Hamilton City Council Municipal Endowment Fund

Final Report

Strictly private and confidential

27 June 2016

pwc

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Chief Executive
Hamilton City Council
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Hamilton

27 June 2016

Assessment of the Municipal Endowment Fund and investment framework practices

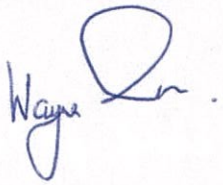
Dear Richard

We are pleased to provide our report on the historical performance of the Municipal Endowment Fund and the options available to Council to continue to utilise the assets to achieve both a financial return and for the development of assets for a wider public benefit.

This report is provided in accordance with the terms of our engagement outlined in our letter dated 25 February 2016 and is subject to the restrictions set out in Appendix 5.1 of this report.

Our principal findings and conclusions together with details of the scope and approach to our work are set out in this report.

Yours faithfully



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Executive Summary

The sale of a number of high yielding properties in recent years has resulted in a significant level of cash held within the fund. This makes it an opportune time to review the management and investment approach of the fund

History

- The original endowment properties appear to have been bare land endowed to Council in circa 1870.
- Over time, it appears the land was leased to private persons and organisations who constructed dwellings, both commercial and residential, on the land with the ground leases being 21 year perpetual leases without rent reviews.
- The management of endowment assets is undertaken in accordance with the Local Government Act 2002 and under the guidance of Council policy.
- Since 2009 the MEF cash holdings have been used by Council to offset debt.

Policy and Objectives

- Historical analysis has been undertaken on the management and performance of the MEF assets for the period 1991 to 1998 under the control of Hamilton Properties Limited ("HPL") and 2008 to 2015 under the control of Council.
- The policy or objectives across both periods were consistent, the key principles including the requirements to ensure:
  1. Capital is preserved;
  2. Income generation is maximised and returns are comparative to market;
  3. Income is applied to municipal purposes which historically has been distributed to Council to reduce the rates burden; and
  4. Investments are made and assets managed in a prudent and professional manner.

Legal Requirements

- Policy can be changed by Council so long as the fund is utilised for municipal purposes which has a broad definition. Legal advice confirms the following constraints:
  - The common law principle of endowment requires the preservation of capital; and
  - The policy can be changed by Council as long as the purpose of the policy provides a municipal purpose.

Hamilton Properties Limited Example

- In partnering with the private sector HPL successfully completed a number of key strategic and community developments returning an average return of 12.1% pa over the eight year period from 1991 to 1998.
- HPL had a number of high-profile and successful business leaders in its governance team and this will be a critical success factor if a similar approach is adopted in the future.
- HPL was able to operate with agility and under a commercially focused mandate to achieve the desired outcomes which included the following key developments: Pukete Industrial Estate; Downtown Plaza; BNZ Tower; and the Novotel Tainui as illustrated on page 10.

Other Councils

- Passive investments, including managed funds, appear to be mostly held within Council. In some cases the investment decisions are outsourced to external financial advisors.
- Through management of investments through a CCO the other Councils appear to have accessed 'wider expertise', in terms of governance and managerial capacity, independent of Council.
- The separation of governance and politics through structure, e.g. a CCO, and clearly set objectives is required to facilitate long-term strategy.
- Development activities are clearly aligned to aspects of Council plans for municipal purposes.

Council need to consider the preferred investment approach based on the desired municipal purpose and the appropriate vehicle to achieve results in the long-term

Strategic Alignment

The MEF could be utilised as a tool to assist Council to better achieve its longer-term strategic objectives as set out in Council plans.

The contribution of the MEF towards achieving these longer-term objectives could be aligned through policy change and may involve the setting of:

- The purpose of the MEF, including consideration of municipal purposes with wider public benefits which are consistent with long-term Council plans;
- A targeted minimum return; and
- An investment strategy in terms of how the purpose and targeted returns of the MEF can be achieved. i.e. management vehicles and types of investment.

Key Considerations

- The sale of a number of high yielding properties in recent years together with the significant level of cash held within the fund suggests that it is an appropriate time to review the management and investment approach of the fund.
- The key questions to address when considering the options include:

  1. **How should the fund be structured?**

     Including consideration of transferring control to a vehicle, such as a CCO, to increase the speed and agility in which commercial decisions are made and opportunities captured.

     This may also include outsourcing the management of existing properties.

  2. **What are the investment activities?**

     Given the current asset base of the fund it appears that a higher return could be achieved in either Balanced Managed Funds or units in Listed Property Companies on a long-run average basis.

  3. **Can the fund be utilised for other municipal purposes to make positive change in Hamilton through the development of key strategic assets whilst still making an acceptable return?**

     The achievements of HPL provide an excellent example of how the MEF could be used under a CCO structure to achieve clearly articulated objectives whilst delivering an acceptable financial return.

     The involvement of influential business leaders in governance positions was and arguably still is a critical success factor.

Policy History

Current Policy

Currently MEF assets are managed by the Council property team, the current MEF Investment Policy has been in place since 1998 when the assets were transferred from HPL to Council

Operating Practices

- The investment of MEF assets and management of the investment properties is undertaken in accordance with the MEF Investment Policy dated 8 April 2009 presented opposite.
- The MEF assets are currently managed by Council staff within the Property team.
- Since 1998 when the MEF returned to Council control, it has not been actively managed and has not undertaken any economic development activity or joint ventures. It has been a passive investment, involving existing commercial property, ground leases and cash.
- The MEF under the current investment approach has achieved an average gross return of 7.5% pa, before the allocation of the HCC overhead or management charge, over the five years to 30 June 2015.
- A full list of properties and their performance is detailed in the analysis attached as appendices.

Future Investment Returns

The future investment returns will be impacted by the following:

- Approximately $27.4m (66%) of the fund is held in cash and has an implied return of 5.5% as it has been applied against Council debt.
- An additional building, the Beggs Wiseman building, classified as a Municipal Investment Property ("MIP") has recently been sold.
- Only three MIP's remain, as at 30 June 2015 the properties were valued at $10.5m and contractually will collectively earn a gross rental yield of 8.1%.
- Based on the current portfolio a gross return of approximately $2.5m (6.1%) appears likely.

Current Policy

1. Maximise the returns on the Municipal Endowment Fund through property rental income and capital appreciation.
2. Maintain the real value of the Municipal Endowment Fund Investment and distribute maximum returns to the Council or in accordance with guidelines as otherwise determined by Council from time to time.
3. Manage properties in a professional and ethical manner ensuring compliance with legal and best practice requirements.
4. Manage the MEF in a prudent manner to minimise specific property and portfolio risk exposures.
5. At the time of new acquisition have an investment plan which provides clear guidance covering types of properties, their location and approved activities of tenants.
6. Operate sound control practices to prevent unauthorised transactions.
7. Provide timely, accurate and understandable information to Council on financial and other matters relating to the Municipal Endowment Fund Investment.

Hamilton Properties Limited

HPL operated under a set of objectives similar to the current MEF policy and was deemed to have achieved its strategic objectives by 1998 whilst achieving a market return

Background

Hamilton Properties Limited ("HPL") is a Council Controlled Organisation ("CCO") established in 1989 with the following purpose:

> *Managing of Council properties, the Domain Endowment Fund ("DEF") and MEF on behalf of the HCC. Funds are held for reserve and investment purposes.*

The objectives of the Company (detailed opposite) were explicitly set with a target date of June 1999. It was determined that the objectives were met by 30 June 1998 and the assets were transferred back to HCC.

HPL is now a dormant or non-active company with tax losses available.

The financial performance of HPL was measured in terms of the return from the development properties and the return from the original endowment properties.

> *HPL contributed to the development of a number of key strategic and community assets (detailed over-page) utilising the MEF fund and achieved an average return of 12.1% over the eight year period (1991 to 1998) on development activities.*

HPL had its own Board of Directors, independent from Council, and appears to have formally reported to Council bi-annually with six monthly and annual reports produced.

Income earned by HPL was distributed to Council through dividends each year.

Statement of Objectives

The Company aims to increase the return on the shareholders' assets under its management. To achieve this the Company intends to:

I) Undertake new profitable investments as cash flows allow which, over their life, will yield a substantially greater return than previously achieved.

II) Promote development of properties in a manner which will maximise the commercial value of the asset by ensuring that the addition of any new capacity is related as closely as possible to actual and forecast market demand;

III) Encourage freeholding of endowment properties to generate capital for investment in higher yielding endowment properties as soon as practicable;

IV) Enter into joint venture or turn-key developments to provide flexible options for the future;

V) Strive to minimise operating costs;

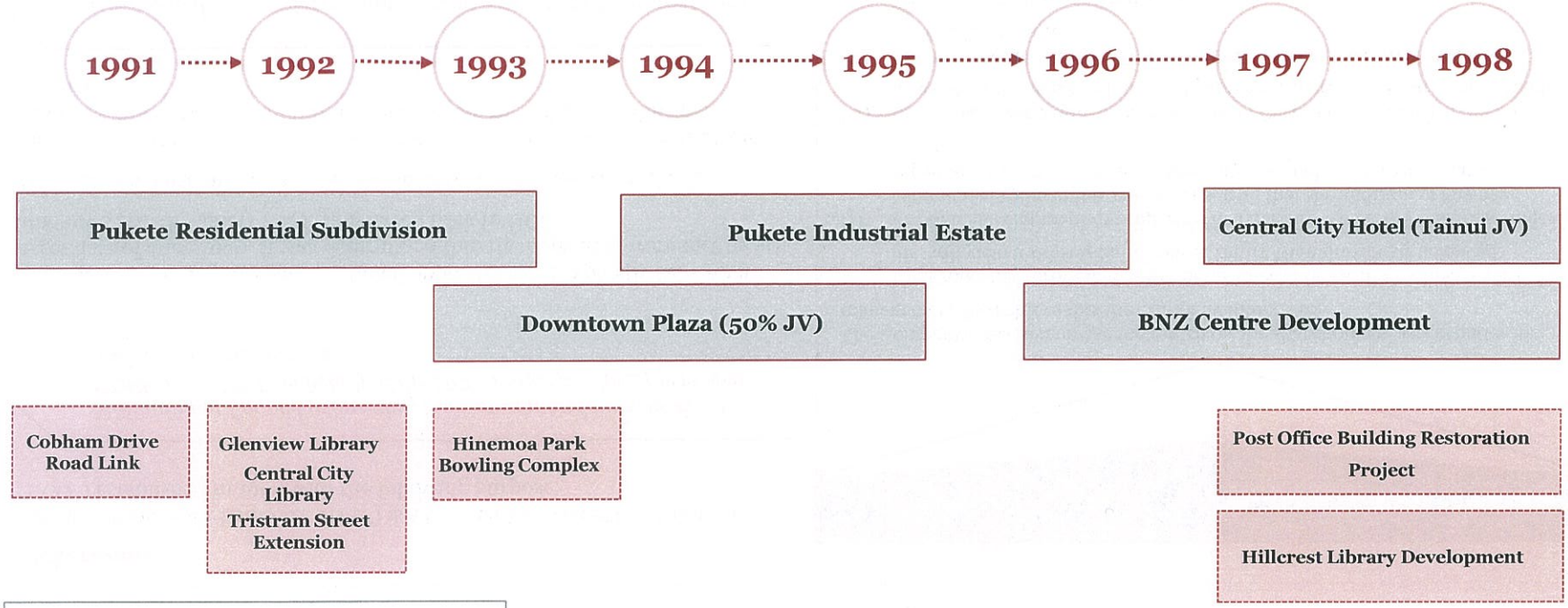
VI) Manage its financial assets and liabilities on a prudent basis;

VII) Offer a property management service to Council including; but not limited to, property leasing, concessions and licenses, specific acquisitions, sales and purchases related to Council's direct operations and to offer the service at competitive rates in a timely manner to the satisfaction of the client as determined by contracts;

VIII) Seek and effectively administer service contracts with other public sector entities.

HPL – Development Timeline

HPL were responsible for a number of key strategic developments over the eight year period



Case Studies - Other Councils

Invercargill City Council (1 of 2)

ICC appear to have a diverse property portfolio including tenanted buildings and industrial, residential and rural development land under the control of a CCO

Invercargill City Council ("ICC")

- The endowment land originated in June 1879 when Conveyance 12863 Deed 28/690 allocated land in the original subdivision of the Town of Invercargill to be set aside as municipal endowments. Additional endowment properties were created in 1956 by the Municipal Corporations Act.
- The Investment Property Activity (the Activity) manages and controls the investment property ultimately owned by ICC. The Activity sits within a CCO, Invercargill City Property Limited ("ICPL") which is a subsidiary of Invercargill City Holdings Limited, a wholly owned subsidiary of Council.
- The Activity reports to the Finance and Policy Committee of Council which reports directly to Council.

Governance

- ICPL has a chairperson and two other directors.
  - The Chairperson is a former managing director of a commercial and industrial property Company with an accounting and finance background. He now holds multiple directorships in the private and local government sector.
  - One director holds a CEO position with a large infrastructure company whilst the second director is an experienced Councillor.

Fund Activity

- The Activity contributes to Councils role of "attracting a diverse range of business and industry to locate to Invercargill" by investing in property that supports appropriate commercial and economic developments in the district.
- The Activity has two areas of focus:
  1. The strategic purchase of property to promote prudent development; and
  2. Investment for the best economic return.
- The overarching goal of the ICC Investment Property Activity is to maximise the investment returns from properties. Its principal objectives are to:
  a) Review changes to interest rates in the market place and to respond to market movements in an appropriate manner whenever possible.
  b) Ensure that Council's investment property is maintained to an appropriate standard in order to improve the quality of the portfolio.
  c) Ensure that the performance of the individual investment properties is reviewed and monitored.
  d) Promote appropriate development around the Invercargill area for industrial and commercial purposes.
  e) Provide a continuing source of income to the Council.
- According to the Council's Investment Property Activity Plan 2014, the property portfolio is valued annually. The latest valuation available performed by Trevor Thayer Valuation Limited as at 30 June 2014 indicates a portfolio value of $25m.
- Of the $25m of investment property, approximately 76% is classified as industrial property with approximately half the portfolio invested in Awarua industrial properties, 16% is classified as commercial property and the remaining 8% is split between rural, residential and development properties, and properties being prepared for disposal.
- The target rate of return on investment property was at least equal to the current market interest rate of 4% prevalent at that time which was achieved in 2014/15 at 5.66%.

Invercargill City Council (2 of 2)

ICC is committed to a central city revitalisation plan and has committed $1.4m to this project

Activity Undertaken

Newspaper articles from late 2014, indicate that endowment funds are applied to Council development activities. Detailed below are examples of development activities undertaken by ICC.

Projects	Detail	Endowment related
Awarua Industrial Development (current)	Rezone rural to industrial, council funding infrastructure and services, actively marketing and pursuing tenants.	No mention of endowment property or funding.
The City Centre Revitalisation Project (current)	Contributing to "A city that is a great place to live and visit". Community outcome by designing spaces, buildings and roads with community safety and interests in mind and encouraging others to do the same. Specific improvements include new seating, gardens, landscaping areas, shelters, parks and new pavers.	$1.4m committed in stages, no mention of specific funding from endowment property.
Urban Rejuvenation	Council to take a supporting role in identifying areas of need, bringing together residents who want to make things happen in their community. Assistance in proposal development and access to funding provided. The program has assisted in a number of initiatives including: a new entrance sign to Bluff, mosaic wall mural, the opening of a community art space and an outdoor snakes and ladders board.	An initial commitment of $212k of funding to cover the estimated consultant's fees in relation to establishing the project and plan.
Don Street Development	A 3,500 square meter office building to be completed by July 2017. The site was purchased in 2014 as it was deemed a strategic CBD location, a second site was purchased in 2015 to enable the larger modern development.	No mention of endowment properties or funding.
Lower Esk Street	ICC purchased five buildings in lower Esk Street in 2011. A building was built to house the ICC and Southland District Council.	Purchase was made with $2m of funding from the endowment funds.

Bay of Plenty Regional Council

BOPRC appear to have a well structured investment arm which operates under a statement of intent set by Council and governed by a mix of Council executives and independent directors

Bay of Plenty Regional Council ("BOPRC")

Quayside Holdings Limited ("QHL") is a 100% owned subsidiary of BOPRC and was established in 1991 to acquire and manage the commercial investment arm of BOPRC, namely its majority interest in the Port of Tauranga.

QHL remains, via a subsidiary, a major shareholder of the Port of Tauranga Limited.

QHL is also an issuer of debt securities on the New Zealand Stock Exchange.

Governance

The Board of Directors consists of seven members, only one of which is explicitly listed as an independent non-executive. There appears to be a mix of legal, financial, commercial and local government expertise across the Board.

Fund Activity

Perpetual Preference Shares

The success of the investment in the Port of Tauranga Limited enabled QHL, in 2008, to issue $200m of Perpetual Preference Shares (PPS). The proceeds from issue of these non-voting units provides the basis for the Regional Councils $200m Infrastructure Fund, from which the Council funds some of the regions infrastructure development.

Quayside Properties Limited ("QPL")

QPL is a subsidiary of QHL and currently holds properties in Rangiuru and Tauranga.

The Rangiuru Industrial Park is the largest prospective industrial zone on the eastern side of Tauranga.

The zoning is 243ha of which 148.6ha is development land bordering the newly completed Tauranga Eastern Link motorway and the East Coast main Trunk Railway line.

The land was zoned industrial in 2007 through a private plan change, sponsored and funded by QPL at a cost of $1.5m.

Statement of Intent (Extract)

- ***Investment Portfolio*** – Generation of commercial returns and an income stream through a diversified share investment portfolio.
  - The targeted return is measured by a three year rolling gross return of ≥7.5% pa.
- ***Infrastructure Portfolio*** – Targeting long term commercial returns through the investment and or management of infrastructure assets (including property) across the Region.
  - Annual Board assessment of benefit of each asset holding.
- ***Commercial Ventures*** – targeting commercial returns and or regional benefits through significant strategic partnerships in new and existing businesses.
  - Positive long term commercial return having regard to potential regional benefits.
  - The targeted return is measured by a three year rolling gross return of ≥7.5% pa.

Dunedin City Council

DCC have invested funds from the sale of endowment properties back into commercial property and have targeted geographic diversity and a minimum dividend return back to Council

Dunedin City Council ("DCC") – Investment Property Portfolio

- The Investment Property Portfolio's original endowment properties were endowed by the City's Founders in 1848, the fund as at June 2014 had a portfolio value of $95m and total debt of $16m.
- The DCC property portfolio appears to be held by both Dunedin City Holdings Limited ("DCHL") and by Council directly. The Investment Property Portfolio represents the business unit under which Dunedin City Council's investments in land and buildings are managed.
- The primary objective of the portfolio is to maximise its return by investing in properties that will increase in value over time.
- A significant portion of the portfolio is endowment land and under the Dunedin City Endowment Lands Act 1988, the Council is required to retain the endowment property capital in property.
- Other objectives of the portfolio are to provide a non-rates income source to the Council, diversify investment outside Dunedin and to provide long-term wealth generation for ratepayers.
- Currently the fund has approximately 22% of investment property outside Dunedin. This includes investments of: $11.1m in Wellington, $5.3m in Auckland and $4.8m in Christchurch.
- The fund is managed by a CEO with extensive commercial and industrial property management experience from the private sector.
- The long term target of the Investment Property Portfolio is a return which is greater than the Council's overall cost of capital. The Council's draft budget provided a target return of 6% for the 2015/16 year.
- Over the next ten years the Council will transition toward the target return by identifying and selling properties that aren't making an appropriate return and by reinvesting in properties that will provide the target rate of return on investment along with capital growth.
- Performance of the property fund is measured through three main measures which include the:
  - Percentage variance from budgeted dividend;
  - Percentage of property portfolio with a net rate of return of 8%; and
  - Percentage of overall occupancy.
- Major capital expenditure for 2014/15 included the Wall Street development, Dukes Road property purchase and School Street property purchase which totalled $3.6m.

Waikato Regional Council

WRC has adopted a mostly passive approach to their Investment Fund, and have chosen to move away from subsidising rates to assist Regional Scale Projects

Waikato Regional Council ("WRC")

The WRC Investment Fund arose as a consequence of the sale of Port of Tauranga and Port of Auckland shares in the mid 1990's.

Investment returns from the fund have been used to fund special projects, finance internal borrowings and reduce the overall level of rates.

Governance

WRC has 14 elected Council members, the representatives work in Committees to make decisions and recommendations.

Investment Goals

The broad investment goals of the fund are:

- To ensure assets of the fund are invested prudently and consistent with the Council's mission, vision and rules; and
- To provide a rates subsidy and set aside funds for regional and economic development.

In 2015 the fund achieved a gross return of 9.1%, above the target of a 4% net return.

Fund Activity

WRC has set a benchmark portfolio to best meet its objectives for the next 5-10 years which is presented opposite.

The fund is managed by an external investment professional, with the exception of 10% of the portfolio, which is managed internally.

Regional Scale Development

- In 2015 the WRC Long-Term Plan committed $26m to be injected into regional scale projects. It will be funded from the WRC Investment Fund, after subsidising rates and allowing for inflation-proofing.
- The annual rates subsidy, currently $2.3m, will be phased out over the next 10 years with the impact to rates offset by efficiency savings.

WRC Investment Fund

Asset Class	Weight (%)
NZ Equities	9
Global Equities	20
Real Assets	11
Growth Assets	**40**
NZ Fixed interest	16
Global Fixed interest	24
Cash	20
Income Assets	**60**
Total	**100**

Source: WRC Statement of Investment Policy & Objectives, dated July 2015

Summary of Key Findings

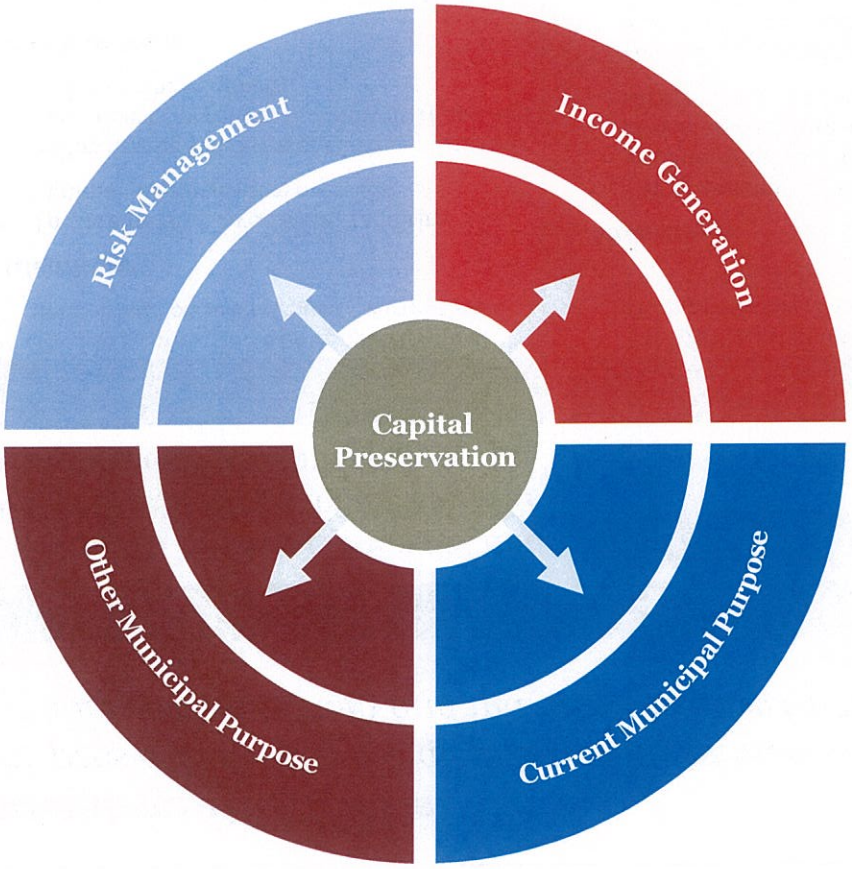
It appears that the use of CCO's and independent directors is common in managing Council commercial property investments with activities managed by way of clearly set objectives or statements of intent

Finding	Example	Key Takeaway
Structure	• **ICC** owns and manages its investment property portfolio through a CCO. The endowment properties are managed under the same objectives as the total ICC investment property portfolio. • **BOPRC** undertakes property development through an investment company subsidiary, QHL. • **DCC** appears to directly manage its investment property portfolio, including endowment properties. • The **WRC** Investment Fund is held within Council, but managed by an external professional advisor.	• A CCO can allow 'wider expertise', in terms of governance and managerial capacity, independent of Council.
Governance	• The Board for the **ICC** CCO, although only three members, includes one Councillor, an independent director and chair who are both senior experienced businessmen from within the region. • The **BOPRC** CCO Board is required to have a minimum of six members, the CEO, two nominated executive directors and three non-executive independent directors from the community. • **DCC** appears to manage investment properties within the Council function, however there are clear objectives set. • **WRC** has broad objectives set including the provision to retain income to preserve capital in real terms.	• The separation of governance and politics through structure (CCO) and clearly set objectives is required to facilitate long-term strategy.
Investment Activities	• **ICC** has undertaken numerous property developments, with endowment funds specifically used on at least one occasion. The development activity varies, including the construction of a new Council office building, industrial subdivision and commercial office building. • **ICC** is currently looking at a CBD revitalisation and rejuvenation project. • **DCC** has invested in commercial property in Auckland, Christchurch and Wellington to achieve geographic diversity. They have also borrowed $16m against the portfolio value of $95m to achieve desired outcomes. • **WRC** has passive investments only. A mix of cash, managed funds and managed property funds.	• Development activities are clearly aligned to aspects of Council plans for municipal purposes. • Activities typically include a mix of development activities and passive investments such as managed funds.

Options

Overview of Considerations

The key common law principle of an endowment is the preservation of capital without which there would be no purpose for the endowment



The diagram opposite highlights the key factors to consider in undertaking an options analysis.

Capital Preservation – appears to be central to all options, it is a common law principle of endowment and legal advice suggests that policy change cannot challenge this requirement as without it, there would be no purpose for the endowment.

Income Generation – a key policy decision of the endowment fund and other similar funds is the requirement to generate a commercial return. This could be altered through policy change, and would require decisions to be made to either maximise income or accept a lower return for wider municipal benefit.

Risk Management – risk is relative to the return. HPL illustrated that increased returns could be achieved over a long period despite the perceived additional risk with development vs. purchasing tenanted buildings.

Current Municipal Purpose – the current municipal purpose is for the income to offset rates. There does not appear to be any legal impediment to alter the application of income to a wider-public benefit.

Other Municipal Purpose – a key principle of endowment is municipal purpose. This is a broad purpose that could include strategic developments with wider economic and public benefits to Hamilton.

Investment Options

The pros and cons of the alternative investment options should be considered along with the most suitable vehicle to hold and manage the investments

Cash at Bank

Managed Funds

Development Activities

It is likely under Option 2 and Option 3 that a portion of the MEF is held in each investment class

Option 1 – Cash Holdings

- The MEF continues to be applied to offset debt or held on term deposit - current state.

Advantages

- This is a passive investment, requiring minimal administrative oversight.
- Following the sell down of existing properties there may be potential for administrative cost savings within Council.

Disadvantages

- No ability to apply capital to other municipal purposes.
- If applied as a debt-offset there is no ability to apply income to other municipal purposes. If held as a term deposit, the MEF policy will dictate how the return is applied.
- If held in cash investments long-term, the capital value of the MEF will decrease in real-terms unless some of the cash is reinvested each year to keep up with inflation.

Option 2 – Managed Funds

- The MEF is predominately invested in Managed Funds. This could be undertaken by HCC or via a CCO.

Advantages

- This is a passive investment, requiring minimal administrative oversight with the possibility of future administrative cost savings within Council.
- Depending on the nature of the fund, on a long-run basis, historical analysis indicates a financial return in excess of the 5.5% debt offset.
- Managed funds allow the MEF to be applied across a variable risk scale depending on the desired financial return (i.e. conservative vs. growth funds).

Disadvantages

- No ability to apply capital to other municipal purposes.

Option 3 – Development Activities

- The MEF to be applied to Development Activities. This could be undertaken by HCC or via a CCO.

Advantages

- Development could act as a catalyst, through partnering with the private sector, to deliver outcomes for Hamilton with a wider public benefit.
- Returns over the long-term, could, as illustrated by the HPL example, significantly exceed the 5.5% pa earned as a debt offset.

Disadvantages

- The MEF capital is at risk, requiring appropriate risk and investment frameworks.
- Development timeframes could mean a large portion of capital does not earn a return in any one year.
- Increased risk of volatility in the level of income distributed to Council per year.

Delivery Options

The desired investment type and application of income will influence the vehicle required to provide the best chance of success

Option 1 – Cash Holdings

Option 2 – Managed Funds

Option 3 - Development Activities

A CCO provides a number of benefits should capital and / or income be applied to other municipal purposes

Within Council (HCC)

Option 1 – Cash Holdings

- Within Council is the lowest cost option and allows the MEF to be applied to a debt offset, providing a greater return than term deposits.

Option 2 – Managed Funds

- Policy change will be required for income to be applied to other municipal purposes.
- If available, the ability to utilise income for other municipal purposes will be subject to short-term priorities within Council.

Option 3 – Development Activities

- Changing priorities can impact achievement of objectives in the long-term.
- The application of income to other municipal purposes will be subject to political consideration.
- There is potential that JV Partners will be less willing to partner direct with Council.

CCO – e.g. HPL Example

Option 1 – Cash Holdings

- Investment of the MEF through debt offset or term deposits does not warrant the administrative costs of a CCO.

Option 2 – Managed Funds

- The statement of objectives will be set by Council allowing the CCO to apply income to achieve a long-term strategy without changing priorities.

Option 3 – Development Activities

- The statement of objectives will be set by Council allowing the CCO to apply both capital and income to achieve a long-term strategy without changing priorities.
- The appointment of external directors would bring experience, expertise and opportunities.
- A CCO will arguably offer an improved ability to act quickly and partner with the private sector.
- An independent Board of Directors removes Council from directly selecting one party over another, reducing perception risk.

Critical Success Factors

The strategic objectives of Council will drive the type of investment required which will in-turn dictate the vehicle to best achieve the desired outcomes

Investment Options

Option A – CCO

- The MEF could be invested in a mix of cash, managed funds and development activities where opportunities are identified.
- A number of critical success factors have been identified through the experience of HPL and other Councils as detailed opposite.
- The nature of investments, will be driven by the strategic objectives set by Council and influenced by the relationship between maximising commercial returns and seeking a wider municipal benefit such as economic stimulation or city revitalisation.
- The statement of objectives under which HPL operated previously (see page 8) appears relevant today, with the addition of targeting developments which drive economic activity aligned to Council's strategic plans.
- The income earned from the CCO could either be distributed to Council via dividend and applied to a chosen municipal purpose or retained by the CCO and reinvested.

Option B –Within Council

- The MEF could be invested in both managed funds and property development activities and managed within Council.
- However, if development activities are undertaken within Council this will likely impact on the ability to incorporate a number of the critical success factors presented opposite. It is also possible that changing priorities within Council could impact the ability to achieve long-term strategic objectives.
- If the MEF was invested in a mix of cash and managed funds, both being passive investments, management within Council could be more cost effective than using a CCO.

Critical Success Factors

- The critical success factors identified through the experience of HPL are also present in the Invercargill City Council and Bay of Plenty Regional Council (Quayside) case studies.
- All three entities undertook property development activities through a CCO with critical success factors including:
  - Independent Board members from within the region with relevant experience and contacts within the private sector;
  - Appropriately skilled and qualified management personnel;
  - Where appropriate, partnering with the private sector through joint ventures;
  - A stable long-term approach, achieved through clearly set objectives and separation from changing priorities in the short-term.
  - The ability to make timely decisions to take advantage of opportunities.

Revised Strategy

Council will need to confirm the strategy for the MEF which will need to set clear objectives including desired municipal purpose and targeted levels of income generation desired.

Currently Council do not have a strategy in relation to utilising the capital and returns from the MEF. Returns are applied to reduce rates.

Clear strategic objectives should be set, these objectives will ultimately determine where the MEF is invested and what vehicle is required to best achieve long-term strategic objectives.

At a high level the objectives need to clearly communicate the municipal purpose. The municipal purpose will influence the targeted returns.

Key considerations may include:

1. Targeted return

- Is a purely commercial return targeted or will returns be influenced by wider municipal purposes. If so to what degree will commercial returns be sacrificed.

Maximising the commercial return

vs.

Potentially accepting a lower return whilst initiating economic activity consistent with a long-term strategic objective.

2. Municipal Purpose

- Returns can be applied to rates, as is the current policy, to other municipal purposes, or a combination.
- Returns could be applied to projects or causes identified by Council. This may be done periodically or returns accumulated.

3. Mechanism to Deliver

The targeted returns and municipal purpose will determine the nature of the investment activity which in turn will influence the vehicle required to best deliver the desired outcome.

Investment options to consider include managed funds and property development activities which could be delivered through a CCO structure or from within Council.

4. The timeline

- Will objectives be measurable?
- Is there a set timeline in which to achieve objectives?
- What is the intention on achievement?
- Will the vehicle be disbanded on completion or will the strategy be revisited by Council?

Appendices

Restrictions

This report has been prepared for Hamilton City Council to outline the history and financial performance of the MEF and assess the options available to utilise the assets to achieve a financial return and also to be used to contribute to other municipal purposes that benefit Hamilton and its ratepayers. This report has been prepared solely for this purpose and should not be relied upon for any other purpose. We accept no liability to any party should it be used for any purpose other than that for which it was prepared.

This report has been prepared solely for use by Hamilton City Council and may not be copied or distributed to third parties without our prior written consent.

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

We have not independently verified the accuracy of information provided to us, and have not conducted any form of audit in respect of Hamilton City Council. Accordingly, we express no opinion on the reliability, accuracy, or completeness of the information provided to us and upon which we have relied.

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

The statements and opinions expressed in this report are based on information available as at the date of the report.

We reserve the right, but will be under no obligation, to review or amend our report, if any additional information, which was in existence on the date of this report, was not brought to our attention, or subsequently comes to light.

This report is issued pursuant to the terms and conditions set out in our engagement letter dated 25 February 2016.

Schedule of Properties

Schedule of Properties	Renewal Date	Expiry Date	Date Purchased	Purchase Amount	Sales Year	30-Jun-08 Actual	30-Jun-09 Actual	30-Jun-10 Actual	30-Jun-11 Actual	30-Jun-12 Actual	30-Jun-13 Actual	30-Jun-14 Actual	30-Jun-15 Actual
Valuation per year													
Municipal Investment Properties													
BNZ Building	N/A	N/A	Jun-98	9,300	Feb-15	17,250	16,000	15,700	15,800	16,200	16,200	16,000	-
Beggs Wiseman Building	Various	Various	May-94	1,226		2,150	2,100	2,000	1,900	1,950	1,725	1,500	1,200
CI munro	N/A	N/A	Nov-99	2,627	Aug-11	8,500	6,900	6,855	7,450	-	-	-	-
ANZ Bank	N/A	N/A	Jul-99	850	Mar-15	1,200	1,125	1,060	1,100	1,100	1,025	1,140	-
Asaleo Care (SCA Hygiene)	Oct-21	Sep-40	May-00	5,271		8,500	7,700	7,650	7,550	7,500	7,050	7,000	6,900
Online Security (Iron Mountain)	None	Apr-18	Apr-02	1,944		2,900	2,600	2,500	2,500	2,400	2,400	2,400	2,875
Masters Avenue Shops	Various	Various	May-96	318		575	560	575	575	590	590	550	675
Total Municipal Investment				**21,535**		**41,075**	**36,985**	**36,340**	**36,875**	**29,740**	**28,990**	**28,590**	**11,650**
Municipal Endowment Properties													
109 Ward Street (PwC Building)	N/A	N/A	Jun-08	2,166	Jul-12	2,166	1,841	1,620	1,740	1,380	-	-	-
145-149 Ward Street	Feb-22	N/A	Jun-08	721		721	512	475	456	456	375	375	400
151-155 Ward Street	May-21	N/A	Jun-08	721		721	512	475	450	456	360	360	370
179 Ward Street	Jan-16	N/A	Jun-08	606		606	428	380	386	386	386	386	424
58 Willoughby Street	Nov-30	N/A	Jun-08	280		280	246	240	240	240	293	293	290
92 Clyde Street	Sep-11	N/A	Jun-08	260		260	189	195	195	160	180	180	180
205 Clyde Street	N/A	N/A	Jun-08	180	Oct-14	180	135	140	140	160	165	165	-
258 Fox street	Mar-20	N/A	Jun-08	165		165	135	140	140	160	165	165	175
12 Wiremu Street	Sep-21	N/A	Jun-08	265		265	222	220	180	190	200	200	210
77 Norton Road	Nov-28	N/A	Jun-08	270		270	225	237	237	240	258	270	270
79 Norton Road	Dec-29	N/A	Jun-08	160		160	130	140	140	140	145	150	160
Total Municipal Endowment				**5,794**		**5,794**	**4,575**	**4,262**	**4,304**	**3,968**	**2,527**	**2,544**	**2,479**
Cash						**-**	**-**	**-**	**-**	**7,450**	**8,830**	**9,435**	**27,440**
Summary													
Cash						-	-	-	-	7,450	8,830	9,435	27,440
Municipal Investment						41,075	36,985	36,340	36,875	29,740	28,990	28,590	11,650
Municipal Endowment						5,794	4,575	4,262	4,304	3,968	2,527	2,544	2,479
Total Assets						**46,869**	**41,560**	**40,602**	**41,179**	**41,158**	**40,347**	**40,569**	**41,569**

Source: Council files and Annual reports

Capital Return Analysis

Schedule of Properties	Date Purchased	Purchase Amount	Valuation / Sale Proceeds	Sale / Valuation Date	No. of Years	CAGR Analysis		Actual Capital Return		Inflationary Benchmark			
						Full term	5 Year CAGR	Appreication / Depreciation	Capital Return - %	Inflationary Benchamark	Benchmark % gain	PPTS variance - + / (-)	Actual vs. Inflation
Valuation per year													
Municipal Investment Properties													
BNZ Building	Jun-98	16,133	16,700	Feb-15	17	0.21%	1.24%	567	3.5%	9,394	58.2%	(54.7%)	(8,827)
Beggs Wiseman Building	May-94	1,226	1,200	Jun-15	21	(0.10%)	(9.71%)	(26)	(2.1%)	714	58.2%	(60.3%)	(739)
CI munro	Nov-99	2,627	7,335	Aug-11	12	9.18%	(3.62%)	4,709	179.3%	986	37.5%	141.7%	3,723
ANZ Bank	Jul-99	850	1,180	Mar-15	16	2.12%	2.17%	330	38.8%	374	43.9%	(5.1%)	(44)
Asaleo Care (SCA Hygiene)	May-00	5,271	6,900	Jun-15	15	1.81%	(2.04%)	1,629	30.9%	2,249	42.7%	(11.8%)	(620)
Online Security (Iron Mountain)	Apr-02	1,944	2,875	Jun-15	13	3.02%	2.83%	931	47.9%	678	34.8%	13.0%	253
Masters Avenue Shops	May-96	318	675	Jun-15	19	4.02%	3.26%	357	112.3%	166	52.2%	60.1%	191
Total Municipal Investment		**28,368**	**36,865**		**15.81**	**1.67%**	**0.29%**	**8,497**	**30.0%**	**14,559**	**51.3%**	**(21.4%)**	**(6,063)**
MunicipalEndowment Properties													
109 Ward Street (PwC Building)	Jun-08	2,166	1,783	Jul-12	4	(4.74%)	(3.82%)	(383)	(17.7%)	254	11.7%	(29.4%)	(637)
145-149 Ward Street	Jun-08	721	400	Jun-15	7	(8.16%)	(3.38%)	(321)	(44.5%)	109	15.1%	(59.6%)	(430)
151-155 Ward Street	Jun-08	721	370	Jun-15	7	(9.19%)	(4.87%)	(351)	(48.7%)	109	15.1%	(63.8%)	(460)
179 Ward Street	Jun-08	606	424	Jun-15	7	(5.03%)	2.22%	(182)	(30.0%)	92	15.1%	(45.1%)	(274)
58 Willoughby Street	Jun-08	280	290	Jun-15	7	0.51%	3.86%	10	3.6%	42	15.1%	(11.5%)	(32)
92 Clyde Street	Jun-08	260	180	Jun-15	7	(5.17%)	(1.59%)	(80)	(30.8%)	39	15.1%	(45.9%)	(119)
205 Clyde Street	Jun-08	180	180	Oct-14	6	-	5.15%	-	0.0%	26	14.4%	(14.4%)	(26)
258 Fox street	Jun-08	165	175	Jun-15	7	0.85%	4.56%	10	6.1%	25	15.1%	(9.0%)	(15)
12 Wiremu Street	Jun-08	265	210	Jun-15	7	(3.30%)	(0.93%)	(55)	(20.8%)	40	15.1%	(35.9%)	(95)
77 Norton Road	Jun-08	270	270	Jun-15	7	-	2.64%	-	0.0%	41	15.1%	(15.1%)	(41)
79 Norton Road	Jun-08	160	160	Jun-15	7	-	2.71%	-	0.0%	24	15.1%	(15.1%)	(24)
Total Municipal Endowment		**5,794**	**4,442**		**5.81**	**(4.47%)**	**0.83%**	**(1,352)**	**(23.33%)**	**801**	**13.8%**	**(37.16%)**	**(2,153)**

Source: Council files and Annual reports and PwC calculations

MEF Financial Return Analysis

MEF - Financial Analysis $ in 000s	Jun-08	Jun-09	Jun-10	Jun-11	Jun-12	Jun-13	Jun-14	Jun-15
Value								
Municipal Investment Properties (MIP)	41,075	36,985	36,340	36,875	29,740	28,990	28,590	11,650
Municipal Endowment Properties (MEP)	5,794	4,575	4,262	4,304	3,968	2,527	2,544	2,479
Cash	-	-	-	-	7,450	8,830	9,435	27,440
Total MEF value	**46,869**	**41,560**	**40,602**	**41,179**	**41,158**	**40,347**	**40,569**	**41,569**
Gross Yield								
Municipal Investment Properties (MIP)	3,098	3,458	3,463	3,407	2,344	2,622	2,470	1,907
Municipal Endowment Properties (MEP)	148	167	167	176	183	111	111	107
Total	**3,245**	**3,625**	**3,630**	**3,583**	**2,527**	**2,732**	**2,580**	**2,014**
Municipal Investment Properties (MIP)		8.9%	9.4%	9.3%	7.0%	8.9%	8.6%	9.5%
Municipal Endowment Properties (MEP)		3.2%	3.8%	4.1%	4.4%	3.4%	4.4%	4.3%
Total		**8.2%**	**8.8%**	**8.8%**	**6.7%**	**8.4%**	**8.2%**	**8.9%**
Net Yield								
Municipal Investment Properties (MIP)	2,670	3,234	3,236	3,317	2,267	2,556	2,365	1,739
Municipal Endowment Properties (MEP)	130	173	130	177	172	112	111	101
Cash - net yield		-	-	-	205	448	502	1,014
Total	**2,801**	**3,407**	**3,366**	**3,494**	**2,644**	**3,116**	**2,978**	**2,853**
Municipal Investment Properties (MIP)		8.3%	8.8%	9.1%	6.8%	8.7%	8.2%	8.6%
Municipal Endowment Properties (MEP)		3.3%	2.9%	4.1%	4.2%	3.4%	4.4%	4.0%
Cash		5.5%	5.5%	5.5%	5.5%	5.5%	5.5%	5.5%
Total		**7.7%**	**8.2%**	**8.5%**	**6.4%**	**7.6%**	**7.4%**	**6.9%**
Inflation Adjusted Returns								
RBNZ - General Inflation	**3.1%**	**3.4%**	**1.9%**	**3.8%**	**2.3%**	**0.8%**	**1.5%**	**0.6%**
Gross Yield		4.8%	7.0%	4.9%	4.5%	7.6%	6.7%	8.3%
Net Yield		4.4%	6.3%	4.7%	4.2%	6.8%	5.8%	6.3%

The return percentages are impacted by the sale of properties and use of average portfolio values in calculating yields

Source: Council files and Annual reports and PwC calculations

Listed Property Funds

Listed Property Companies

Listed property funds	1 year	2 year	3 year	4 year	5 year	6 year	7 year	8 year	9 year	10 year
Augusta Capital Limited (NZSE:AUG)										
Share price appreciation	23%	10%	15%	15%	16%	15%	5%	-1%		
Dividend yield	5%	5%	5%	6%	7%	10%	18%	13%	6%	
Total return	28%	15%	20%	21%	22%	25%	23%	12%	6%	
Stride Property Limited (NZSE:STR)										
Share price appreciation	27%	6%	13%	12%						
Dividend yield	5%	6%	5%	7%	5%					
Total return	32%	12%	18%	19%						
Property for Industry Ltd. (NZSE:PFI)										
Share price appreciation	23%	10%	11%	8%	6%	6%	3%	1%	2%	4%
Dividend yield	4%	5%	5%	6%	6%	6%	6%	6%	5%	6%
Total return	27%	15%	16%	14%	12%	12%	10%	6%	7%	10%
Argosy Property Limited (NZSE:ARG)										
Share price appreciation	25%	8%	11%	12%	9%	12%	3%	-2%	0%	0%
Dividend yield	5%	7%	6%	7%	10%	11%	14%	9%	7%	8%
Total return	31%	14%	17%	19%	19%	22%	16%	7%	6%	8%
Precinct Properties New Zealand Limited (NZSE:PCT)										
Share price appreciation	18%	7%	8%	9%	9%	5%	0%	-2%	1%	3%
Dividend yield	4%	5%	5%	5%	6%	8%	7%	7%	5%	7%
Total return	22%	12%	13%	15%	15%	13%	7%	5%	6%	9%
Goodman Property Trust (NZSE:GMT)										
Share price appreciation	24%	7%	5%	6%	4%	7%	-2%	-4%	0%	1%
Dividend yield	5%	6%	6%	6%	9%	9%	13%	8%	6%	8%
Total return	30%	13%	11%	12%	12%	16%	11%	4%	6%	9%
Kiwi Property Group Limited (NZSE:KPG)										
Share price appreciation	16%	5%	7%	7%	5%	5%	1%	-3%	0%	1%
Dividend yield	5%	5%	6%	7%	7%	8%	8%	7%	5%	6%
Total return	22%	11%	13%	13%	12%	13%	9%	4%	5%	8%
Average share price appreciation	**22%**	**8%**	**10%**	**10%**	**8%**	**8%**	**2%**	**-2%**	**1%**	**2%**
Average dividend yield	**5%**	**6%**	**5%**	**6%**	**7%**	**9%**	**11%**	**8%**	**6%**	**7%**
Average total return	**27%**	**13%**	**15%**	**16%**	**16%**	**17%**	**13%**	**6%**	**6%**	**9%**

	3 Years	5 Years	7 Years
Average - Income return	5%	6%	7%
Average - Capital return	10%	8%	2%
Average - Total return	15%	14%	9%

Note: Annual returns are based on years ending 31 March or last trading day of March

Source: Capital IQ

Balance Managed Funds

Balanced funds annual returns

For the year ending March

Balanced fund	2015	2014	2013	2012	2011	2010	2009
Milford Kiwisaver Balanced fund	15%	10%	18%	3%	4%		
Mercer Balanced	11%	8%	8%	0%	5%	25%	-21%
Staples Rodway Kiwisaver Balanced Fund	14%	9%	13%	3%	7%	20%	-14%
OneAnswer Balanced Growth Fund	15%	9%	14%	2%	6%	22%	-16%
ANZ Balanced Fund - Default	13%	7%	10%	3%	5%	14%	-11%
ANZ Balanced Growth Fund - Default	15%	9%	11%	2%	6%	18%	-16%
AON - ANZ Balance Fund	13%	7%	14%	3%	8%	26%	-10%
Westpac Balanced Fund	12%	7%	10%	0%	7%	19%	-10%
ASB Balanced Fund	13%	7%	10%		6%	22%	-18%
AMP - Fisher Balanced Fund	9%	7%	9%	1%	5%	16%	-10%
Forsyth Barr Balanced Portfolio	12%	2%	9%	-7%	1%	13%	
Average	***13%***	***8%***	***11%***	***1%***	***6%***	***19%***	***-14%***
Fundsource Balanced fund average	***12%***	***7%***	***11%***	***2%***	***6%***	***18%***	***-12%***

	3 Years	5 Years	7 Years
Average return	***11%***	***8%***	***6%***

Note 1: LTM denotes last twelve months to September 2015

Note 2: all returns shown are after total fund fees (not membership fees) and tax (28% PIR).

Note: 3 Grey shading indicates data was unavailable

Source: http://fundfinder.sorted.org.nz/

Gareth Morgan (KiwiWealth) – Balanced Fund

The performance of the KiwiWealth Balanced Fund has been illustrated as we understand Council hold units through the Vibrant Trust.

Gareth Morgan - Balanced Fund annual returns

For the year ending 31 December

Balanced fund	2015	2014	2013	2012	2011	2010	2009	2008	2007	2006	2005	2004
Gareth Morgan - Balanced Fund	5.5%	9.3%	13.9%	7.6%	-1.6%	3.5%	3.7%	-8.9%	3.7%	14.6%	11.2%	10.8%
Fundsource Balanced fund average	*12%*	*7%*	*11%*	*2%*	*6%*	*18%*	*-12%*					
Additional / (reduced) return	*-7%*	*2%*	*3%*	*6%*	*-7%*	*-15%*	*16%*					

	3 Years	5 Years	7 Years	10 Years
Average return	*10%*	*6%*	*6%*	*5%*

Source: http://fundfinder.sorted.org.nz/

Glossary of terms used in this document

Term	Meaning
BMF	Balanced Managed Fund
CAGR	Compound Annual Growth Rate
CBD	Central Business District
CCO	Council Controlled Organisation
City	Hamilton City
DEF	Domain Endowment Fund
HCC or the Council	Hamilton City Council
HPL	Hamilton Properties Limited
LPC	Listed Property Companies
LTCCP	Long-term Council Community Plan
MEF	Municipal Endowment Fund
MEP	Municipal Endowment Properties
MIP	Municipal Investment Properties