Capital Structure Review Report – Review Panel Options

Option One **NOT PREFERRED**	**The Port does not invest, so it can keep paying dividends (do nothing)** • This 'do nothing' option involves the Port continuing to pay dividends of up to $10m per annum, with insufficient limited retained earnings to fund wave 1 capital development needs. • The decision to invest in a new wharf and dredging are deferred for the foreseeable future. If the Port grows as planned, it will become short of on-port space, with the risk of increased costs of operations and reduced service levels. The Port would also not be able to receive larger ships if there is a change in the size of ships calling at New Zealand ports. • Although not guaranteed, this option could result in reduced dividends over time if the Port's and Hawkes Bay's relevance in the New Zealand supply chain diminishes.
Option Two **NOT PREFERRED**	**The Port increases its debt levels to fund Port development needs (e.g. bank debt, shareholder loan or issuing a bond)** • This would involve the Port borrowing up to $125m to fund major development needs. $40m of this debt is considered within prudent levels of borrowing as outlined in para 48. $85m would be above levels considered prudent, with the Port having very high levels of debt and considered a sub investment grade asset. • Interest costs would reduce Port profits and the dividend it is able to pay. • Borrowing could take the form of a bank loan or a shareholder loan. • A bond issue is another form of loan. A bond would have the same effect on the Port's financial position, and usually has a higher interest cost. • The Port, HBRIC and Council have informally indicated that such high levels of debt would not be acceptable, as they place the investment at risk.
Option Three **CONSIDER FURTHER**	**The Port increases its prices or introduces a levy on Port users to fund Port development** • Under this scenario, the Port would apply a special price or levy over a five/ten year period (for example), to pay for the cost of the Port capital and any interest charges it may incur. • This option would be a pure user pays solution but doesn't quantify the commercial risks of such an approach. • This option presents the Port with the ability to source funds and for Council/HBRIC to maintain full ownership control of the Port.
Option Four **NOT PREFERRED**	**HBRIC/the Port receives dividend relief for a defined period** • Under this scenario the Council would grant HBRIC/the Port a dividend holiday until the Port could retain sufficient earnings to fund its development needs. This option would meet the Port's needs but create a hole of circa $10m p.a. in Council's current income. Very quickly, this would either eat into Council's cash reserves, require major cost and service cutting or large increases in rates (which at $10m p.a is more than triple current rates). • Council has informally indicated that this option is not viable.
Option Five **NOT PREFERRED**	**Council invests more capital into HBRIC/Port**

	• Further Council investment in the Port would substantially increase the Council's risk concentration in this asset, which already dominates the Council's commercial investment portfolio, producing modest cash returns. • Under this scenario Council would invest a further $85m of equity into the Port (via HBRIC), with the Port borrowing the remaining $40m required for the upcoming major developments. • Council could either borrow the $85m required (by bank loan or issuing a Council community bond for example), or invest its $60m of cash reserves and either borrow the balance or sell other commercial investments. • Borrowing the full $85m would increase Council's costs by around $3m per annum. Using cash reserves and selling other assets would reduce Council income by $3m+. These values would decline over time as the Port investment produces a payback. However, the Port investments are 25+ year investments.
Option Six **CONSIDER FURTHER**	**Council charges ratepayers a special levy to fund the Port developments** • Under this scenario, Council would apply a special rate over a ten year period (for example), to pay for the cost of the Port capital and any interest charges it may occur if the Council borrows up front to fund the development. • This would result in an additional cost to each ratepayer of circa $1,700 over 10 years. ($85m+ c. $35m interest costs spread over 70,344 ratepayers). This represents an approximately 63% average rates increase each year. • This option presents the Council with the ability to source funds and maintain full ownership control of the Port.
Option Seven **CONSIDER FURTHER**	**Introduce a minority investment partner to the Port** • Under this scenario, Council/HBRIC invites another investor to buy shares in the Port. This could range from 25% to 49% of the shares. • Council via HBRIC remains the majority owner of the Port, with effective control. • Dividends would reduce by the equivalent percentage sold. • Selecting a good 'partner' would be essential to a sustainable shareholding arrangement. Partners could be general investors or strategic partners who bring sector expertise. • Flagstaff estimates that this option could fund the Port's $85m capital requirements and release up to $50m+ for Council to re-invest elsewhere or allocate to Council requirements. • Council's risk profile is improved significantly through diversification of the commercial investment portfolio if proceeds are reinvested elsewhere.
Option Eight **CONSIDER FURTHER**	**The Port is publically listed on the NZX, with the Council retaining majority ownership** • Under this scenario, the Port is listed on the NZX, with Council (via HBRIC) retaining 51-75% of the shares. • Council (via HBRIC) remains the majority owner of the Port, with effective control, however is subject to the disciplines of the stock exchange. • Dividends would reduce by the equivalent percentage sold. • The option enables public investment. • Flagstaff estimates that this option could fund the Port's $85m capital requirements and release further upside to option (6) for the Council to re-invest elsewhere or allocate to Council requirements. • There is a question about whether the size of the market listing would be

	material enough to promote ongoing trading of shares, which may support the share price over time.
Option Nine **CONSIDER FURTHER**	**The Port is leased to another party (with Council/HBRIC maintaining ownership of the Port assets)** • Under this scenario, the Port is leased to another party for a period of 30-50 years with HBRIC/Council retaining ownership of the Port infrastructure, with a third party taking over the day to day operations of the Port. Full port operations control reverts back to HBRIC/Council at the end of the lease. • This is a model that has been adopted at several ports in Australia, with significant value gains realised by local Government owners. • Council can retain important control rights through the lease including pricing controls, service standards and investment requirements. • Flagstaff estimate that this option could fund the Port's capital requirements and release the most capital of all the options, with Council via HBRIC maintaining base ownership of the Port assets and good control rights. Stringent monitoring arrangements would be required. The more demanding the control rights, the lower the price expectation. • Council's risk profile is improved significantly through diversification of the commercial investment portfolio if proceeds are reinvested elsewhere. • There are numerous variants that can be applied to this model including Council retaining some ownership in the operating company and upfront vs ongoing payments.