9 November 2004 from proceeds of selling the Council's 38.2% shareholding in listed lines and gas pipeline business Powerco Limited. The opening balance of the PIF was $259 million.

The PIF is a significant financial asset for the New Plymouth District, enabling financial benefits to accrue to the Council and its communities.

The PIF has operated with the intention of being a sustainable fund, whereby an annual release from the PIF is provided to Council to subsidise general rates. That release payment should, over the medium term, be lower than the earnings of the PIF (inflation adjusted) so that the PIF maintains or grows its capital base.

However, the PIF has not always been managed sustainably.

Releases were not reduced to account for lowered market returns during the 2008 global financial crisis (GFC) and the fund lacked diversity, with a high concentration of value locked into a number of Tasmanian dairy farms which required significant capital investment. The PIF lost around $113 million in value over 5 years. Subsequently, the Council considerably reduced releases and increased rates to enable the PIF to recover its pre-GFC value.

From 2016, the Council implemented a series of changes to how the PIF was managed in order to prevent these issues from recurring.

Current structure

Currently the New Plymouth PIF Guardians Limited, a Council-controlled organisation, is comprised of a fully independent board of experienced financial governance specialists. The Guardians oversee the PIF as a sustainable perpetual investment fund in accordance with a Governance Deed.

Governance Deed

This PIF Governance Deed constitutes a deed dated 1 March 2017 between NPDC and the New Plymouth PIF Guardians.

The deed outlines the process for appointing PIF Guardians.

The deed also outlines objectives for the management of the PIF as follows:

The parties understand that the Council's objectives (PIF Objectives) in relation to the management of the PIF are:

- *to at least maintain the real capital of the PIF as a sustainable perpetual investment fund in the long term (the Founding Principle) whilst generating a sufficient return to maintain a sustainable release to the Council; and*

to ensure that the following principles underpin the operation of the PIF:

- *all investments are made on purely commercial terms; and*
- *the PIF will be managed on the basis of a prudent, commercial, diversified portfolio investment style and asset allocation, which manages risk to further the Founding Principle.*

Operation of the PIF: The parties agree that their obligations under this PIF Governance Deed shall be construed in light of their mutual intention that the PIF Objectives be achieved.

The Governance Deed locks in a supermajority of council and support of the PIF Guardians as a requirement to make any amendments as follows:

Amendment: No amendment to (or termination of) this Deed will be effective unless executed by the Council and NPG. The Council may not execute any such amendment (or termination) otherwise than with the authority of a vote of not less than 75% of elected members of the Council.

Investment policy and objectives

The Governance Deed also requires the PIF Guardians to regularly review the Statement of Investment Policy and Objectives (SIPO) as follows:

Review of SIPO: To review the SIPO (including the Strategic Asset Allocation) on a regular basis to ensure that it remains consistent with this PIF Governance Deed (including the PIF Objectives) and, without prejudice to the foregoing, to conduct a detailed review of the SIPO (SIPO Review) on an approximate 3 yearly basis. The SIPO Review will be conducted with the intention that the results will be available for consideration in the preparation of the Council's long term plan.

The SIPO Review shall include:

(a) a comprehensive review of the performance of the PIF;

(b) the preparation and conduct of a workshop for the Council covering, among other things: PIF history; organisational architecture principles; structural arrangements; advisor and agent performance measurement; and monitoring arrangements; and

(c) recommendations to Council for ratification of existing or revised arrangements with third parties.

Any amendments to the SIPO will be notified to the Council as soon as reasonably practicable.

The SIPO provides guidance for the Fully Outsourced Agent (FOA) which is tasked with implementing strategies.

The SIPO (included in the appendices of this report) provides a structured framework for quantifying risk, capturing investment benefits and ultimately communicating investment strategy to the FOA and Investment Managers responsible for implementation.

The diagram below summarises the Guardians' process for making investment decisions:

Investment objectives and risk tolerance	▪ Guardians determine the long-term investment objectives having considered the Founding Principle and set the risk parameters within which the investment objectives are to be achieved.
Selection of FOA	▪ Guardians select a FOA in line with the provider due diligence requirements set out in Section 4.10.
Strategic asset allocation	▪ Guardians determine long term (strategic) asset allocation with a 10+ year view ▪ FOA implement the investment approach that corresponds to the Guardians' investment beliefs
Dynamic asset allocation	▪ FOA dynamically tilts asset allocation into/away from asset sectors based on a medium-term (3-5 year) view
Investment strategies	▪ FOA determines the underlying investment strategies to be implemented within each asset class
Investment Managers	▪ FOA appoints investment managers to implement the investment strategies
Securities selection	▪ Investment managers buy and sell securities

Strategic Asset Allocation

The Guardians have, in consultation with the FOA, developed the following strategic asset allocation (SAA) and allowable ranges.

The total exposure of the Fund to growth and income assets is set out in the table to the right. The ranges for these override the ranges set for each individual asset class – i.e. the individual asset class allocations may not be such as to cumulatively have the effect of making the total exposure of the Fund to growth or income assets fall outside the growth or income range.

Asset class	Strategic asset allocation %	Allowable range %
Global equities – developed markets	40	25 - 55
Global equities – emerging markets	5	0 - 10
Private equity	17.5	10 - 25
Alternative assets	17.5	10 - 25
Total growth assets	***80***	***60 - 95***
Fixed income	15	5 – 25
Cash	5	0 – 20
Total income assets	***20***	***5 – 40***
Total	*100*	

Fully Outsourced Agent

As per the above process diagram the PIF Guardians are responsible for the appointment of a fully outsourced agent (FOA) which is responsible for implementing the SIPO.

The FOA is responsible for appointing investment managers who are tasked with implementing investment strategies by buying and selling securities.

In 2017 when the current structure was put in place the PIF Guardians appointed Mercer as FOA. Mercer's performance and fee structure is reviewed regularly, and the Guardians have the option to change agents in line with the processes outlined in the Governance Deed.

The PIF Guardians provide quarterly reports to Council covering a range of metrics articulated in the SIPO including the following:

Currency hedging

The Fund's policy is to target a foreign currency exposure of 25% of the total portfolio. The allowable range for foreign currency exposure is 0 – 50% of the portfolio.

The FOA is to implement this exposure in the most efficient manner depending on the available products.

Dividend release rule

The release to the NPDC from the PIF is based on a model that follows industry best practice and a formula that enables the PIF to fulfil its perpetual objective both in terms of the maintenance and enhancement of the target capital value over time and the delivery of sustainable levels of release payments to the NPDC.

The annual release payment is based on the following formula in the long term:

$$D_t = \underbrace{80\% \times D_{t-1} \times (1 + CPI_{t-1})}_{\text{Weight on previous year's payment}} + \underbrace{20\% \times 3.3\% \times PIF_{t-1} \times (1 + CPI_{t-1})}_{\text{Weight towards long-term 3.3\% pa target}}$$

where

- D_t = release payment in year t
- D_{t-1} = prior year's release payment
- CPI_{t-1} = prior year's inflation rate
- PIF_{t-1} = prior year's opening audited PIF value

This rule means that the annual release will average approximately 3.3% of Fund value over time. The 80% weight on previous year's

TX1 Insight

release provides a smoothing mechanism to ensure that the release payment is relatively stable.

The release payment made by way of four equal payments which are made in the last week of each calendar quarter or with mutual consent between NPDC and the Guardians.

PIF underpins NPDC's AA+ Credit Rating

The structure of the PIF has been developed in a way that underpins NPDC's AA+ credit rating from S&P Global, assisting Council to minimise its costs of borrowing and also allowing for the optimisation of Council's insurance arrangements.

The following excerpts reflect S&P's commentary on NPDC in its most recent assessment:

New Plymouth's PIF bolsters its operating revenues. The PIF had a balance of NZ$362 million as of January 2024, which would be enough in itself to fund about two years of the council's operating expenses. PIF targets a total return on its portfolio over the medium term of 3.3% a year plus inflation. This allows it to pay an annual "release" to the council to subsidise the latter's budgets. The cash release will be NZ$11.8 million in fiscal 2024.

New Plymouth's PIF underpins its exceptional liquidity coverage. The council's total free cash position - after applying our standard haircuts to non-cash assets, and after budget needs - should be sufficient to cover about 196% of debt service during the next 12 months.

Supporting our strong financial management assessment is New Plymouth's prudent management of the PIF. Assets are diversified across listed equities, fixed income, alternative assets, private equity and cash. The council has outsourced management to Mercer (N.Z.) Ltd. and an independent "board of guardians" monitors the PIF. The New Plymouth District Council (Perpetual Investment Fund) Act 2023 was passed in the New Zealand Parliament in July 2023. The Act aims to ring-fence the benefits from the PIF to current New Plymouth residents. The bill also outlines general principles for sustainable management of the fund.

The full S&P report on NPDC is available here:

https://disclosure.spglobal.com/ratings/en/regulatory/article/-/view/type/HTML/id/3162082

NPDC Perpetual Investment Fund Act 2023

The Council resolved, during long-term plan deliberations on 19 May 2021, for Council officers to report on introducing a local bill to contain the benefits of the PIF to the current district boundaries and provide legislative protections to its capital base to ensure benefits flow to the New Plymouth District communities in perpetuity.

Council officers explored various options for achieving these goals and reported back to the Council on 20 January 2022.

Council officers recommended that:

- draft legislation should be developed for community consultation, on the basis that geographically containing the PIF and ensuring it is used in a perpetual manner through legislation is both feasible and in the public interest:
- the Council should retain some ability to use the capital base of the PIF, for example in emergency situations, in order to avoid a negative impact on the Council's credit rating and insurance.

New Plymouth District Council Perpetual Investment Fund Act 2023 was approved by Parliament in June of 2023. A copy of the Act is attached in the appendices of this report.

Investment performance as at June 2024

NPDC PIF

Fund size
$376.0m

Returns (after fees and taxes)

Since inception p.a. (Nov 2004)	5 years p.a.	3 years p.a.	1 year	3 months
7.2%	8.8%	7.7%	12.9%	5.3%

Distributions to Council (release payments)

Since inception (Nov 2004)	5 years	3 years	1 year
$260.2m	$49.6m	$31.7m	$11.5m

NB. Implementation of Guardian and Full Outsource Agent (Mercer) model took effect 1 March 2017.
Results and distributions incorporate TIML results for period prior to March 2017.

Mercer

Fund Performance

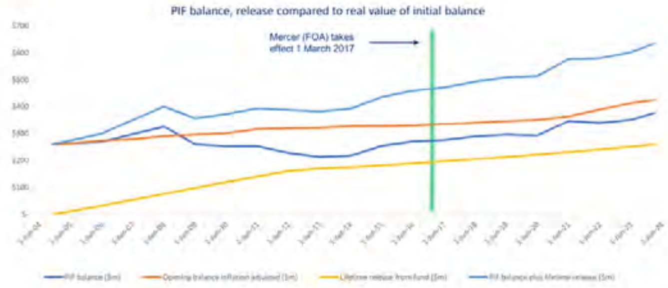
- The NPDC PIF returned 5.3% for the quarter (after fees). The Fund is above its CPI + 3.3% objective over all time periods shown except 3 years (+3.8% vs objective over the quarter and +5.5% vs objective over 1 year). The Fund is lagging against the secondary benchmark across all timeframes as high inflation continues to eat away at total relative returns.
- Worth noting is the strong performance of equities, fixed income and cash relative to benchmark (+0.8% over 3 months, +1.2% over 1 year). Within the Overseas Shares sleeve, Schroder's have generated excess returns of +2.0% over 1 year.

	3 months (%)	1 year (%)	3 years (% p.a.)	5 years (% p.a.)
Fund return (net of fees)	5.3	12.9	7.7	8.8
Value-add (total portfolio including legacy PE)				
• Relative to CPI + 3.3%	*+3.8*	*+5.5*	*-1.5*	*+1.2*
• Relative to benchmark*	*-0.8*	*-3.3*	*-1.0*	*-0.3*
Equities, Fixed Interest and Cash	9.3	20.8	8.3	9.8
Relative to benchmark	*+0.8*	*+1.2*	*+1.0*	*+1.0*
Private Equity and Alternatives**	2.0	6.3	9.7	9.1
Relative to benchmark	*+0.2*	*-3.4*	*-1.3*	*-0.2*

*The Fund's secondary benchmark is a composite of the underlying sector benchmarks. This includes CPI + 4% for Alternatives (Listed Real Assets) and CPI + 6% for Private Equity.
**Alternatives includes Listed Property & Infrastructure

Mercer

PIF Balance



Note: The "PIF Balance plus Lifetime Release ($m)" trend only adds lifetime releases from the Fund to actual balances at each year end, and therefore omits hypothetical compounding returns which would have been achieved had the release amounts remained invested along with the existing balance.

Source: NPDC

Mercer

PIF performance since inception

The table above shows the PIF balance and distributions over the past 20 years.

As outlined previously in this report, during the period between 2008 and 2013 the balance of the fund decreased by more than $100m as a result of the global financial crisis.

Despite the deterioration in performance, the PIF continued to pay annual dividends of around $20m to Council until 2012, effectively paying capital out to the shareholder to meet cashflow requirements.

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Through this period the fund divested various shareholdings to fund release payments. As a result the PIF ended up with the majority of its investment value concentrated in a group of Tasmanian dairy farms in need of ongoing investment.

In 2012 the annual release was cut to around $9m as a new Council administration sought to stabilise the fund and review Council's investment strategy.

In late 2016 the PIF sold its Tasmanian dairy farming operations for $307m and implemented the PIF Guardians model outlined in this report.

A comprehensive comparison of investment performance between the PIF and Council's historic 38.2% shareholding of Powerco over the past 20 years would require consideration of the following elements:

- Timing and quantum of distributions during the period
- Timing and quantum of equity injections during the period
- Market value of investments at the closing date of the comparison

Powerco is no longer a listed company meaning it is not required to disclose debt levels, equity injections and/or distributions to shareholders.

At the last public disclosure in 2018, Powerco's Annual Report outlined borrowings of $1.35b, with debt levels increasing annually by around $50m as the business ramped up capital expenditure. The company paid a $58m total dividend, with a 38.2% share equating to $22.3m.

The market value of Powerco shares can only be determined immediately following a share sale.

To develop a market estimate for Powerco requires consideration of following:

- the value of the regulated asset base (RAB),
- determination of an appropriate RAB multiple reflecting the premium the market will be willing to pay for the business
- adjustment to account for internal borrowings

Given the information required to undertake this analysis is not publicly available, it is not possible to develop a robust comparison of investment performance between Powerco and the PIF.

Other Council investments

Council has also grown its investment portfolio outside of the PIF, purchasing the Government's 50% share in New Plymouth Airport and establishing a CCO to operate the airport and oversee construction of a new terminal which was completed in 2020.

The Airport Company, known as Papa Rererangi I Puketapu (PRIP), borrows funds from NPDC on commercial terms and is in the process of making the final investment decision on a solar farm on land NPDC owns around the airport site.

The balance sheet capacity and credit strength the PIF provides NPDC has enabled Council to undertake the investment in the Airport and consider other potential commercial opportunities.

In the 2024-34 LTP Council resolved to explore opportunities relating to creating a new commercial development division within council (DevCo) with a view to identifying further opportunities to grow public wealth and capture value in areas including but not limited to land development, housing, minor works, traffic management and commercial signage.

Community outcomes following the sale of Powerco

In 2004 New Plymouth District Council sold its share in listed electricity and gas distribution company Powerco to Australia's Prime Infrastructure.

Prime Infrastructure purchased the council shares and subsequently acquired 100% of the company leading to its delisting from NZX.

Several shares sales have occurred since then with the company now owned by QIC (the Queensland State Government pension fund) and Dexus (formerly AMP Capital).

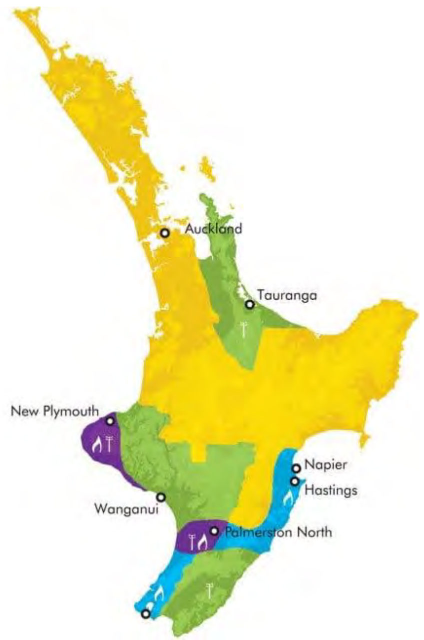
This section provides a summary of what has changed for customers and communities over the past 20 years.

Economic impact

At the time of the sale the company's head office was in New Plymouth with regional offices in Tauranga, Palmerston North and Wellington with around 165 staff working across its Corporate, Electricity and Gas asset management teams.

Powerco's head office remains in New Plymouth with regional offices in Tauranga, Palmerston North and Wellington and now employs around 300 staff in its Corporate, Electricity and Gas asset management teams. Powerco is a significant employer in New Plymouth with around 200 full time staff.

Following delisting new Australian directors brought their expertise with experience across multiple industries and countries with improved focus



on risk management, environmental management and health and safety practices.

The company has made investments >$30m in its New Plymouth offices over the past 20 years with a range of new offices, a new back-up control room and most recently a state-of-the-art Network Operations Centre opened in 2019. Links to two of the projects below:

https://www.powerco.co.nz/what-we-do/our-projects/network-operations-centre

https://www.boon.co.nz/projects/powerco-project-open/

TX1 Insight

In 2010 shareholders QIC and Prime Infrastructure invested an additional $100 million into the company to prepare the business for a step change in its asset management maturity and a corresponding increase in capital investments in the company's networks. https://www.stuff.co.nz/business/3463812/Powerco-to-repay-100m-of-bonds

Environmental and social governance

Powerco continues to mature its approach to environmental and social governance. Starting out with Enviromark Certification in 2010 the Company has subsequently joined the Sustainable Business Council and is also a member of GRESB.

GRESB (Global Real Estate Sustainability Benchmark) is a mission-driven and investor-led organisation that provides actionable and transparent environmental, social, and governance (ESG) data to financial markets.

The company has also developed a comprehensive Emissions Reduction Programme. Links attached: https://www.powerco.co.nz/-/media/project/powerco/powerco-documents/what-we-do/2021-sustainability-reference-report.pdf https://www.gresb.com/nl-en/

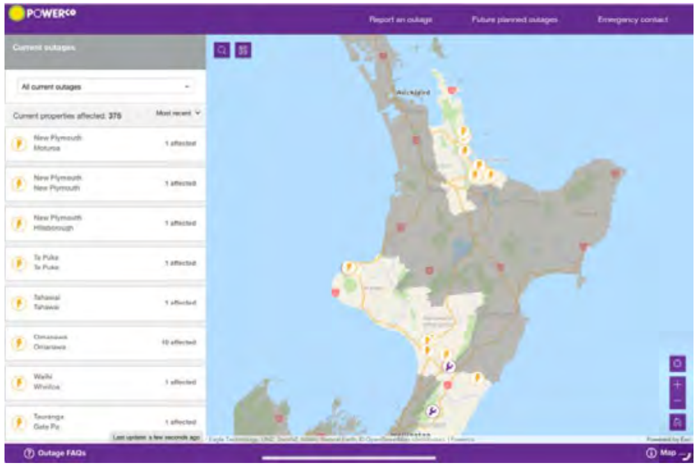
The company is involved in a range of community projects and sponsorships and each year takes applications for a Community Fund for projects which meet the following criteria:

- Contribute directly to the community
- Contribute long term solutions to issues
- Demonstrate the ability to make effective use of the funds requested
- Have clear measurable outcomes

Customer experience

Since 2004 Powerco has made a step change in its customer focus with a range of investments including a customer call centre and online outage portal developed to provide customers information in realtime related to planned and unplanned network outages and estimated restoration times.

Powerco outage web-portal

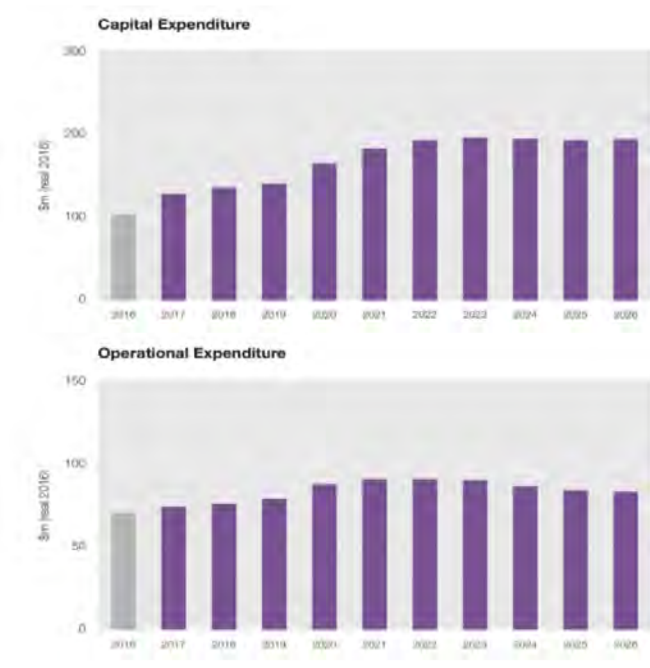


Two of the key measurable outcomes for customers are number of power cuts and duration of power cuts. Powerco has maintained its network performance over the past 20 years, ie the average time customers are without power, adjusted for severe weather events, has been stable.

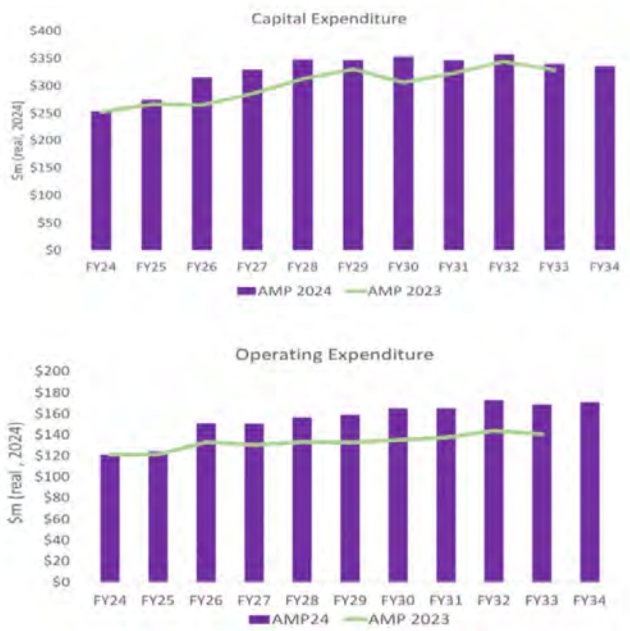
The company has consistently lifted both capex and opex over the past 20 years and the following graphs illustrate both historic investment levels and forecast expenditure.

The company successfully applied for and then delivered an electricity network customised price path proposal which invested $1.27 billion in its networks between 2018 and 2023.

Powerco 2016 Asset Management Plan Capex and Opex forecasts



Powerco 2024 Asset Management Plan Capex and Opex forecasts



Conclusion

Powerco was recognised as a well-run successful business in 2004 when it was sold. Subsequent owners have continued to invest in and grow the business, building its connections within community and performance in terms of environmental, social and corporate governance. Shareholders have provided significant capital, empowering the company to hire more people, invest in technology, improve customer service and participate in community projects.

Local Government Operating Environment

You are not alone

Councils across NZ are assessing balance sheet composition as they approach borrowing limits and face emerging risks in preparation for a prolonged period of significant capital investments outlined in 10-year long term plans accompanied by 30-year infrastructure strategies.

Cost escalations evident in LTPs

Draft LTP's across the country have the highest proposed average rate increases the sector has ever seen and contain financial forecasts requiring significant increases in borrowings to fund significantly expanded capital works programmes.

The financial forecasts underpinning LTPs reflect cost escalations over 2021-2023, with the overall capital goods price index peaking at 13%pa and civil construction costs at 15%pa.

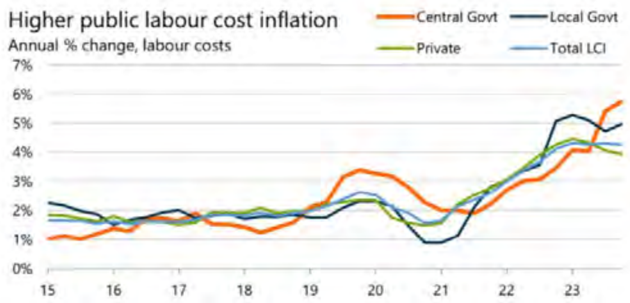
Cumulative inflation since 2020 (when Long Term Plans were last assessed) is more than 25% across the capital costs that local

Annual civil inflation 2015-23. Infometrics

government invests in. Civil construction costs are up 27% over the last three years (compared to 19% for consumer price inflation).

Over the last three years local government labour costs have also increased just over 13%, compared to below 12% for other sectors.

Annual labour costs 2015-23. Infometrics



Changes to water reform

The former Government's Three Waters Reform model was expected to address some of the challenges many councils have relating to funding future capital requirements by transferring them off balance sheets as well as providing additional borrowing headroom for councils by transferring their water-related debt to the proposed statutory entities.

However, following the change in Government, it is unclear what impact water reform will have on council credit metrics outside of Auckland over the next two to three years. Auckland Council is the outlier with specific legislation within the Local Water Done Well reform designed to create balance sheet separation from Watercare expected to be passed this year.

The above factors have led to a high level of scrutiny on all aspects of Councils' operations including the management of investments.

Investment strategies under review

Investment strategy reviews across the country are considering long term implications of retaining legacy assets, investment concentration, investment cycles, growth vs dividend investments, regional risks and related planning implications.

Investment concentration and regional risk

As Council risk management processes mature, awareness of the implications of investment concentration around legacy assets are starting to be better understood.

Councils across New Zealand have interests in a range of legacy assets including ports, airports, lines companies, gas networks, contracting businesses and forests.

Councils' investments in these assets range from full ownership to shareholdings. In several cases one or two investments represent most or all of a Council's income generating investments. Council owned ports, airports and networks are exposed to the same localised risks as their shareholders, causing Councils to consider how their investments offset or contribute to regional risks.

As an example, Wellington's exposure to seismic and sea level rise risk is compounded by its primary income generating investment being its shareholding in Wellington International Airport which is itself exposed to those same risks.

When considering the impact of significant natural events, this creates the potential for income generating assets to be impaired at a time when their Council shareholders will have to be funding recovery efforts, over and above traditionally budgeted activities.

Several of the proposals include provision for perpetual investment funds to be designed in a way that provides a level of self-insurance, reducing external insurance premiums and providing coverage for significant natural events. The self-insurance consists of retaining the ability to call on part of the capital of a fund following a significant natural event that leads to a material impairment of a Council asset base.

Councils are also having to look through the life of their infrastructure strategies and understand medium to long term capital requirements of their asset bases as well as the asset bases of their investments, dividend availability and long-term investment performance.

Growth vs Dividend investments

New Zealand is entering a period of prolonged capital investment and many of the legacy assets comprising Council investment portfolios (e.g. ports, airports and lines companies) have developed asset management plans requiring a ramping up of their capital investment programmes.

Planned capital investments will continue to deliver growth in the value of these assets, however in some cases the levels of capital required limit the abilities of the businesses to pay dividends over the period of LTPs.

Governance teams are being asked to determine whether growth or dividend investments are the best fit with their LTPs.

Related financial implications

Council financial processes favour investments capable of generating stable and predictable cash flows. Unpredictable dividend streams have to be mitigated either with rate increases or borrowing to make-up for shortfalls in revenue requirements.

As Councils prepare to significantly ramp up capital investments many are at or approaching borrowing limits with a number of those rated by S&P currently on negative outlook.

Borrowing constraints are one of the primary drivers of a shift of Council preferences from growth investments to those capable of delivering regular predictable dividends.

The factors outlined above have come together in a way that has seen Auckland Council, Bay of Plenty Regional Council, Wellington City Council, Christchurch City Council and Dunedin City Council all consider making changes to their investment strategies over the past 18 months.

Proposals have included partial divestment, full divestment, asset lease, active portfolio management and the establishment of diversified perpetual investment funds as outlined later in this paper.

Auckland Council – Auckland Airport 2023

Auckland Council considered selling its 18.09% shareholding in Auckland International Airport Limited (AIAL) during its annual plan 2023/24. The proposed sale aimed to improve the council's financial position by reducing debt to deliver savings on interest costs, which were projected to be greater than the dividends received from the shares.

Key Proposal Details

Amendment to Shareholding Policy: The council proposed amending the Auckland Airport Shareholding Policy in the 10-year Budget 2021-2031 to allow for the sale of the entire shareholding.

Use of Proceeds: Proceeds from the sale would be used to reduce the council's debt.

Financial Benefits: The sale was expected to alleviate budget pressures by lowering annual interest costs, leading to a better cash position than retaining the shares and receiving dividends.

Lack of Strategic Control: The council's minority shareholding did not provide significant control or influence over AIAL. Strategic outcomes could be achieved through other means, such as regulation or commercial incentives.

Preferred Option: The preferred option was a full sell-down rather than a partial one, as it would yield higher interest savings compared to future dividend income.

Rationale for the Proposal

Interest Savings vs. Dividends: The council was paying significant interest on debt while not receiving dividends due to the impact of COVID-19 on AIAL's operations. The sale was projected to save $719 million in interest over eight years compared to an estimated $532 million in dividends.

Strategic Value Assessment: The council had no significant strategic outcomes tied to its AIAL shareholding. Key considerations such as regional infrastructure, monopoly control, external impacts, and New Zealand ownership were managed through other regulatory and commercial mechanisms.

Financial Projections and Assumptions

Market Price and Interest Rates: The financial assessment was based on current market prices ($7.46 per share) and projected interest rates. The council assumed the sale and debt reduction would occur on July 1, 2023.

Sensitivity Analysis: Projections considered potential variations in share prices, interest rates, and dividend growth. The estimated savings ranged from $647 million to $791 million for interest savings and $497 million to $570 million for potential dividends.

($millions)	FY24	FY25	FY26	FY27	FY28	FY29	FY30	FY31	Total
Interest cost savings	87	87	88	89	90	91	93	94	**719**
Potential dividend foregone	39	49	63	73	75	76	78	79	**532**
Net funding benefit	**48**	**38**	**25**	**16**	**16**	**15**	**15**	**15**	**187**

Implications of the Proposal

Strategic: The council's influence on AIAL through land-use planning and regulatory roles would continue without shareholding. Current shareholding was insufficient to control AIAL's strategic direction.

TX1 Insight

Balance Sheet: Selling shares would reduce the council's financial assets and debt, providing additional borrowing capacity.

Operating Statement: Lower debt levels would reduce annual interest costs, improving the council's operating funding position. The council would no longer receive dividends or need to account for annual fair value adjustments of shares.

Options Analysis

Full Sell-Down (Preferred Option)

Advantages: Projected $48 million funding benefit in 2023/2024, $187 million over eight years, and reduced borrowing needs.

Disadvantages: Loss of potential future dividends and share value appreciation; no longer holding a 'blocking stake' against takeovers.

Status Quo

Advantages: Continued receipt of dividends; maintenance of a 'blocking stake'.

Disadvantages: Did not address financial challenges, potential erosion of shareholding percentage, holding a financial asset with returns below cost of debt.

Immediate Partial Sell-Down

Advantages: Provided $22 million funding benefit in 2023/2024, $90 million over eight years, retained a 'blocking stake'.

Disadvantages: Less impact on financial challenges, need for significant reinvestment to avoid dilution of shares, reduced potential for benefiting from future dividend increases or share value appreciation.

Outcome: Council decided to implement a partial sell down from 18.09% to around 11% raising $836 million to reduce debt. Completed 2023.

Auckland Council – Auckland Airport to Auckland Future Fund 2024

Following the 2023 divestment, the Auckland council owned just over 11% of AIAL. Council also owned 100% of Ports of Auckland (POAL).

Note: Detailed analysis of the POAL options considered are covered later in this report but are referenced in this section as the Council consultation material combined both assets in the investment strategy changes proposed as part of LTP 24 deliberations.

Investment Performance and Strategic Importance

These investments have experienced fluctuations in returns, influenced by commercial factors and the COVID-19 pandemic. Despite these fluctuations, the investments remain integral to the council's financial strategy. Key objectives include protecting asset value, providing financial resilience, enhancing cash returns, diversifying investment risks, improving investment flexibility, and achieving strategic outcomes for the airport and port.

Objectives of the Proposal

Protecting Asset Value: The proposal aims to maintain the real value of the council's intergenerational assets over the long term.

Providing Financial Resilience: The proposal supports the council's ability to respond to shocks, such as climate change impacts, natural events, and financial disruptions, ensuring liquidity and funding for emergency expenditures.

Enhancing Cash Returns: The proposal seeks to improve cash returns from investments, surpassing the council's long-term cost of capital.

Delivering Diversification: The council intends to spread investments across a range of assets to reduce risk.

Improving Flexibility: The proposal allows the council to rebalance investments to reflect changing community needs and investment objectives.

Achieving Strategic Outcomes: The proposal ensures continued delivery on strategic objectives for the airport and port.

Key Decisions for the Council

Establishing a Regional Wealth Fund:

The council is considering the establishment of an Auckland Future Fund to manage financial investments.

Transferring AIAL Shareholding:

The council was evaluating whether to transfer its AIAL shareholding into the fund.

Leasing Port Operations:

The council was contemplating changing the way the port is run by leasing operations while retaining ownership of the land and wharves, and potentially investing the proceeds in the fund.

Proposed Option

Option 1: Auckland Future Fund with AIAL Shares and Port Lease Proceeds

This option involves establishing the Auckland Future Fund, transferring the council's AIAL shares into the fund, and granting a 35-year operating lease for port operations. The upfront payment from the lease would be invested in the fund, while the council retains ownership of the port land and wharves.

Other Options Considered

Option 2: Enhanced Status Quo

No establishment of the Auckland Future Fund. The council retains AIAL shares and continues to operate POAL, working to enhance financial performance and returns.

Option 3: Auckland Future Fund with AIAL Shares Only

Establishing the fund and transferring AIAL shares, but POAL continues operating the port without transferring port returns to the fund.

Option 4: Auckland Future Fund with AIAL Shares and POAL Dividends

Establishing the fund with AIAL shares and investing POAL dividends into the fund, while POAL continues to operate the port.

Overview of Options Assessment

The proposed Auckland Future Fund aims to spread investments across multiple assets, reducing risk and potentially improving long-term returns. It would enhance the council's financial resilience, provide a level of self-insurance, and support council operations with annual cash distributions.

Self-Insurance Component

A portion of the fund, estimated at a minimum of $1 billion, would be set aside for self-insurance, reducing insurance premiums and providing coverage for significant natural events.

Financial Assessment and Implications

The financial assessment of the fund is based on several uncertain factors, including investment returns and the level of investment.

AC's summary of options and implications

	Option 1 Auckland Future Fund with AIAL and port lease	Option 2 Enhanced Status Quo	Option 3 Auckland Future Fund with AIAL	Option 4 Auckland Future fund with AIAL shares and POAL dividends
Protecting assets	✓+ Base case dividends set at level to maintain real asset growth.	✓ Limited levers to ensure value is protected.	✓+ Base case dividends set at level to maintain real asset growth.	✓✓ Reinvestment of dividends provides for growth exceeding inflation
Self-insurance / resilience	✓✓ Greater ability to absorb shocks, albeit changes to fund value or dividends may be needed.	✗ Low portfolio liquidity and ability to use asset value to self-insure	✓ Limited ability to self-insure against larger shocks without impacting fund value and future dividends	✓ Limited ability to self-insure against larger shocks without impacting fund value and future dividends
Enhanced cash returns	✓✓✓ Potential for greatest returns	✓ AIAL / POAL dividends received	✓✓ Potential for greater returns from diversified portfolio, albeit limited cash following self-insurance event	✗ Lower cash returns than status quo due to reinvestment of POAL dividends
Diversification	✓✓✓ Full asset value / proceeds reinvested in diversified investment portfolio	✗ Concentrated investment exposure/ risk.	✓✓ Reinvestment of AIAL proceeds in a diversified investment portfolio	✓✓ Reinvestment of AIAL proceeds in a diversified investment portfolio
Flexibility	✓✓✓ Larger scale provides greater flexibility to balance financial objectives.	✓ Limited ability to rebalance assets to reflect changing community needs.	✓✓ Fund expected to enable timely response to changing community needs and market conditions.	✓✓ Fund expected to enable timely response to changing community needs and market conditions.
Strategic outcomes	✓✓✓ Strategic outcomes for airport maintained through other means Strategic outcomes for port improved	✓✓ Strategic outcomes continue to be delivered	✓✓ Strategic outcomes for airport maintained through other means Outcomes for port maintained	✓✓ Strategic outcomes for airport maintained through other means Outcomes for port maintained
Projected financial contribution (9 years: 2025/2026 - 2033/2034)	**$1.8 billion**	**$1.2 billion**	**$1.7 billion**	**$1.0 billion**
Projected rates increase for 2025/2026	**3.5%**	**6.5%**	**4.2%**	**7.5%**

The expected average return is projected at 7.5% annually, with 2% reinvested into the fund. This net return (5.5%) would be distributed to the council for operations.

Projected Financial Benefits

The fund is expected to provide greater financial benefits compared to maintaining current AIAL and POAL operations, reducing the need for higher rate increases. It also offers a level of self-insurance, potentially lowering external insurance premiums by approximately $12 million per year.

Airport Shareholding Proposal

Transfer to Auckland Future Fund: The council proposes transferring its remaining AIAL shares into the Auckland Future Fund, managed by an investment manager authorised to sell the shares and reinvest the proceeds.

Strategic Assessment

Given the council's limited control over AIAL with an 11% stake, the shareholding has no significant strategic value for the council's goals. The influence on the airport can continue through land-use planning and regulatory roles without holding shares.

Financial Implications

Transferring AIAL shares to the fund was projected to provide higher cash distributions compared to retaining the shares, enhancing funding for council operations and reducing the need for rate increases.

Current Status

Council decided shares valued at 1.3b will be transferred into an investment fund and sold as part of LTP2024.

TX1 Insight

Auckland Council - Ports of Auckland to Auckland Future Fund 2024

Auckland Council owns 100% of Port of POAL, which manages Auckland's commercial freight and cruise ship harbour facilities on the Waitematā Harbour. POAL operates on 77 hectares of reclaimed land used for containers, cars, and other cargo.

The council considered two main options for the future operations of the port with a third status quo plus hybrid as outlined below:

Continued Operation by POAL – status quo

POAL would continue to own and operate the port, implementing a turnaround plan to improve returns to the council.

The Status Quo option was forecast to deliver projected profits of $856 million over nine years.

Lease of Port Operations - preferred option

The Council or POAL would lease the port land and operations to an external party for about 35 years. The council would receive an upfront payment, while the lessee would operate the port, make capital investments, and earn profits. The port's operations and land would revert to the council at the lease's end.

The Lease Option was forecast to deliver an estimated $941 million contribution over nine years, factoring in interest costs on POAL debt.

Reinvestment Approach - Status Quo plus

The third option considered was for POAL to continue to deliver port operations but for the annual dividends from the port to be invested into an Auckland Future Fund, rather than used by the council to fund existing services.

The Reinvestment Approach with annual dividends from POAL being reinvested was forecast to deliver a lower projected contribution of $185 million over nine years.

Figure 5: Projected POAL profit from port operations

$ million	FY25	FY26	FY27	FY28	FY29	FY30	FY31	FY32	FY33	FY34	Total
POAL projected profit		**78**	**84**	**89**	**93**	**98**	**101**	**103**	**104**	**106**	**856**

Figure 6: Projected financial contribution from investment of port lease proceeds in a fund

$ million	FY25	FY26	FY27	FY28	FY29	FY30	FY31	FY32	FY33	FY34	Total
Projected gross fund return		158	161	164	167	170	174	177	181	185	**1,536**
Less reinvestment into fund		(42)	(43)	(44)	(45)	(45)	(46)	(47)	(48)	(49)	**(410)**
Net fund proceeds		**116**	**118**	**120**	**123**	**125**	**128**	**130**	**133**	**135**	**1,127**
Less: interest costs on retained port debt		(19)	(19)	(20)	(20)	(21)	(21)	(22)	(22)	(22)	**(185)**
Projected financial contribution		**96**	**99**	**101**	**103**	**104**	**106**	**108**	**111**	**113**	**941**

Figure 7: Projected financial contribution from investment of port dividends in a fund

$ million	FY25	FY26	FY27	FY28	FY29	FY30	FY31	FY32	FY33	FY34	Total
Projected gross fund return		0	6	12	19	27	34	43	51	60	**253**
Less reinvestment into fund		0	(2)	(3)	(5)	(7)	(9)	(11)	(14)	(16)	**(67)**
Projected financial contribution		**0**	**4**	**9**	**14**	**20**	**25**	**31**	**38**	**44**	**185**

TX1 Insight

Strategic Assessment and Implications

The Port of Auckland is a strategic asset for the region and the country, integral to the North Island supply chain.

As the sole owner, the council has governance control but cannot be involved in daily operations due to legal constraints under the Port Companies Act 1988. The Act mandates that POAL operates as a 'successful business' akin to privately-owned companies.

The council outlined six strategic objectives for POAL:

1. Retain Ownership of Port Land: Ensuring continued council ownership of the port land and seabed.
2. Secure POAL's Development: Supporting POAL as a community asset and economic growth enabler, ensuring access to capital for investment needs, and optimising the North Island logistics chain.
3. Deliver Efficient and Sustainable Services: Providing competitive port services, adhering to community expectations, and maintaining high safety and environmental standards.
4. Optimise Waterfront Land Use: Releasing waterfront land for community purposes, preserving options for future port relocation, and mitigating transfer risks.
5. Enhance Community Control: Safeguarding community interests, enhancing council governance, and ensuring compliance with legal obligations.
6. Optimise Financial Returns: Maximising dividends and returns on ratepayer capital without increasing the funding burden on ratepayers and reducing POAL's debt impact on the council.

Financial Assessment and Implications

A financial assessment, based on expert external advice and peer-reviewed projections, estimated an upfront lease payment of $2 billion to $3 billion for the port operations, with a central estimate of $2.1 billion.

Comparing the two main options over a 35-year lease term, the lease option was assessed as having the potential to deliver approximately $300 million in higher returns than the enhanced status quo.

Leasing the port operations and investing the proceeds in the AFF was projected to deliver the highest financial contribution, supporting council operations and reducing the need for rate increases and debt.

Other Considered Options

Debt Repayment: Using lease proceeds to repay debt would reduce financial contributions to the council but not protect long-term asset value.

Shorter/Longer Lease Terms: A significantly shorter lease may not attract operators, while a longer lease would restrict long-term decisions.

The analysis indicated that leasing the port operations was likely to yield the best financial outcomes and support council's strategic objectives.

Current Status

Council decided not to proceed with the lease of port land and assets.

PoAL, the union and Mayor developed a proposal to increase dividends and presented it to the LTP deliberations.

PoAL agreed to contribute $1.1 billion in profits to Auckland Council over the next 10 years, exceeding the projected net returns from investing the proceeds of a port lease by $172 million.

Christchurch City Council – CCHL Active Portfolio Management 2023

Introduction

In December 2021, the Christchurch City Council (CCC) issued a Letter of Expectations (LOE) to Christchurch City Holdings Limited (CCHL), prompting a review of its core purpose and alignment with the city's strategic priorities and future challenges.

Due to personnel changes at CCHL, the Council managed the review and commissioned Northington Partners Limited (Northington) to evaluate CCHL's operations.

By December 2022 Council resolved to develop a clear Value Strategy for CCHL and to create business cases for a hybrid portfolio management approach. CCHL also engaged KPMG for a portfolio review, leading to workshops with elected members to understand CCHL's position and develop relevant business cases.

CCHL explored options for more active management of its portfolio and sought guidance from the CCC on the next steps.

A report was prepared for CCC's Finance and Expenditure Committee in December 2023, influenced by a recommendation letter from CCHL, aiming to provide a basis for Council's decision-making regarding future portfolio management.

CCHL's board made a recommendation to CCC to consult on an Active Portfolio Management operating model through the draft 2024-2034 Long Term Plan process, noting such a decision would override the December 2022 Council decision.

Options Considered

Status quo: Not advanced due to external advisors' assessment.

Enhanced Status quo: Continued operations with improved capital management and operational oversight.

Active portfolio management: Recommended by CCHL, involving a new investment governance framework and greater investment flexibility.

Divestment of all assets: Not supported by Council or CCHL.

For 'Option 3 - Active Portfolio Management,' a public consultation process was required under the Local Government Act 2002 (LGA), necessitating an amendment to the Long-Term Plan.

The amendment process involves detailed proposal preparation, stakeholder engagement, and compliance with decision-making requirements, including auditing.

CCHL provided the following rationale for its request.

In making this recommendation we also note that over the course of the 10-year period covered by the LTP, the more flexible mandate could deliver nearly $450m of additional dividends to Council over CCHL's existing forecasts, and over $220m above what is possible under an enhanced status quo discussed below.

Council Value Strategy

CCHL noted that during 2023 it worked closely with Council to develop the Value Strategy which informed Council's long-term requirements from its investment portfolio.

The Value Strategy workshops identified the following investment objectives (in priority order):

- For the benefit of current and future generations
- Supporting growth of Christchurch and Canterbury through resilient infrastructure
- Sustainable real growth in dividends
- Balanced risk appetite.

In addition to this Council identified a funding gap of approximately $80m to 100m per year over the LTP period (assuming rate increases were limited to the Local Government Cost Index (LGCI) plus 2%). CCHL was asked to consider how best to contribute to reducing this funding gap, over and above the existing dividend forecasts provided to Council.

CCHL's recommended option responded to both the Investment Objectives and the request to help close the funding gap over the course of the LTP.

Active Portfolio Manager

CCHL identified the key features of the Active Portfolio Manager as follows:

CCHL is acknowledged as the key Strategic Asset owned by Council, with capital remaining fully invested in meeting Council's long-term investment objectives, unless otherwise requested by Council.

Current Governance arrangements between Council and CCHL are modified to add an Investment Governance framework, through the adoption of an Investment Policy Framework (IPF). The IPF will have four main features:

i. Council approves CCHL's Investment Objectives;

ii. Council approves CCHL's permitted investment activities (Asset Allocation);

iii. CCHL is granted greater flexibility to invest within the approved asset allocation; and

iv. CCHL delivers greater certainty to Council in respect of future income through the adoption of a distribution policy.

The IPF will include "guardrails" which seek to preserve the public interest in accessing sustainable, inclusive and affordable economic infrastructure assets.

Existing Council governance processes relating to strategic and operational expectations, such as the Statement of Intent, would remain in place.

In exercising investment flexibility, CCHL would be required to establish a liquidity portfolio as part of a more prudent, long-term approach to managing Council's invested capital.

To deliver the dividend commitments identified in transitioning to a distribution policy the liquidity portfolio would need at least $350m invested in suitable assets.

CCHL's view of the Enhanced Status Quo

This option would see CCHL continue to operate within the existing mandate and existing assets, while seeking to lift returns over time through stronger oversight of capital management and operational improvements.

While CCHL believed a lift in performance was possible, as reflected in the revised dividend forecasts, it did not believe the mandate delivered on Council's Value Strategy.

CCHL's concerns were reflected at the public annual stakeholder meeting, noting the status quo did not resolve the material tension in addressing:

- Council's desire for stronger dividends, including the ability to ask for special dividends;
- CCHL's requirement to repay debt attached to the post-quake special dividend;
- Subsidiaries' capital requirements to invest in growth and resilience that supports Christchurch and Canterbury; and
- The flexibility required to successfully adapt to the mega-trends of climate change, digital transformation and changing consumer preferences.

It was CCHL's view that, under the enhanced status quo, it would see a dilution of long-term ownership in existing assets given the constraints on access to new capital.

CCHL expressed a firm belief that the Active Portfolio Manager option provided Council with more effective levers to shape the circumstances under which new capital could be accessed and plan for that in a way that ensured the growth of the region was not restricted.

Key Decisions for Council

Council was asked to decide whether to continue developing the business case for Active Portfolio Management and whether it should be part of the Long Term Plan 24 or through a special consultative procedure post-adoption.

The Council was asked to direct the preparation of assessment and advice in response to CCHL's recommendations.

Management's advice was, given the public interest and the scope of work, a substantial change to CCHL's operating model was impractical for the immediate draft Long Term Plan. Therefore, a special consultative procedure post-adoption of the final Long Term Plan was recommended for considering the business case for Active Portfolio Management.

The Finance and Performance Committee was advised to acknowledge CCHL's work and thank the Board and staff for their efforts in conducting the Portfolio Review and engaging with elected members.

Current Status

Council decided not to consult on Active Portfolio Management in its draft long term plan.

Wellington City Council – Wellington Airport to Perpetual Investment Fund 2024

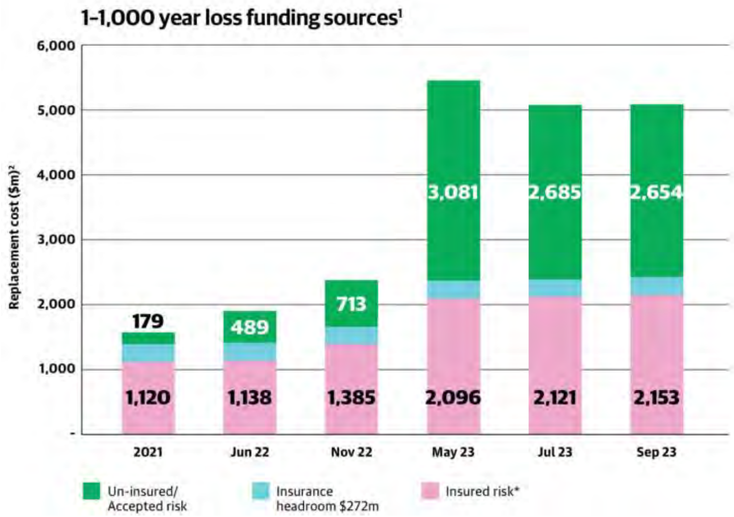
Wellington Council is grappling with two major financial challenges: increasing difficulty and cost of insuring its assets, leading to significant underinsurance, and a lack of diversification in its investment portfolio, which leaves it exposed to uniform types of risk.

The insurance issue is exacerbated by Wellington's seismic profile and climate change impacts, making coverage either unavailable or extremely costly. Additionally, the Council's investments are heavily concentrated in Wellington-based property assets and a 34% shareholding in Wellington International Airport Ltd (WIAL), leading to vulnerability from local disruptions like natural disasters.

Challenge 1: Cost and Availability of Insurance

Wellington's seismic risk has made it increasingly difficult for the Council to secure adequate insurance coverage. The 2022 National Seismic Hazard Model indicates a higher potential payout for insurers after a major earthquake, thus driving up premiums. Combined with the rising value and replacement costs of buildings and infrastructure, the Council faces a significant insurance gap.

Over recent years, the Council has become unsustainably underinsured, with an estimated shortfall of $2.6 billion. The $272 million debt headroom held by the Council to cover uninsured risk is now insufficient to manage the expected losses from a major event.



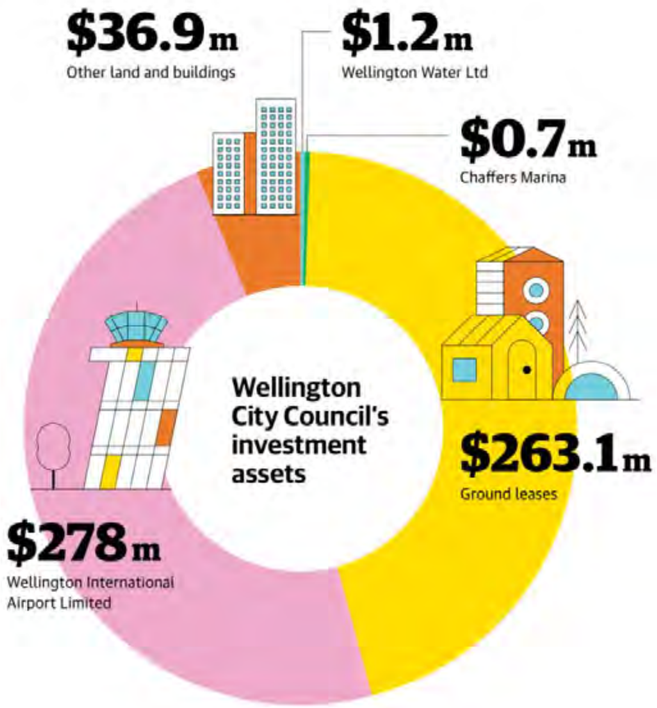
Notes to graph: 1: A 1-1000 year loss describes the loss expected from an event which has probability of 0.1% in any one year. 2: The total replacement cost of all insurance Council assets is $14.8 billion. * Insured risk – The amount of funding the Council expects to receive from external sources after an event.

Challenge 2: Lack of Diversification in the Investment Portfolio

Currently, 93% of the Council's investments are tied up in Wellington-based assets, primarily through WIAL shares and property ground leases. This concentration exposes Council to significant risk from local market disruptions or natural disasters. A single adverse event could drastically reduce the value of these investments, making it challenging to liquidate assets for cash if needed. Additionally, the Council relies heavily on dividends from WIAL, which could be reduced or suspended following a disruptive event, thereby threatening a crucial revenue stream.

Proposed Solution: Establishing a Perpetual Investment Fund

To mitigate these risks, the Council proposes setting up a Perpetual Investment Fund. This fund would be created by selling the Council's 34% shareholding in WIAL and reinvesting the proceeds, along with future sales of certain property ground leases, into a diversified portfolio. The fund is intended to be a publicly owned, enduring financial asset supporting the city's recovery from natural disasters and addressing the insurance gap. Importantly, the proceeds from the sale of WIAL shares will not be used for other Council projects or to pay down debt.



Benefits of the Perpetual Investment Fund

Diversification: The fund will diversify the Council's investments away from Wellington-based property, reducing exposure to local risks and providing a more stable revenue stream.

Financial Security: The fund will provide accessible funding for recovery efforts following a natural disaster, covering insurance shortfalls and other unexpected costs.

Public Ownership and Accountability: As a strategic asset in the Council's Significance and Engagement Policy, any significant changes to the fund will require community consultation, ensuring transparency and public involvement.

How the Fund Will Work

The Perpetual Investment Fund will be set up over the next two years through the sale of the Council's WIAL shares. The initial fund balance is estimated to be around $492 million, based on a midrange valuation of the shares and after accounting for sale costs. Additionally, future sales of property ground leases, estimated at $50 million, will be invested in the fund over the next five to ten years.

Investment Strategy

The Council will develop a comprehensive strategy to govern the fund, including investment guidelines and criteria for withdrawals. The fund will be managed by a professional investment manager, focusing on

TX1 Insight

environmental, social, and governance (ESG) factors, subject to further advice. The Council assumes an annual return of 7% for modelling purposes, a conservative estimate compared to the returns of similar funds and benchmarks like the New Zealand Superannuation Fund.

Revenue and Reinvestment

The Council needs to decide how to split the returns between reinvestment and revenue generation. For modelling purposes, a 5:2 split is assumed, with 70% of returns reinvested to grow the fund and 30% used as revenue for the Council. This approach aims to match the current dividend revenue from WIAL, ensuring no immediate impact on rates or levels of service.

Options for Consideration

The Council has three options:

Option A: Sell Full Holding of WIAL Shares

Pros: Provides maximum diversification, reduces risk, and ensures a stable revenue stream. Frees up the entire $272 million debt headroom and eliminates future capital funding obligations for the airport.

Cons: The Council will no longer receive dividends from WIAL, though the fund's returns are expected to compensate.

Option B: Sell Partial Holding of WIAL Shares

Pros: Offers some diversification and risk mitigation while retaining some dividend income from WIAL. Reduces, but does not eliminate, the need for debt headroom.

Cons: Less diversification and risk mitigation compared to Option A. The Council retains some future capital funding obligations for the airport.

Option C: Retain All WIAL Shares

Pros: Maintains current dividend income, keeping rates lower.

Cons: Does not address diversification or insurance challenges. The Council continues to hold significant uninsured risk and future capital funding obligations for the airport. Debt headroom must be retained and potentially increased.

WCC's assessment of options and implications

	Full sale	Partial sale	No sale
Wellbeings			
Social wellbeing	✓	?/✓	✗
Economic wellbeing	✓	?/✗	✗
Environmental wellbeing	✓	✓	✗
Cultural wellbeing	✓	✓	✗
Section 14 LGA principles			
Give effect to priorities and outcomes in an efficient and effective manner	✓	?/✗	✗
Take into account interests of future, as well as current, communities	✓	?/✓	✗
Assess the expected returns from investing in a commercial activity and satisfy itself that the returns outweigh the risks inherent in the activity	✓	?/✗	✗
Ensure prudent stewardship of its resources, including by planning effectively for the future management of its assets	✓	?/✓	✗
Have regard to the views of its communities	✓ ?	✗ ✓	✓ ✗

Current Status

Councillors voted to progress the proposal, instructing officers to test the market and bring recommendations back to Council by December 2024

BAY OF PLENTY REGIONAL COUNCIL TOI MOANA   PORT OF TAURANGA

Bay of Plenty Regional Council – Port of Tauranga to Perpetual Investment Fund 2024

The Bay of Plenty Regional Council is considering reducing its shareholding in the Port of Tauranga Limited (PoTL) from 54.14% to a minimum of 28%.

This proposal is managed by Quayside Holdings Limited (Quayside), which oversees the Council's investment in PoTL. Currently, Quayside's investment portfolio, heavily concentrated in PoTL shares valued at $2.1 billion, generates significant dividends that reduce regional rates.

Current Situation

Quayside owns 54.14% of PoTL, providing substantial dividends to the Bay of Plenty Regional Council, accounting for 24% of the Council's annual revenue. This reduces average household rates by $380 annually. The PoTL shareholding, identified as a strategic asset, is crucial for the region's economy, providing employment and driving economic activity.

Issues with the Current Portfolio

Independent financial experts suggest that Quayside's current investment portfolio is not optimal for long-term, intergenerational sustainability. The portfolio's heavy reliance on PoTL shares limits the ability to realise capital gains and poses concentration risks. Diversifying the portfolio could mitigate these risks and ensure a more stable and sustainable income stream.

Benefits of Reducing Risk

Diversification would reduce financial risks associated with heavy reliance on PoTL shares. This is important as the Council faces increasing demands for services and infrastructure, climate risks, insurance uncertainties, and rising costs due to interest rates and inflation.

Diversifying the portfolio would:

- Increase resilience to financial shocks and climate change.
- Provide a reliable and growing dividend stream.
- Allow Quayside to adjust its investment portfolio for continued growth.
- Ensure continued rates subsidies for households.

Proposed Actions

The Council has proposed selling some PoTL shares, reducing the shareholding to no less than 28%. This would keep PoTL as a strategic asset, preventing any potential takeover. Proceeds from the sale would be used to repay $200 million in Perpetual Preference Shares (PPS), with the remaining funds invested in a diversified portfolio. Quayside would continue to pay annual dividends from this diversified portfolio, enhancing long-term financial stability.

What is Quayside Holdings Limited?

Quayside, established in 1991, is the investment arm of the Bay of Plenty Regional Council. It manages a significant investment portfolio, aiming to support regional growth and prosperity through long-term returns.

TX1 Insight

Perpetual Preference Shares (PPS)

Issued in 2008, PPS raised $200 million for funding regional infrastructure projects. The cost of PPS has risen and repaying it could save $9.6 million annually. Selling PoTL shares below 50.1% requires PPS repayment.

Financial implications of managed sell-down

The proposal assumes that returns from a diversified portfolio will match or exceed current dividends from PoTL shares. Quayside also has a policy to protect against short-term investment downturns, ensuring stability.

The Cameron Partners modelling suggested that selling $1.1 billion worth of PoTL shares could increase the QHL dividend to Council by $7 million in the year after sale and by a cumulative $185 million over the following 10 years. This modelling is based on multiple assumptions including that:

- The proceeds of the PoTL managed sell down are used to repay the PPS with the remainder reinvested based on the current QHL Statement of Investment Policies and Objectives.
- The current Dividend Distribution Policy is used to set QHL dividends to Council, which smooths changes to dividends over time.

The current Distribution Policy includes the concept of a dividend reset. If a dividend reset were applied after managed sell-down of the PoTL shares, the QHL dividend to Council would increase by $11 million in the year after sale, based on the Cameron Partners modelling.

Therefore, as a rule of thumb, selling $100 million of PoTL shares could result in an immediate increase of the QHL dividend to Council of around $1 million, which would continue to increase over time subject to investment performance.

These dividend estimates were used to illustrate one potential benefit of the managed sell down, which could include options other than increased dividends to Council.

Implementation of the Sell Down

If the proposal proceeds, the sale of shares would be managed to optimise financial returns while maintaining a minimum 28% shareholding. The proceeds would be reinvested, considering the need to repay PPS. Council and Quayside would revise the investment strategy accordingly.

Accountability and Monitoring

Council will continue oversight of PoTL through existing regulatory frameworks. No additional accountability measures are proposed for the publicly traded shares.

Conflicts of Interest

Any conflicts of interest arising from the sell-down process will be managed according to the Council's current processes, ensuring no inappropriate financial gains for advisors involved.

Option One – Status Quo

The status quo option would see Quayside retain the existing 54.14% shareholding in PoTL.

Option Two - Preferred Option

The Council prefers the option to reduce PoTL shareholding to a minimum of 28% for better financial management and long-term benefits. This managed sell-down aims to balance immediate financial needs with future sustainability and growth, ensuring continued support for regional initiatives while maintaining financial prudence.

BOPRC's summary of options and implications

Scenario	Strategic			Financial			
	Ownership and Control of Port	Port Strategic Outcomes	Retains flexibility	Diversifies financial exposure	Cash return to QHL	Liquidity	Debt (PPS) repayment
Option 1 54.1% Shareholding Status Quo	✓✓✓ Controlling stake	Yes	✗	✗	✓	✗	No
Option 2 Council Preferred Reduce Shareholding to no less than 28%	✓✓ Negative control*	Yes	✓✓✓	✓✓✓	✓✓	✓✓	Yes

KEY: ✓ = Positive ✓✓ = Strong positive ✓✓✓ = Very Strong Positive ✗ = Negative

*Negative control: When a minority shareholder has the ability to block action by the board or shareholders – for example it could block any takeovers.

Outcome

Council decided to progress a managed sell down of its 54.14% shareholding in PoTL to a minimum of 28%, to repay the Perpetual Preference Shares valued at $200 million and to invest the remaining proceeds of the divestment into a diversified investment fund.

Dunedin City Council
Aurora Energy Limited - Diversified Investment Fund

In New Zealand, the question of public asset sales often incites vocal opposition. In our view, some of the arguments against have merit and need to be addressed, others do not.

Often there is criticism around "selling the family silver". The case can be made that Aurora Energy Limited (Aurora Energy) is a quality asset, but the question really should be, is it the best asset for Dunedin City Council (Council) to own?

The Council's proposal isn't novel. Many regional councils have long-term investment funds seeded by the partial or outright sale of infrastructure and property assets, including Northland, Waikato, the Bay of Plenty, and the Council's Waipori Fund (just to name a few). A number of regions also have Community Trusts which were seeded by the sale of power companies, regional banks, or other assets. Their sizeable assets generate income which is invested back into those regions.

Benefits of Diversification

A key principle of investing is diversification – not having all your eggs in one basket in order to protect yourself against future unexpected shocks. Arguably, the Council's assets are not currently diversified. If a major economic shock or natural disaster impacted the Dunedin economy, hurting Dunedin ratepayers and raising the Council's need for funds, it might also impact Aurora Energy's assets.

A diversified investment fund could provide the Council with higher investment returns over the long-term, with less risk (volatility), a more consistent and sustainable income stream, and greater liquidity relative to its investment in Aurora Energy.

Our initial impression, given the Council's perpetual/inter-generational investment horizon, is that a growth focused portfolio for the investment fund may be most appropriate. A growth portfolio would typically have a significant exposure to global equities (50% or more). Global equities provide options for diversification into currencies, sectors, and investment themes that are not well represented in the New Zealand market.

Additionally, the Council's broader asset and rates base is also within New Zealand. Should a major adverse event impact the Dunedin and/or broader New Zealand economy, having greater offshore diversification (and exposure to foreign currencies) provides some insurance and should lessen the negative impact.

EXAMPLE OF GROWTH PORTFOLIO BENCHMARK (ASSUMED IN OUR MODELLING)

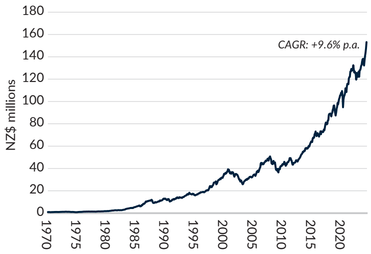
Asset Class	*Benchmark Indices*	*Growth Benchmark Weights*
Cash	S&P/NZX 90-Day Bank Bill Index	3%
NZ Fixed Interest	S&P/NZX NZ Government Bond Index	7%
Global Fixed Interest	Bloomberg U.S. Aggregate Total Return Index Hedged NZD	10%
NZ Equities	S&P/NZX 50 Gross Index	15%
Australian Equities	S&P/ASX 200 Accumulation Index (NZD)	15%
Global Equities	MSCI ACWI NTR Index (NZD)	50%

FORSYTH BARR

Historical Returns

As shown in the chart, a passive (i.e. not actively managed) growth benchmark portfolio has delivered a historical compound annual return of approximately +9.6% p.a. (before fees), since the beginning of 1970. That is, $1 million invested in a growth portfolio in 1970 would be worth approximately $150 million today (approximately 150x the initial $1 million investment) assuming all returns were reinvested.

LONG-TERM PERFORMANCE OF GROWTH BENCHMARK PORTFOLIO (NZD TOTAL RETURNS)



Source: Forsyth Barr Analysis, Refinitiv Datastream

Long-Term Funds Can Benefit from Active Management

Please note that the growth benchmark portfolio does not capture any benefits from active investment management or include any allocation to private market investments, which have historically provided higher returns and would likely be appropriate for the Council given its perpetual/inter-generational investment horizon.

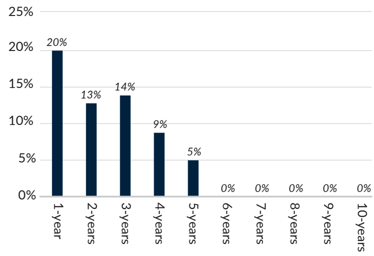
As examples of the potential benefits, both the NZ Super Fund and ACC utilise active management and invest in private markets. The NZ Super Fund has delivered returns of +9.8% p.a. (after fees over nearly 21 years) since its inception in September 2003 vs. its benchmark of +8.3% (to April 2024). The NZ Super Fund's asset allocation is 80% equities:20% fixed income/cash, in line with what we have assumed may be appropriate for the Council's investment fund. Similarly, ACC's Investment Fund has delivered returns of +9.3% p.a. over 32 years since 1992 vs. its benchmark of +8.1% (to June 2023).

The Risk of Negative Returns Decreases the Longer the Investment Horizon

While investing in a diversified investment portfolio (particularly a growth focused portfolio) comes with risk (volatile returns) in the short-term, in our view, the primary risk an investor faces is not short-term market volatility but rather not being able to meet their long-term investment objectives and required return. The chart below highlights the risk of negative returns over a range of time-periods.

The chart illustrates that the likelihood of negative returns decreases materially the longer the investment horizon. Since 1970, a growth portfolio has delivered a negative return in 20% of one-year periods (approximately one in every five years). This drops to only 5% of five-year periods having delivered a negative return, with all periods longer than five years having delivered positive returns.

GROWTH BENCHMARK PORTFOLIO - HISTORICAL OCCURRENCE OF NEGATIVE RETURNS



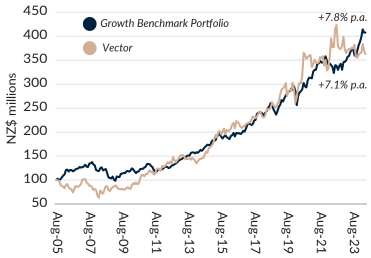
Source: Forsyth Barr Analysis, Refinitiv Datastream

Comparison Using NZX Listed Vector as a Proxy for Aurora Energy

The most comparable company to Aurora Energy listed on the NZX is Vector. Vector is New Zealand's largest distributor of electricity and gas, owning and operating networks across the Auckland region. Vector also owns 50% of Vector Metering, and owns and operates a gas trading business, Vector Fibre – a fibre network company, and HRV – a ventilation and heating/cooling solutions company.

Vector was listed on the NZX in August 2005. $1 million invested in Vector at its listing would be worth approximately $3.6 million today, equivalent to a compound annual return of +7.1% p.a.. This solid return (albeit below that earned by a growth portfolio) includes the benefit Vector received from selling assets, most notably the divestments of (what is now) Wellington Electricity in 2008 for $785 million, its gas transmission and non-Auckland distribution networks in 2015 for $953 million, and 50% of its New Zealand and Australian metering business in 2023 for $1.7 billion. The total $3.4 billion proceeds from these divestments compares to Vector's current market capitalisation of $3.7 billion, i.e. they were very significant for the company. These sales helped Vector to both meet its capital investment programme and maintain a dividend.

VECTOR VS GROWTH BENCHMARK PORTFOLIO - TOTAL RETURNS (NZD) SINCE VECTOR'S SHARE MARKET LISTING IN AUGUST 2005



Source: Forsyth Barr Analysis, Refinitiv Datastream

Since August 2005	*Growth Benchmark Portfolio*	*Vector*
Compound annual growth rate (CAGR, p.a.)	7.8%	7.1%
Annualised Volatility	9.3%	16.1%
Maximum peak-to-trough drawdown	-28.2%	-38.5%

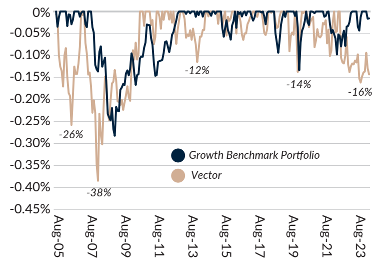
Source: Forsyth Barr Analysis, Refinitiv Datastream

Appreciating Risk and Volatility

While we have used NZX listed Vector as a proxy for Aurora Energy, we suspect the comparison is somewhat generous (in favour of Aurora Energy). In 2011 Aurora Energy paid a $12 million dividend to Dunedin City Holdings Limited (DCHL), however, dividends have steadily declined, with Aurora Energy not having paid a dividend to DCHL since 2017. As the Council has outlined, Aurora Energy is unlikely to provide a dividend to the Council in the short-term. If it does provide a dividend, it is likely to be debt funded (i.e., Aurora Energy would probably need to borrow funds to provide a dividend to the Council). This compares to Vector, which has grown its dividend from $144 million in 2011 to $170 million in 2023.

One observation that may come as a surprise, given Vector is viewed as a defensive business (meaning its earnings are typically not significantly impacted by economic conditions), is that its market price has actually been significantly more volatile than that of a growth portfolio. Vector's annualised volatility has been almost two times higher! This volatility has been caused by factors such as its high debt levels – during the Global Financial Crisis (GFC) Vector suffered a materially worse decline, and uncertainty and surprise around Commerce Commission regulatory decisions.

PEAK-TO-TROUGH DRAWDOWNS (NZD)



Source: Forsyth Barr Analysis, Refinitiv Datastream

Some may believe that a diversified investment fund would be more volatile than the Council's investment in Aurora Energy. In our opinion however, this view is likely inaccurate. The Council's investment in Aurora Energy may be perceived to be low volatility, but this is only because the asset is not priced (marked-to-market) daily, as is the case with listed assets. If Aurora Energy were a listed asset (like Vector), it would likely exhibit similar high levels of volatility.

Additional Benefits of a Diversified Investment Fund

In addition to providing a more consistent and sustainable income stream by way of dividends and interest payments, a diversified investment fund could also provide the Council with near-immediate access to funds should it deem that necessary, e.g. in response to a major event impacting the Dunedin region or required to advance a major strategic initiative. The majority of the diversified investment fund's investments would be liquid and, therefore, easily converted to cash in a shorttimeframe. The Council's investment in Aurora Energy does not provide this option.

Another claim is that asset sales are a short-term gain but a long-term loss. That may or may not be true depending on how the process is managed. History suggests that governments aren't the best owners of businesses. If you consider the Mixed Ownership Model process when Meridian Energy, Mercury Energy (then Mighty River Power), and Genesis Energy were partially floated on the NZX. Today the New Zealand government receives around $460 million in dividends a year from its 50.1% stakes in these three companies, substantially higher than the $191 million it received in 2012 when it owned 100%. Prospective buyers of Aurora would factor potential operational improvements in the price they are willing to pay for the asset.

A further (understandable) concern is that private owners prioritise profits over public interests. Aurora Energy is a regulated company. Consumers would continue to be protected by the Commerce Commission and Electricity Authority if Aurora Energy was sold to a new owner. The Council could incorporate other obligations as part of the sale if desired.

The Importance of Governance and a Long-Term Investment Plan

One valid concern around government asset sales is that the proceeds may be squandered. There are precedents where asset sale proceeds have been spent on short-term projects and/or operating expenses, and not preserved for the long-term.

If Aurora Energy is divested and a fund is established, it will be important that the right governance rules and structures are put in place to ensure the funds are preserved for the long-term benefit of ratepayers as intended. This isn't hard to do. The New Zealand Super Fund, for example, has rules in place so governments can't tap into its funds. Effective governance will position the Council to make informed investment decisions that align with its overall mission and preserve the fund's long-term strategy.

Summary

History suggests that a diversified investment fund of the nature proposed by the Council is likely to deliver higher long-term returns than Aurora and, importantly, with less risk and volatility than having the funds tied up in a single regional asset. The reduced debt resulting from the sale would also lower the overall financial risk the Council carries.

A well-structured governance regime, including a clearly articulated Statement of Investment Policy and Objectives, should ensure the diversified fund is effectively managed over the long-term to enhance the Council's overall financial strength and provide intergenerational benefits to Dunedin's ratepayers.

DUN6631 - July 2024

Scenario Analysis 1 - RETAIN AURORA, BASE

Council	Year 1 Scenario 1 2026	Year 2 Scenario 1 2027	Year 3 Scenario 1 2028	Year 4 Scenario 1 2029	Year 5 Scenario 1 2030	Year 6 Scenario 1 2031	Year 7 Scenario 1 2032	Year 8 Scenario 1 2033	Year 9 Scenario 1 2034	Total Scenario 1 2025-34
DCC Rates Increase (%)	9.95%	5.90%	5.90%	5.90%	5.90%	5.90%	5.90%	5.90%	5.90%	6.35%
DCC Rates Revenue ($ million)	263	278	295	312	331	350	371	393	416	3,007
DCC Interest Expenditure ($ million)	38	36	40	45	49	53	56	59	62	439
DCC Capital Expenditure ($ million)	204	210	212	254	230	234	235	239	253	2,071
DCC Debt Balance ($ million)	808	905	993	1,116	1,207	1,292	1,363	1,423	1,477	
DCC Debt Movement ($ million)	98	97	88	123	91	85	72	60	53	767
DCC Surplus/(Deficit) ($ million)	(15)	(12)	(4)	(2)	2	9	19	31	48	77

DCHL	Year 1 Scenario 1 2026	Year 2 Scenario 1 2027	Year 3 Scenario 1 2028	Year 4 Scenario 1 2029	Year 5 Scenario 1 2030	Year 6 Scenario 1 2031	Year 7 Scenario 1 2032	Year 8 Scenario 1 2033	Year 9 Scenario 1 2034	Total Scenario 1 2025-34
DCHL Total Revenue ($ million)	372	399	419	443	464	475	486	498	515	4,070
DCHL Interest Expenditure ($ million)	38	34	36	37	39	40	41	42	43	350
DCHL Debt Balance ($ million)	789	817	859	898	925	952	979	1,000	1,017	
DCHL Debt Movement ($ million)	38	28	42	39	27	27	28	21	17	266

Group (DCC + DCHL)	Year 1 Scenario 1 2026	Year 2 Scenario 1 2027	Year 3 Scenario 1 2028	Year 4 Scenario 1 2029	Year 5 Scenario 1 2030	Year 6 Scenario 1 2031	Year 7 Scenario 1 2032	Year 8 Scenario 1 2033	Year 9 Scenario 1 2034	Total Scenario 1 2025-34
Group Total Revenue	769	807	847	887	928	958	991	1,026	1,071	8,284
Group Interest Expenditure ($ million)	76	71	76	82	88	93	97	101	104	789
Group Debt Balance ($ million)	1,597	1,722	1,852	2,014	2,132	2,243	2,343	2,424	2,494	
Group Debt Movement ($ million)	136	126	129	162	118	111	99	81	70	1,033

Metrics	Year 1 Scenario 1 2026	Year 2 Scenario 1 2027	Year 3 Scenario 1 2028	Year 4 Scenario 1 2029	Year 5 Scenario 1 2030	Year 6 Scenario 1 2031	Year 7 Scenario 1 2032	Year 8 Scenario 1 2033	Year 9 Scenario 1 2034
DCC Financial Strategy									
Debt ($ million)	808	905	993	1,116	1,207	1,292	1,363	1,423	1,477
Limit at 250% of Revenue ($ million)	993	1,020	1,070	1,112	1,160	1,208	1,263	1,321	1,390
Debt at 250% of Revenue (%)	203%	222%	232%	251%	260%	267%	270%	269%	266%
Limit at 250% of Revenue (%)	250%	250%	250%	250%	250%	250%	250%	250%	250%
Uncalled Capital (current limit $1.6 billion)									
Consol Debt ($ million)	1,597	1,722	1,852	2,014	2,132	2,243	2,343	2,424	2,494

Scenario Analysis 2 - RETAIN AURORA, BASE (WITH HIGH OPEX/CAPEX)

Council	Year 1 Scenario 2 2026	Year 2 Scenario 2 2027	Year 3 Scenario 2 2028	Year 4 Scenario 2 2029	Year 5 Scenario 2 2030	Year 6 Scenario 2 2031	Year 7 Scenario 2 2032	Year 8 Scenario 2 2033	Year 9 Scenario 2 2034	Total Scenario 2 2025-34
DCC Rates Increase (%)	9.95%	5.90%	5.90%	5.90%	5.90%	5.90%	5.90%	5.90%	5.90%	6.35%
DCC Rates Revenue ($ million)	263	278	295	312	331	350	371	393	416	3,007
DCC Interest Expenditure ($ million)	38	38	45	52	59	65	70	75	79	521
DCC Capital Expenditure ($ million)	214	244	255	284	260	259	260	264	278	2,318
DCC Debt Balance ($ million)	822	969	1,130	1,317	1,464	1,591	1,706	1,812	1,913	
DCC Debt Movement ($ million)	113	147	161	187	147	127	115	105	101	1,203
DCC Surplus/(Deficit) ($ million)	(20)	(29)	(36)	(38)	(27)	(12)	(4)	5	20	(140)
DCHL	Year 1 Scenario 2 2026	Year 2 Scenario 2 2027	Year 3 Scenario 2 2028	Year 4 Scenario 2 2029	Year 5 Scenario 2 2030	Year 6 Scenario 2 2031	Year 7 Scenario 2 2032	Year 8 Scenario 2 2033	Year 9 Scenario 2 2034	Total Scenario 2 2025-34
DCHL Total Revenue ($ million)	372	399	419	443	464	475	486	498	515	4,070
DCHL Interest Expenditure ($ million)	38	34	36	37	39	40	41	42	43	350
DCHL Debt Balance ($ million)	789	817	859	898	925	952	979	1,000	1,017	
DCHL Debt Movement ($ million)	38	28	42	39	27	27	28	21	17	266
Group (DCC + DCHL)	Year 1 Scenario 2 2026	Year 2 Scenario 2 2027	Year 3 Scenario 2 2028	Year 4 Scenario 2 2029	Year 5 Scenario 2 2030	Year 6 Scenario 2 2031	Year 7 Scenario 2 2032	Year 8 Scenario 2 2033	Year 9 Scenario 2 2034	Total Scenario 2 2025-34
Group Total Revenue	769	807	847	887	928	958	991	1,026	1,071	8,284
Group Interest Expenditure ($ million)	77	72	80	89	98	105	111	117	122	871
Group Debt Balance ($ million)	1,611	1,786	1,989	2,215	2,389	2,542	2,685	2,812	2,930	
Group Debt Movement ($ million)	151	175	203	226	174	153	143	127	118	1,469
Metrics	Year 1 Scenario 2 2026	Year 2 Scenario 2 2027	Year 3 Scenario 2 2028	Year 4 Scenario 2 2029	Year 5 Scenario 2 2030	Year 6 Scenario 2 2031	Year 7 Scenario 2 2032	Year 8 Scenario 2 2033	Year 9 Scenario 2 2034	
DCC Financial Strategy										
Debt ($ million)	822	969	1,130	1,317	1,464	1,591	1,706	1,812	1,913	
Limit at 250% of Revenue ($ million)	993	1,020	1,070	1,112	1,160	1,208	1,263	1,321	1,390	
Debt at 250% of Revenue (%)	207%	238%	264%	296%	315%	329%	338%	343%	344%	
Limit at 250% of Revenue (%)	250%	250%	250%	250%	250%	250%	250%	250%	250%	
Uncalled Capital (current limit $1.6 billion)										
Consol Debt ($ million)	1,611	1,786	1,989	2,215	2,389	2,542	2,685	2,812	2,930	

Scenario Analysis 3 - RETAIN AURORA, 10% RATES (WITH HIGH OPEX/CAPEX)

Council	Year 1 Scenario 3 2026	Year 2 Scenario 3 2027	Year 3 Scenario 3 2028	Year 4 Scenario 3 2029	Year 5 Scenario 3 2030	Year 6 Scenario 3 2031	Year 7 Scenario 3 2032	Year 8 Scenario 3 2033	Year 9 Scenario 3 2034	Total Scenario 3 2025-34
DCC Rates Increase (%)	10.00%	10.00%	10.00%	10.00%	10.00%	10.00%	10.00%	10.00%	10.00%	10.00%
DCC Rates Revenue ($ million)	263	289	318	350	385	423	466	512	564	3,570
DCC Interest Expenditure ($ million)	38	38	44	50	55	57	59	58	56	454
DCC Capital Expenditure ($ million)	214	244	255	284	260	259	260	264	278	2,318
DCC Debt Balance ($ million)	822	958	1,095	1,241	1,329	1,375	1,384	1,353	1,283	
DCC Debt Movement ($ million)	113	136	136	147	88	46	9	(31)	(70)	574
DCC Surplus/(Deficit) ($ million)	(20)	(18)	(11)	2	32	69	103	142	191	490

DCHL	Year 1 Scenario 3 2026	Year 2 Scenario 3 2027	Year 3 Scenario 3 2028	Year 4 Scenario 3 2029	Year 5 Scenario 3 2030	Year 6 Scenario 3 2031	Year 7 Scenario 3 2032	Year 8 Scenario 3 2033	Year 9 Scenario 3 2034	Total Scenario 3 2025-34
DCHL Total Revenue ($ million)	372	399	419	443	464	475	486	498	515	4,070
DCHL Interest Expenditure ($ million)	38	34	36	37	39	40	41	42	43	350
DCHL Debt Balance ($ million)	789	817	859	898	925	952	979	1,000	1,017	
DCHL Debt Movement ($ million)	38	28	42	39	27	27	28	21	17	266

Group (DCC + DCHL)	Year 1 Scenario 3 2026	Year 2 Scenario 3 2027	Year 3 Scenario 3 2028	Year 4 Scenario 3 2029	Year 5 Scenario 3 2030	Year 6 Scenario 3 2031	Year 7 Scenario 3 2032	Year 8 Scenario 3 2033	Year 9 Scenario 3 2034	Total Scenario 3 2025-34
Group Total Revenue	769	818	871	925	982	1,032	1,086	1,146	1,219	8,847
Group Interest Expenditure ($ million)	77	72	79	87	93	97	100	100	99	804
Group Debt Balance ($ million)	1,611	1,775	1,953	2,139	2,254	2,327	2,363	2,353	2,300	
Group Debt Movement ($ million)	150	164	178	186	115	72	36	(10)	(53)	840

Metrics	Year 1 Scenario 3 2026	Year 2 Scenario 3 2027	Year 3 Scenario 3 2028	Year 4 Scenario 3 2029	Year 5 Scenario 3 2030	Year 6 Scenario 3 2031	Year 7 Scenario 3 2032	Year 8 Scenario 3 2033	Year 9 Scenario 3 2034
DCC Financial Strategy									
Debt ($ million)	822	958	1,095	1,241	1,329	1,375	1,384	1,353	1,283
Limit at 250% of Revenue ($ million)	993	1,047	1,129	1,206	1,296	1,392	1,501	1,620	1,760
Debt at 250% of Revenue (%)	207%	229%	242%	257%	256%	247%	231%	209%	182%
Limit at 250% of Revenue (%)	250%	250%	250%	250%	250%	250%	250%	250%	250%
Uncalled Capital (current limit $1.6 billion)									
Consol Debt ($ million)	1,611	1,775	1,953	2,139	2,254	2,327	2,363	2,353	2,300

Scenario Analysis 4 - SELL AURORA, BASE - FUND RETURN AT 5%

Council	Year 1 Scenario 4 2026	Year 2 Scenario 4 2027	Year 3 Scenario 4 2028	Year 4 Scenario 4 2029	Year 5 Scenario 4 2030	Year 6 Scenario 4 2031	Year 7 Scenario 4 2032	Year 8 Scenario 4 2033	Year 9 Scenario 4 2034	Total Scenario 4 2025-34
DCC Rates Increase (%)	9.95%	5.90%	5.90%	5.90%	5.90%	5.90%	5.90%	5.90%	5.90%	6.35%
DCC Rates Revenue ($ million)	263	278	295	312	331	350	371	393	416	3,007
DCC Interest Expenditure ($ million)	38	36	39	41	44	46	47	48	48	387
DCC Capital Expenditure ($ million)	204	210	212	254	230	234	235	239	253	2,071
DCC Debt Balance ($ million)	808	882	932	1,015	1,063	1,102	1,124	1,131	1,129	
DCC Debt Movement ($ million)	98	74	50	83	48	39	23	7	(3)	419
DCC Surplus/(Deficit) ($ million)	(15)	12	34	38	45	55	69	84	104	425

DCHL	Year 1 Scenario 4 2026	Year 2 Scenario 4 2027	Year 3 Scenario 4 2028	Year 4 Scenario 4 2029	Year 5 Scenario 4 2030	Year 6 Scenario 4 2031	Year 7 Scenario 4 2032	Year 8 Scenario 4 2033	Year 9 Scenario 4 2034	Total Scenario 4 2025-34
DCHL Total Revenue ($ million)	182	192	199	207	213	221	225	228	232	1,899
DCHL Interest Expenditure ($ million)	23	8	7	7	7	7	7	7	7	82
DCHL Debt Balance ($ million)	184	173	170	169	167	166	170	174	178	
DCHL Debt Movement ($ million)	(567)	(11)	(3)	(2)	(1)	(2)	4	4	4	(573)

Group (DCC + DCHL)	Year 1 Scenario 4 2026	Year 2 Scenario 4 2027	Year 3 Scenario 4 2028	Year 4 Scenario 4 2029	Year 5 Scenario 4 2030	Year 6 Scenario 4 2031	Year 7 Scenario 4 2032	Year 8 Scenario 4 2033	Year 9 Scenario 4 2034	Total Scenario 4 2025-34
Group Total Revenue	579	623	663	688	715	743	770	798	830	6,410
Group Interest Expenditure ($ million)	61	43	46	49	51	53	54	55	56	469
Group Debt Balance ($ million)	992	1,055	1,102	1,183	1,230	1,267	1,294	1,305	1,307	
Group Debt Movement ($ million)	(468)	63	47	81	47	37	27	11	2	(154)

Metrics	Year 1 Scenario 4 2026	Year 2 Scenario 4 2027	Year 3 Scenario 4 2028	Year 4 Scenario 4 2029	Year 5 Scenario 4 2030	Year 6 Scenario 4 2031	Year 7 Scenario 4 2032	Year 8 Scenario 4 2033	Year 9 Scenario 4 2034
DCC Financial Strategy									
Debt ($ million)	808	882	932	1,015	1,063	1,102	1,124	1,131	1,129
Limit at 250% of Revenue ($ million)	993	1,078	1,159	1,204	1,254	1,305	1,363	1,424	1,496
Debt at 250% of Revenue (%)	203%	205%	201%	211%	212%	211%	206%	199%	189%
Limit at 250% of Revenue (%)	250%	250%	250%	250%	250%	250%	250%	250%	250%
Uncalled Capital (current limit $1.6 billion)									
Consol Debt ($ million)	992	1,055	1,102	1,183	1,230	1,267	1,294	1,305	1,307

Scenario Analysis 5 - SELL AURORA, BASE (WITH HIGH OPEX/CAPEX) - FUND RETURN AT 5%

Council	Year 1 Scenario 5 2026	Year 2 Scenario 5 2027	Year 3 Scenario 5 2028	Year 4 Scenario 5 2029	Year 5 Scenario 5 2030	Year 6 Scenario 5 2031	Year 7 Scenario 5 2032	Year 8 Scenario 5 2033	Year 9 Scenario 5 2034	Total Scenario 5 2025-34
DCC Rates Increase (%)	9.95%	5.90%	5.90%	5.90%	5.90%	5.90%	5.90%	5.90%	5.90%	6.35%
DCC Rates Revenue ($ million)	263	278	295	312	331	350	371	393	416	3,007
DCC Interest Expenditure ($ million)	38	38	43	49	54	58	61	63	66	469
DCC Capital Expenditure ($ million)	214	244	255	284	260	259	260	264	278	2,318
DCC Debt Balance ($ million)	822	946	1,069	1,216	1,320	1,401	1,467	1,520	1,565	
DCC Debt Movement ($ million)	113	124	123	147	104	81	66	53	45	855
DCC Surplus/(Deficit) ($ million)	(20)	(5)	2	2	16	34	45	58	76	208

DCHL	Year 1 Scenario 5 2026	Year 2 Scenario 5 2027	Year 3 Scenario 5 2028	Year 4 Scenario 5 2029	Year 5 Scenario 5 2030	Year 6 Scenario 5 2031	Year 7 Scenario 5 2032	Year 8 Scenario 5 2033	Year 9 Scenario 5 2034	Total Scenario 5 2025-34
DCHL Total Revenue ($ million)	182	192	199	207	213	221	225	228	232	1,899
DCHL Interest Expenditure ($ million)	23	8	7	7	7	7	7	7	7	82
DCHL Debt Balance ($ million)	184	173	170	169	167	166	170	174	178	
DCHL Debt Movement ($ million)	(567)	(11)	(3)	(2)	(1)	(2)	4	4	4	(573)

Group (DCC + DCHL)	Year 1 Scenario 5 2026	Year 2 Scenario 5 2027	Year 3 Scenario 5 2028	Year 4 Scenario 5 2029	Year 5 Scenario 5 2030	Year 6 Scenario 5 2031	Year 7 Scenario 5 2032	Year 8 Scenario 5 2033	Year 9 Scenario 5 2034	Total Scenario 5 2025-34
Group Total Revenue	579	623	663	688	715	743	770	798	830	6,410
Group Interest Expenditure ($ million)	62	45	50	56	61	65	68	71	73	550
Group Debt Balance ($ million)	1,007	1,119	1,239	1,385	1,487	1,566	1,636	1,694	1,743	
Group Debt Movement ($ million)	(454)	112	120	145	103	79	70	57	49	283

Metrics	Year 1 Scenario 5 2026	Year 2 Scenario 5 2027	Year 3 Scenario 5 2028	Year 4 Scenario 5 2029	Year 5 Scenario 5 2030	Year 6 Scenario 5 2031	Year 7 Scenario 5 2032	Year 8 Scenario 5 2033	Year 9 Scenario 5 2034
DCC Financial Strategy									
Debt ($ million)	822	946	1,069	1,216	1,320	1,401	1,467	1,520	1,565
Limit at 250% of Revenue ($ million)	993	1,078	1,159	1,204	1,254	1,305	1,363	1,424	1,496
Debt at 250% of Revenue (%)	207%	219%	231%	253%	263%	268%	269%	267%	261%
Limit at 250% of Revenue (%)	250%	250%	250%	250%	250%	250%	250%	250%	250%
Uncalled Capital (current limit $1.6 billion)									
Consol Debt ($ million)	1,007	1,119	1,239	1,385	1,487	1,566	1,636	1,694	1,743

Scenario Analysis 6 - SELL AURORA, 10% RATES (WITH HIGH OPEX/CAPEX) - FUND RETURN AT 5%

Council	Year 1 Scenario 6 2026	Year 2 Scenario 6 2027	Year 3 Scenario 6 2028	Year 4 Scenario 6 2029	Year 5 Scenario 6 2030	Year 6 Scenario 6 2031	Year 7 Scenario 6 2032	Year 8 Scenario 6 2033	Year 9 Scenario 6 2034	Total Scenario 6 2025-34
DCC Rates Increase (%)	10.00%	10.00%	10.00%	10.00%	10.00%	10.00%	10.00%	10.00%	10.00%	10.00%
DCC Rates Revenue ($ million)	263	289	318	350	385	423	466	512	564	3,570
DCC Interest Expenditure ($ million)	38	37	42	46	49	50	50	47	42	402
DCC Capital Expenditure ($ million)	214	244	255	284	260	259	260	264	278	2,318
DCC Debt Balance ($ million)	822	935	1,034	1,140	1,185	1,185	1,145	1,061	935	
DCC Debt Movement ($ million)	113	112	99	106	45	(0)	(40)	(84)	(126)	226
DCC Surplus/(Deficit) ($ million)	(20)	6	26	42	75	115	152	194	247	838

DCHL	Year 1 Scenario 6 2026	Year 2 Scenario 6 2027	Year 3 Scenario 6 2028	Year 4 Scenario 6 2029	Year 5 Scenario 6 2030	Year 6 Scenario 6 2031	Year 7 Scenario 6 2032	Year 8 Scenario 6 2033	Year 9 Scenario 6 2034	Total Scenario 6 2025-34
DCHL Total Revenue ($ million)	182	192	199	207	213	221	225	228	232	1,899
DCHL Interest Expenditure ($ million)	23	8	7	7	7	7	7	7	7	82
DCHL Debt Balance ($ million)	184	173	170	169	167	166	170	174	178	
DCHL Debt Movement ($ million)	(567)	(11)	(3)	(2)	(1)	(2)	4	4	4	(573)

Group (DCC + DCHL)	Year 1 Scenario 6 2026	Year 2 Scenario 6 2027	Year 3 Scenario 6 2028	Year 4 Scenario 6 2029	Year 5 Scenario 6 2030	Year 6 Scenario 6 2031	Year 7 Scenario 6 2032	Year 8 Scenario 6 2033	Year 9 Scenario 6 2034	Total Scenario 6 2025-34
Group Total Revenue	579	634	686	726	769	817	865	918	978	6,972
Group Interest Expenditure ($ million)	62	45	49	53	57	57	57	54	50	484
Group Debt Balance ($ million)	1,006	1,108	1,204	1,309	1,352	1,350	1,314	1,235	1,114	
Group Debt Movement ($ million)	(454)	101	96	105	44	(2)	(36)	(79)	(122)	(347)

Metrics	Year 1 Scenario 6 2026	Year 2 Scenario 6 2027	Year 3 Scenario 6 2028	Year 4 Scenario 6 2029	Year 5 Scenario 6 2030	Year 6 Scenario 6 2031	Year 7 Scenario 6 2032	Year 8 Scenario 6 2033	Year 9 Scenario 6 2034
DCC Financial Strategy									
Debt ($ million)	822	935	1,034	1,140	1,185	1,185	1,145	1,061	935
Limit at 250% of Revenue ($ million)	993	1,105	1,218	1,298	1,390	1,489	1,601	1,723	1,866
Debt at 250% of Revenue (%)	207%	211%	212%	220%	213%	199%	179%	154%	125%
Limit at 250% of Revenue (%)	250%	250%	250%	250%	250%	250%	250%	250%	250%
Uncalled Capital (current limit $1.6 billion)									
Consol Debt ($ million)	1,006	1,108	1,204	1,309	1,352	1,350	1,314	1,235	1,114

Scenario Analysis 7 - SELL AURORA, BASE (WITH HIGH OPEX/CAPEX) - FUND RETURN AT 3%

Council	Year 1 Scenario 7 2026	Year 2 Scenario 7 2027	Year 3 Scenario 7 2028	Year 4 Scenario 7 2029	Year 5 Scenario 7 2030	Year 6 Scenario 7 2031	Year 7 Scenario 7 2032	Year 8 Scenario 7 2033	Year 9 Scenario 7 2034	Total Scenario 7 2025-34
DCC Rates Increase (%)	9.95%	5.90%	5.90%	5.90%	5.90%	5.90%	5.90%	5.90%	5.90%	6.35%
DCC Rates Revenue ($ million)	263	278	295	312	331	350	371	393	416	3,007
DCC Interest Expenditure ($ million)	38	38	44	50	56	60	64	68	70	488
DCC Capital Expenditure ($ million)	214	244	255	284	260	259	260	264	278	2,318
DCC Debt Balance ($ million)	822	955	1,093	1,255	1,375	1,472	1,555	1,626	1,689	
DCC Debt Movement ($ million)	113	133	138	162	120	97	83	70	63	979
DCC Surplus/(Deficit) ($ million)	(20)	(15)	(13)	(13)	0	18	28	40	58	84
DCHL	**Year 1 Scenario 7 2026**	**Year 2 Scenario 7 2027**	**Year 3 Scenario 7 2028**	**Year 4 Scenario 7 2029**	**Year 5 Scenario 7 2030**	**Year 6 Scenario 7 2031**	**Year 7 Scenario 7 2032**	**Year 8 Scenario 7 2033**	**Year 9 Scenario 7 2034**	**Total Scenario 7 2025-34**
DCHL Total Revenue ($ million)	182	192	199	207	213	221	225	228	232	1,899
DCHL Interest Expenditure ($ million)	23	8	7	7	7	7	7	7	7	82
DCHL Debt Balance ($ million)	184	173	170	169	167	166	170	174	178	
DCHL Debt Movement ($ million)	(567)	(11)	(3)	(2)	(1)	(2)	4	4	4	(573)
Group (DCC + DCHL)	**Year 1 Scenario 7 2026**	**Year 2 Scenario 7 2027**	**Year 3 Scenario 7 2028**	**Year 4 Scenario 7 2029**	**Year 5 Scenario 7 2030**	**Year 6 Scenario 7 2031**	**Year 7 Scenario 7 2032**	**Year 8 Scenario 7 2033**	**Year 9 Scenario 7 2034**	**Total Scenario 7 2025-34**
Group Total Revenue	579	613	649	675	701	729	756	784	817	6,305
Group Interest Expenditure ($ million)	62	45	51	57	63	68	71	75	78	570
Group Debt Balance ($ million)	1,007	1,128	1,263	1,424	1,542	1,637	1,725	1,800	1,867	
Group Debt Movement ($ million)	(454)	122	135	160	118	95	87	75	68	407
Metrics	**Year 1 Scenario 7 2026**	**Year 2 Scenario 7 2027**	**Year 3 Scenario 7 2028**	**Year 4 Scenario 7 2029**	**Year 5 Scenario 7 2030**	**Year 6 Scenario 7 2031**	**Year 7 Scenario 7 2032**	**Year 8 Scenario 7 2033**	**Year 9 Scenario 7 2034**	
DCC Financial Strategy										
Debt ($ million)	822	955	1,093	1,255	1,375	1,472	1,555	1,626	1,689	
Limit at 250% of Revenue ($ million)	993	1,054	1,125	1,169	1,220	1,271	1,329	1,390	1,463	
Debt at 250% of Revenue (%)	207%	226%	243%	268%	282%	289%	292%	292%	289%	
Limit at 250% of Revenue (%)	250%	250%	250%	250%	250%	250%	250%	250%	250%	
Uncalled Capital (current limit $1.6 billion)										
Consol Debt ($ million)	1,007	1,128	1,263	1,424	1,542	1,637	1,725	1,800	1,867	

Assumptions for Financial Modelling

The modelled scenarios include the following high-level assumptions.

Scenario 1 – Retain Aurora, Base Scenario

1 This is the base scenario for the financial modelling scenario analysis. The scenarios therefore assume:

a) An overall rate increase in year 1 of 9.95% and in years 2-9 of 5.90% each year.

b) A DCHL dividend of $11 million in year 1 only.

c) Other operating revenue and expenditure budgets include:

i)	The 2024/25 Annual Plan budget plus an allowance for inflation.
ii)	Minor adjustments to reflect completed capital projects, e.g., Smooth Hill and the South Dunedin Library and Community Complex.

d) The capital expenditure budgets include:

i)	Total capital expenditure of $2.0 billion over 9 years.
ii)	Transport capital expenditure is predominately renewals, but also includes Shaping Future Dunedin, an allowance for growth and some new improvement projects.
iii)	3 Waters capital expenditure increases from $93 million in year 1 to $174 million in year 9 reflecting the most current estimate.
iv)	Waste Futures capital expenditure continues the programme included in the 10 Year Plan 2021-2031 with price adjustments. This assumes 100% Council ownership of Smooth Hill.
v)	No provision for amenity upgrades.
vi)	Capital expenditure for community facilities is consistent with the LTP for 2021-2031.
vii)	Property capital expenditure is predominantly renewals, with an allowance for performing arts and additional community housing units.

e) Depreciation assumptions are based on the 2024/25 Annual Plan, plus any impacts of the capital expenditure programme (based on average rates). There is no adjustment for revaluation impacts.

f) Interest expense is assumed at 5% for year 1 and 4.25% from years 2-9.

g) NZTA Waka Kotahi subsidy assumption is 51% on all Transport capital expenditure.

Scenario 2 – Retain Aurora, Base Scenario (with high operational and capital expenditure)

2 This scenario has higher operational and capital expenditure budgets (compared to Scenario 1 above), the scenario therefore assumes:

a) An overall rate increase in year 1 of 9.95% and in years 2-9 of 5.90% each year.

b) A DCHL dividend of $11 million in year 1 only.

c) Other operating revenue and expenditure budgets include:

i)	The 2024/25 Annual Plan budget plus an allowance for inflation.
ii)	Minor adjustments to reflect completed capital projects, e.g., Smooth Hill and the South Dunedin Library and Community Complex.
iii)	An allowance for a portion of Kettle Park remediation. Please note that the figures included are indicative only and are yet to be confirmed or considered by Council.
iv)	An increase in service level payments to community focussed CCOs.
v)	Additional operating costs associated with the capital expenditure programme.

d) The capital expenditure budget includes:

i)	Total capital expenditure of $2.3 billion over 9 years.
ii)	Transport capital expenditure is predominately renewals, which includes Shaping Future Dunedin, an allowance for growth and some new improvement projects.
iii)	3 Waters capital expenditure increases from $93 million in year 1 to $174 million in year 9 reflecting the most current estimate.
iv)	Waste Futures capital expenditure continues the programme included in the 10 Year Plan 2021-2031 with price adjustments. This assumes 100% Council ownership of Smooth Hill.
v)	No provision for amenity upgrades.
vi)	Capital expenditure for community facilities is consistent with the LTP for 2021-2031.
vii)	Property capital expenditure is predominantly renewals, with an allowance for performing arts and additional community housing units.
viii)	Capital expenditure increases to provide for additional property improvements (e.g., Municipal Chambers), additional transport projects (e.g., Peninsula connections), and other projects. These increases are $247 million over the 9-year period.

e) Depreciation assumptions are based on the 2024/25 Annual Plan, plus any impacts of the capital expenditure programme (based on average rates). There is no adjustment for revaluation impacts.

f) Interest expense is assumed at 5% for year 1 and 4.25% from years 2-9.

g) NZTA Waka Kotahi subsidy assumption is 51% on all Transport capital expenditure.

Scenario 3 – Retain Aurora, with a 10% rate increase each year (with high operational and capital expenditure)

3 This scenario has a rate increase of 10% per annum, with all other assumption consistent with scenario 2. Therefore, this scenario assumes:

a) A 10% per annum rate increase across all years.

b) A DCHL dividend of $11 million in year 1 only.

c) Other operating revenue and expenditure budgets include:

i)	The 2024/25 Annual Plan budget plus an allowance for inflation.
ii)	Minor adjustments to reflect completed capital projects, e.g., Smooth Hill and the South Dunedin Library and Community Complex.
iii)	An allowance for a portion of Kettle Park remediation. Please note that the figures included are indicative only and are yet to be confirmed or considered by Council.
iv)	An increase in service level payments to community focussed CCOs.
v)	Additional operating costs associated with the capital expenditure programme.

d) The capital expenditure budget includes:

i)	Total capital expenditure of $2.3 billion over 9 years.
ii)	Transport capital expenditure is predominately renewals, which includes Shaping Future Dunedin, an allowance for growth and some new improvement projects.
iii)	3 Waters capital expenditure increases from $93 million in year 1 to $174 million in year 9 reflecting the most current estimate.
iv)	Waste Futures capital expenditure continues the programme included in the 10 Year Plan 2021-2031 with price adjustments. This assumes 100% Council ownership of Smooth Hill.
v)	No provision for amenity upgrades.
vi)	Capital expenditure for community facilities is consistent with the LTP for 2021-2031.
vii)	Property capital expenditure is predominantly renewals, with an allowance for performing arts and additional community housing units.
viii)	Capital expenditure increases to provide for additional property improvements (e.g., Municipal Chambers), additional transport projects (e.g., Peninsula connections), and other projects. These increases are $247 million over the 9-year period.

e) Depreciation assumptions are based on the 2024/25 Annual Plan, plus any impacts of the capital expenditure programme (based on average rates). There is no adjustment for revaluation impacts.

f) Interest expense is assumed at 5% for year 1 and 4.25% from years 2-9.

g) NZTA Waka Kotahi subsidy assumption is 51% on all Transport capital expenditure.

Scenario 4 – Sell Aurora, Base Scenario

4 This scenario is based on Scenario 1, however with Aurora sold and the introduction of a diversified investment fund. The scenario therefore assumes:

a) Council receives a 5% return on the diversified investment fund.

b) The additional investment revenue is applied to a reduction in debt.

c) An overall rate increase in year 1 of 9.95% and in years 2-9 of 5.90% each year.

d) A DCHL dividend of $11 million in year 1 only.

e) Other operating revenue and expenditure budgets include:

i)	The 2024/25 Annual Plan budget plus an allowance for inflation.
ii)	Minor adjustments to reflect completed capital projects, e.g., Smooth Hill and the South Dunedin Library and Community Complex.

f) The capital expenditure budgets include:

i)	Total capital expenditure of $2.0 billion over 9 years.
ii)	Transport capital expenditure is predominately renewals, but also includes Shaping Future Dunedin, an allowance for growth and some new improvement projects.
iii)	3 Waters capital expenditure increases from $93 million in year 1 to $174 million in year 9 reflecting the most current estimate.
iv)	Waste Futures capital expenditure continues the programme included in the 10 Year Plan 2021-2031 with price adjustments. This assumes 100% Council ownership of Smooth Hill.
v)	No provision for amenity upgrades.
vi)	Capital expenditure for community facilities is consistent with the LTP for 2021-2031.
vii)	Property capital expenditure is predominantly renewals, with an allowance for performing arts and additional community housing units.

g) Depreciation assumptions are based on the 2024/25 Annual Plan, plus any impacts of the capital expenditure programme (based on average rates). There is no adjustment for revaluation impacts.

h) Interest expense is assumed at 5% for year 1 and 4.25% from years 2-9.

i) NZTA Waka Kotahi subsidy assumption is 51% on all Transport capital expenditure.

Scenario 5 – Sell Aurora, Base Scenario (with high operational and capital expenditure)

5 This scenario is based on Scenario 2, however with Aurora sold and the introduction of a diversified investment fund. The scenario therefore assumes:

a) Council receives a 5% return on the diversified investment fund.

b) The additional investment revenue is applied to a reduction in debt.

c) An overall rate increase in year 1 of 9.95% and in years 2-9 of 5.90% each year.

d) A DCHL dividend of $11 million in year 1 only.

e) Other operating revenue and expenditure budgets include:

i)	The 2024/25 Annual Plan budget plus an allowance for inflation.
ii)	Minor adjustments to reflect completed capital projects, e.g., Smooth Hill and the South Dunedin Library and Community Complex.
iii)	An allowance for a portion of Kettle Park remediation. Please note that the figures included are indicative only and are yet to be confirmed or considered by Council.
iv)	An increase in service level payments to community focussed CCOs.
v)	Additional operating costs associated with the capital expenditure programme.

f) The capital expenditure budget includes:

i)	Total capital expenditure of $2.3 billion over 9 years.
ii)	Transport capital expenditure is predominately renewals, which includes Shaping Future Dunedin, an allowance for growth and some new improvement projects.
iii)	3 Waters capital expenditure increases from $93 million in year 1 to $174 million in year 9 reflecting the most current estimate.
iv)	Waste Futures capital expenditure continues the programme included in the 10 Year Plan 2021-2031 with price adjustments. This assumes 100% Council ownership of Smooth Hill.
v)	No provision for amenity upgrades.
vi)	Capital expenditure for community facilities is consistent with the LTP for 2021-2031.
vii)	Property capital expenditure is predominantly renewals, with an allowance for performing arts and additional community housing units.
viii)	Capital expenditure increases to provide for additional property improvements (e.g., Municipal Chambers), additional transport projects (e.g., Peninsula connections), and other projects. These increases are $247 million over the 9-year period.

g) Depreciation assumptions are based on the 2024/25 Annual Plan, plus any impacts of the capital expenditure programme (based on average rates). There is no adjustment for revaluation impacts.

h) Interest expense is assumed at 5% for year 1 and 4.25% from years 2-9.

i) NZTA Waka Kotahi subsidy assumption is 51% on all Transport capital expenditure.

6

Scenario 6 – Sell Aurora with a 10% rate increase each year (with high operational and capital expenditure)

7 This scenario is based on Scenario 3, however with Aurora sold and the introduction of a diversified investment fund. The scenario therefore assumes:

a) Council receives a 5% return on the diversified investment fund.

b) The additional investment revenue is applied to a reduction in debt.

c) A DCHL dividend of $11 million in year 1 only.

d) Other operating revenue and expenditure budgets include:

i)	The 2024/25 Annual Plan budget plus an allowance for inflation.
ii)	Minor adjustments to reflect completed capital projects, e.g., Smooth Hill and the South Dunedin Library and Community Complex.
iii)	An allowance for a portion of Kettle Park remediation. Please note that the figures included are indicative only and are yet to be confirmed or considered by Council.
iv)	An increase in service level payments to community focussed CCOs.
v)	Additional operating costs associated with the capital expenditure programme.

e) The capital expenditure budget includes:

i)	Total capital expenditure of $2.3 billion over 9 years.
ii)	Transport capital expenditure is predominately renewals, which includes Shaping Future Dunedin, an allowance for growth and some new improvement projects.
iii)	3 Waters capital expenditure increases from $93 million in year 1 to $174 million in year 9 reflecting the most current estimate.
iv)	Waste Futures capital expenditure continues the programme included in the 10 Year Plan 2021-2031 with price adjustments. This assumes 100% Council ownership of Smooth Hill.
v)	No provision for amenity upgrades.
vi)	Capital expenditure for community facilities is consistent with the LTP for 2021-2031.
vii)	Property capital expenditure is predominantly renewals, with an allowance for performing arts and additional community housing units.
viii)	Capital expenditure increases to provide for additional property improvements (e.g., Municipal Chambers), additional transport projects (e.g., Peninsula connections), and other projects. These increases are $247 million over the 9-year period.

f) Depreciation assumptions are based on the 2024/25 Annual Plan, plus any impacts of the capital expenditure programme (based on average rates). There is no adjustment for revaluation impacts.

g) Interest expense is assumed at 5% for year 1 and 4.25% from years 2-9.

h) NZTA Waka Kotahi subsidy assumption is 51% on all Transport capital expenditure.

8

Scenario 7 – Sell Aurora, Base Scenario (with high operational and capital expenditure), Fund Return at 3%

9 This scenario is based on Scenario 5, however Council receiving a 3% return (instead of 5%) on the diversified investment fund. This scenario therefore assumes:

a) Council receives a 3% return on the diversified investment fund.

b) The additional investment revenue is applied to a reduction in debt.

c) An overall rate increase in year 1 of 9.95% and in years 2-9 of 5.90% each year.

d) A DCHL dividend of $11 million in year 1 only.

e) Other operating revenue and expenditure budgets include:

i)	The 2024/25 Annual Plan budget plus an allowance for inflation.
ii)	Minor adjustments to reflect completed capital projects, e.g., Smooth Hill and the South Dunedin Library and Community Complex.
iii)	An allowance for a portion of Kettle Park remediation. Please note that the figures included are indicative only and are yet to be confirmed or considered by Council.
iv)	An increase in service level payments to community focussed CCOs.
v)	Additional operating costs associated with the capital expenditure programme.

f) The capital expenditure budget includes:

i)	Total capital expenditure of $2.3 billion over 9 years.
ii)	Transport capital expenditure is predominately renewals, which includes Shaping Future Dunedin, an allowance for growth and some new improvement projects.
iii)	3 Waters capital expenditure increases from $93 million in year 1 to $174 million in year 9 reflecting the most current estimate.
iv)	Waste Futures capital expenditure continues the programme included in the 10 Year Plan 2021-2031 with price adjustments. This assumes 100% Council ownership of Smooth Hill.
v)	No provision for amenity upgrades.
vi)	Capital expenditure for community facilities is consistent with the LTP for 2021-2031.
vii)	Property capital expenditure is predominantly renewals, with an allowance for performing arts and additional community housing units.
viii)	Capital expenditure increases to provide for additional property improvements (e.g., Municipal Chambers), additional transport projects (e.g., Peninsula connections), and other projects. These increases are $247 million over the 9-year period.

g) Depreciation assumptions are based on the 2024/25 Annual Plan, plus any impacts of the capital expenditure programme (based on average rates). There is no adjustment for revaluation impacts.

h) Interest expense is assumed at 5% for year 1 and 4.25% from years 2-9.

i) NZTA Waka Kotahi subsidy assumption is 51% on all Transport capital expenditure.