

Notice of Meeting:

I hereby give notice that an ordinary Meeting of the Finance Committee will be held on:

Date: Tuesday 3 April 2018
Time: 9.30am
Meeting Room: Council Chamber
Venue: Municipal Building, Garden Place, Hamilton

Richard Briggs
Chief Executive

Finance Committee OPEN LATE AGENDA

Membership

Chairperson	Cr G Mallett
Deputy Chairperson	Cr R Pascoe
Members	Mayor A King Deputy Mayor M Gallagher Cr M Bunting Cr J R Casson Cr S Henry Cr D Macpherson Cr A O'Leary Cr P Southgate Cr G Taylor Cr L Tooman Cr R Hamilton

Quorum: A majority of members (including vacancies)

Meeting Frequency: Six weekly

Becca Brooke
Governance Team Leader

29 March 2018

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Background

7. On 7 November 2017, the Finance Committee approved the setting up of an entity to build and operate Spray Dryer Two:
 - a) *approves the Spray Dryer Two proposal by NZ Food Innovation (Waikato) Ltd, on the basis that the shareholding arrangements in the new subsidiary does not inhibit Councils ability to sell its shareholding in NZ Food Innovation (Waikato) Ltd in the future;*
 - b) *notes that no Council direct investment is required in this proposal;*
 - c) *notes the NZ Food Innovation (Waikato) Ltd will invest \$1.4m from existing cashflows in a new company to be established to build and operate a Spray Dryer and receive a 10% shareholding in the company;*
 - d) *notes the development of Spray Dryer Two aligns with the approved Innovation Waikato Ltd and Group of companies 2017-2018 Statement of Intent; and*
 - e) *that the CE investigate and report to council an exit strategy for NZ Food Innovation (Waikato) Ltd noting that this strategy is unable to be executed until 2020 at the earliest due the legal contractual considerations.*
8. Subsequent to this resolution, various investment and ownership options were considered by NZ Food Innovation (Waikato) Ltd and it was determined that a Limited Partnership (LP) is the optimal model for the ownership and operation of Spray Dryer Two. The adoption of the LP model of ownership triggers the creation of three Council Controlled Organisation (CCO) entities.
9. This report was originally considered at the Council meeting on 15 March 2018, however due to the complexity of the Limited Partnership structure, it was resolved:

That this item of business be adjourned to be discussed at a future Elected Member Briefing and brought back to the 19 April 2018 Council Meeting for decision.
10. The Chair and Chief Executive of NZ Food Innovation (Waikato) Ltd along with the company's legal advisor presented to a Public Excluded Elected Member Briefing on 22 March 2018. A copy of the presentation, modified to exclude proposed investor names, is attached in Appendix One.
11. This report was resolved to be considered by the next Council meeting on 19 April 2018. However, an endorsement and a decision on the LP structure is required as soon as possible to enable the Spray Dryer Two project to proceed, in particular the legal and commercial workstreams. Thus, the report has been presented to this Finance Committee.

Discussion

12. The proposed LP ownership model is outlined in the diagrams attached to Appendix One and Two. This ownership model will create more than one CCO due to the way the LP's are structured. Under the Local Government Act (LGA) any CCO, even as a subsidiary entity (or subsidiary of a subsidiary), cannot be created without public consultation occurring first.
13. This is a minor technical/legal compliance matter to give effect to the previous resolution to support the creation of an entity to operate Spray Dryer Two.
14. In order to meet the legal compliance requirements of the LGA, it is proposed that the Chief Executive be delegated the authority to finalise a Consultation Document, conduct a consultation process and make any determination in relation to the proposed CCO's.

15. This process is the same as the steps followed for the establishment of the CCO, Waikato Innovation Growth Ltd (WIGL), when the Chief Executive was given the same authority as part of the restructure and sale process of Waikato Innovation Park Ltd.
16. In that case, the consultation was similarly technical and not significant and the duration was for one week. It is proposed to follow the same process for the creation of the LP CCO's.
17. The proposed Limited Partners representing 90% of the LP have approved the structure as they recognise the benefits of the structure. Callaghan Innovation, the other shareholder in NZFIWL have also approved the structure. It is noted that HCC's indirect interest in the LP is 7% (being HCC's share of the 10% investment by NZFIWL).
18. **Rationale for Limited Partnership**
19. The board and management of NZFIWL have identified the primary reasons for choosing a LP structure. They note that while the tax efficiency of a LP is advantageous to the proposed investors, it was not the main driver of the proposed restructure. The rationale are:
 - Control – having NZFIWL in control of the General Partner provides it with a high level of control over the LP and allows both Spray Dryer One and Two to be run most efficiently. This would be much harder to achieve in a company structure.
 - The LP structure allows the Limited Partners to have the “right” level of input through the Advisory Board mechanism. The LP structure is perfect for this as it provides a commonly understood level of oversight for LP's which suits.
 - Familiarity – LP's are increasingly common in NZ and very common off-shore and supported by the proposed investors.

Financial Considerations

20. There are no costs to Council to complete the public consultation for the establishment of the proposed CCO's apart from the use of existing staff time. All legal costs associated with the development of the proposed CCO structure and the preparation of the consultation document have been met by NZ Food Innovation (Waikato) Ltd.

Risks

21. There are no known risks associated with the decisions required for this matter. The resolutions of the Finance Committee on 7 November 2017 are being complied with.
22. The proposed ownership structure being consulted on, whilst new to Council, is a commonly used business structure in New Zealand, and complies with all legal and tax obligations.
23. The LP structure does not inhibit Council in the future from selling its shareholding in NZ Food Innovation (Waikato) Ltd. Any future sale would be of Council's 70% share in NZ Food Innovation (Waikato) Ltd, including any subsidiaries such as the LP structure outlined in this report.

Significance & Engagement Policy

Significance

24. Staff considered the following factors under the Significance and Engagement Policy:
There's a legal requirement to engage with the community.
25. Staff have assessed that the recommendation in this report has low significance.

Engagement

- 26. Given the low level of significance, staff recommend a short period of public engagement with the opportunity for submissions. Any submissions would be considered and determined by the Chief Executive.
- 27. A copy of the draft public consultation document is attached in Appendix Two. It is intended that public consultation occur immediately following the approval of this recommendation from the Finance Committee (with appropriate public communications).

Attachments

Attachment 1 - Presentation by NZ Food Innovation (Waikato) Ltd on ownership structure for Spray Dryer One and Two

Attachment 2 - Draft Proposal - Establishment of 3 Council Controlled Organisations .

New Zealand Food Innovation (Waikato) Limited

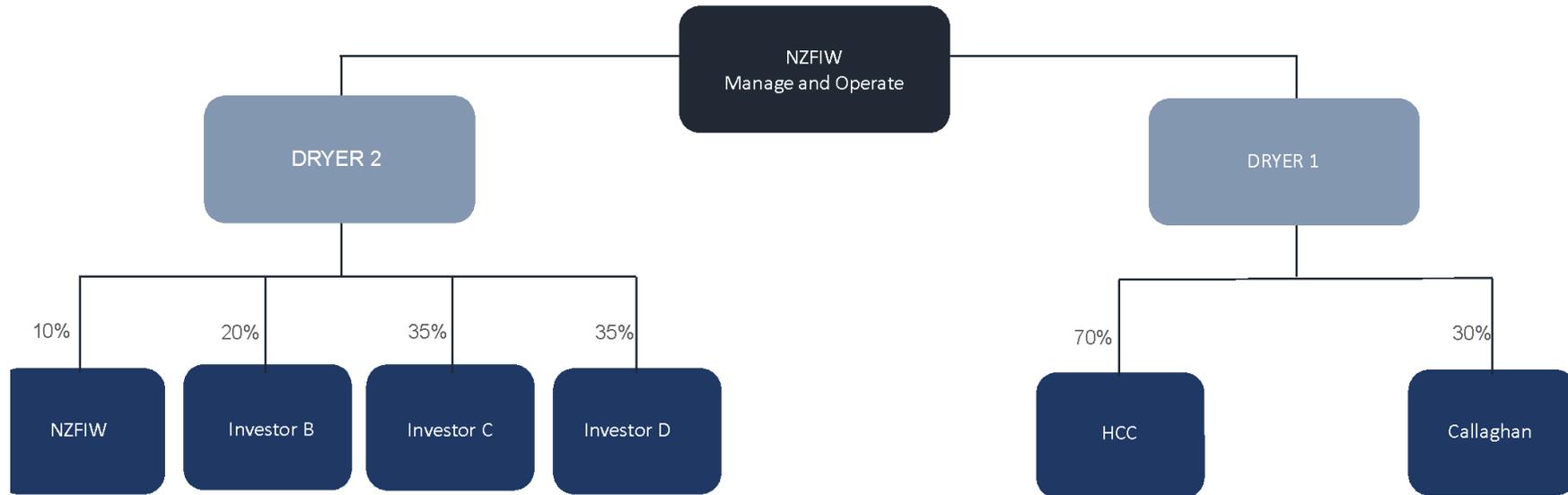
Dryer 1 and Dryer 2 – Approval for 3 CCOs

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Item 16

Attachment 1

OBJECTIVE

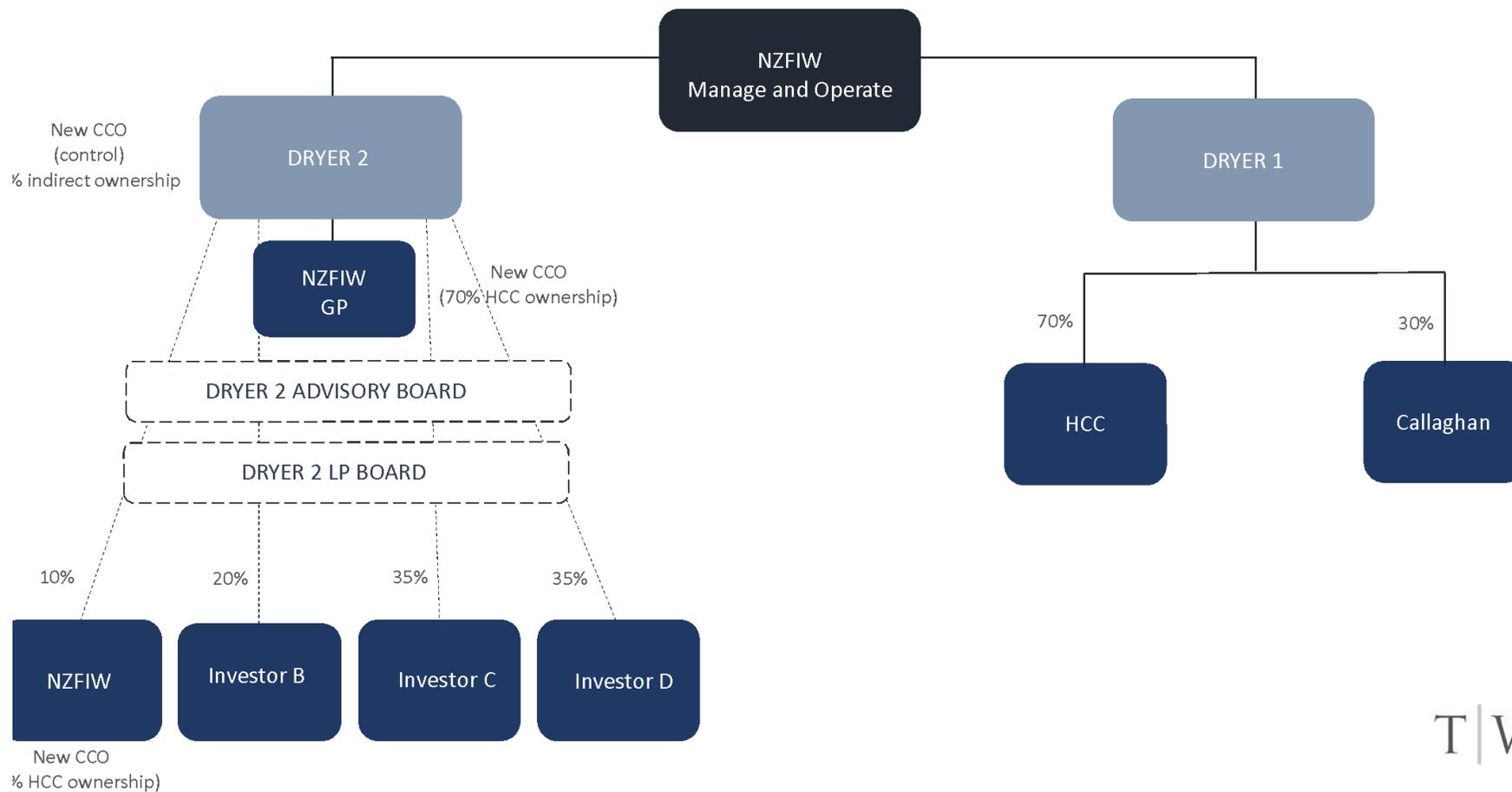


Issue

- Majority shareholders of Dryer 2 would want control of a Board under a company structure which puts tension on NZFIW managing 2 plants optimally.
- Tax position is not main driver.
- Company structure is a deal breaker for NZFIW Board.



LIMITED PARTNERSHIP SOLUTION



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EXPLANATION OF LIMITED PARTNERSHIPS

- Form of Partnership involving general partners, who are liable for all debts of the partnership, and limited partners, who are liable to the extent of their capital contribution to the Partnership provided they do not take part in management.
- Separate legal personality.
- A schedule to the Limited Partnership Act lists activities which Limited Partners can undertake without being deemed to take part in management (“safe harbour activities”).
- Partners can group their own tax affairs.
- (Under proposed structure exposure of General Partner is the same as exposure under a Company structure through the use of a special purpose vehicle as General Partner).

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LIMITED PARTNERSHIPS ARE NOW COMMON

Examples

- Spring Sheep Dairy NZ Limited Partnership (Landcorp and SLC Group).
- Terax Limited Partnership (Rotorua Lakes Council and Scion).
- Haumaru Housing Limited Partnership (Auckland Council and The Selwyn Foundation).

Offshore Familiarity

- LP supported by one of the investor partners.

Callaghan

- The Callaghan director of NZFIW is fully supportive of the Limited Partnership structure being deployed in this context.

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OPTIONS CONSIDERED

Company

- Pros:
 - Simple Structure.
- Cons:
 - Would still be a CCO (as NZFIW would require a Board majority).
 - Not as tax effective (LTC not available as shareholders of a LTC must be natural persons, trustees or another LTC).
 - More difficult to negotiate required level of control using this conceptual framework.

Limited Partnership

- Pros:
 - Provides a conceptual framework which delivers on NZFIW control requirement.
 - Tax effective.
- Cons:
 - More complicated structure (mitigated so that in practice, works like a Company).
 - Exposure to liability of General Partner risk is removed by use of a special purpose subsidiary, putting NZFIW in the same liability position as if it were a Company structure.

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LP GOVERNANCE

NZFIW GP

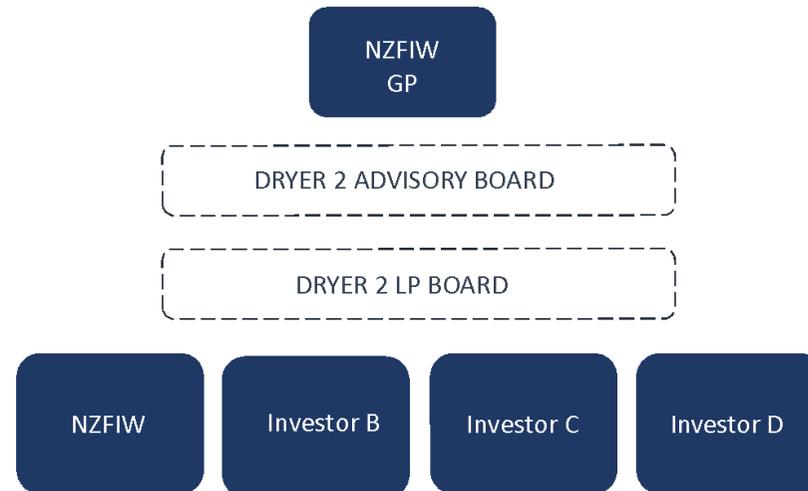
- Makes all management decisions (other than “safe harbour” decisions).
- Is liable for all debts and obligations of LP.
- Is a wholly-owned subsidiary of NZFIW with no assets.

DRYER 2 Advisory Board

- Representation 50/50 between Investors and NZFIW.
- No legal status.
- Meets to discuss strategic direction of financial prospects and reporting (safe harbours).
- Meet 6/7 times per annum.

DRYER 2 LP Board

- Votes based on LP interest properties.
- Decides on key matters (which are all safe harbours).
- Meets maybe once per annum.



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COST

Recap – 3 CCOs, the Limited Partnership (control, 7% HCC ownership), the GP (70% HCC ownership) and the Limited Partner (70% HCC ownership)

- The accounting for a limited partnership is at the limited partnership level
- The General Partner typically does not have anything in its accounts. Rights to profit distributions and assets will sit with limited partners and are accounted for in limited partnership accounts.
- The Limited Partner will only hold the 10% interest in the Limited Partnership and nothing else, so minimal transactions.
- Therefore while there are 3 CCOs in total, there will be minimal transactions for the extra two.

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RISK MANAGEMENT

- This structure creates no more risk for NZFIW or HCC than a Company model.
- The exposure to the Limited Partnership's debts and obligations:
 - For the **Limited Partnership** CCO will be limited to the extent of its capital in the Limited Partnership (just like a shareholding in a Company).
 - For the **General Partner** will be nil, as the General Partner will be a special purpose vehicle with no assets and as the General Partner is a limited liability company, NZFIW / HCC will not be exposed to the debts and obligations of the General Partner.
 - To the extent NZFIW / HCC is exposed to reputation risk this is no different to the exposure were a Company structure adopted.
- Private Investors are investing \$45m, NZFIW \$1.4m (HCC indirect interest \$0.98m).

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D-2617045

Proposal
Establishment of 3 Council Controlled
Organisations
March 2018

DRAFT



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PROPOSAL

PURPOSE

1. This document is a Statement of Proposal ("**Proposal**") prepared by Hamilton City Council ("**Council**") for consultation, pursuant to sections 56 and 82 of the Local Government Act 2002 (the "**Act**").
2. This Proposal relates to Council's plan to establish 3 new council controlled organisations (as defined in the Act) (the "**CCOs**").
3. Information on this Proposal and more can be found at www.hamilton.govt.nz.

BACKGROUND TO PROPOSAL

4. The proposal to establish the 3 CCOs relates to a proposed investment opportunity being proposed by New Zealand Food Innovation (Waikato) Limited ("**NZFIW**"). Council indirectly owns 70% of the shares of NZFIW. The remaining 30% shareholding of NZFIW is owned by Callaghan Innovation, a government agency supporting hi-tech businesses in New Zealand.
5. NZFIW owns an independent spray dryer situated at Innovation Park, Ruakura, Hamilton ("**Dryer 1**"). Dryer 1 offers open access to New Zealand producers and product developers.
6. NZFIW proposes to construct a new spray dryer to manufacture Sheep, Goat, Bovine and Nutritional Powders ("**Dryer 2**"). Dryer 2 is to be located next to Dryer 1 and is proposed to be a stand-alone spray dryer.
7. Dryer 2 is proposed to be owned by a new limited partnership to be named NZFIW D2 LP (the "**Limited Partnership**"), structured as follows:
 - (a) Third party investors and NZFIW will invest in, and contribute capital to, the Limited Partnership as limited partners via their own investment vehicles. NZFIW will invest in the Limited Partnership via a limited liability company which will be a wholly owned subsidiary of NZFIW and proposed to be named NZFIW D2 LP Limited ("**NZFIW LP Co**").
 - (b) A wholly owned NZFIW subsidiary will also be the general partner of the Limited Partnership and proposed to be named NZFIW D2 GP Limited ("**NZFIW GP Co**"). Due to its experience with Dryer 1, it is proposed that the current NZFIW board will undertake the governance of NZFIW GP Co;
 - (c) NZFIW will provide management services and employees to the Limited Partnership for the operation of Dryer 2. As manager, NZFIW will prepare and provide to each limited partner financial statements and reports and will charge an agreed management fee.

The proposed structure is set out in Appendix A.

8. Under this structure the 3 new CCO's will comprise:
 - (a) the Limited Partnership;
 - (b) NZFIW LP Co; and
 - (c) NZFIW GP Co.

RATIONALE

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9. The reasons for the proposed structure are as follows:
 - (a) this structure allows Drier 1 to remain independent of Drier 2. NZFIW's governance model has shown that operating independently, from the parent investment arm is commercially optimal for the spray dryer "open access model";
 - (b) this structure provides flexibility within New Zealand law and is an internationally recognised structure that investors will expect and be familiar with;
 - (c) the Limited Partnership will have "look through" tax status and this structure provides flexibility to allow an investor to organize its own internal structuring and reporting;
 - (d) this structure will protect the individual investors from exposure to or liability from both the Limited Partnership and other investors .

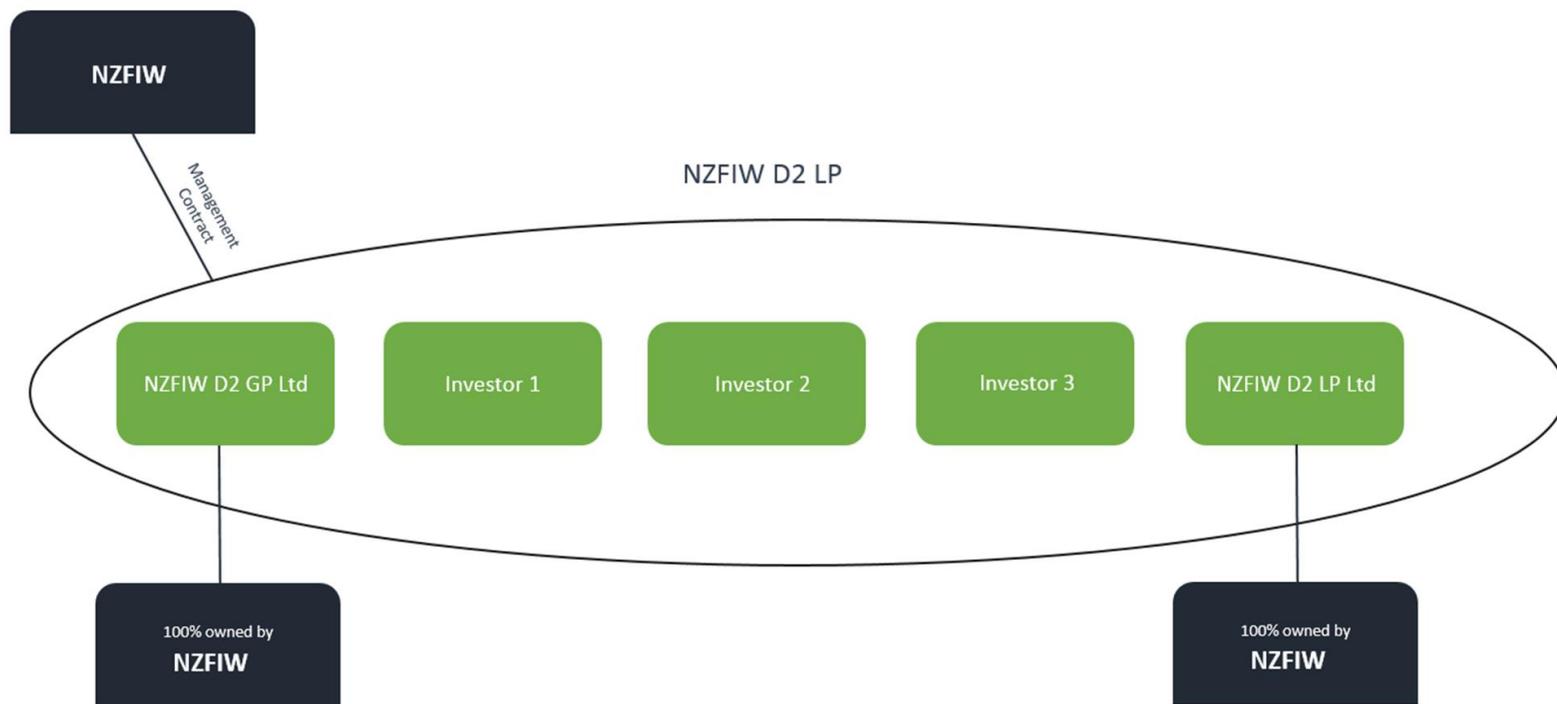
ALTERNATIVE OPTIONS

10. Council has considered the following reasonable practicable alternative options to the incorporation of the 3 CCOs:
 - (a) **Option 1: Not incorporate the CCOs at all:** Council has considered the option of not establishing the 3 CCOs at all. However, Council considers that this may prevent or delay the construction of Dryer 2 or mean that Dryer 2 would be 100% owned by third party investors; or
 - (b) **Option 2: Revisit the structure so as to remove one or more of the CCO's:** Council has considered the option of amending the proposed structure so as remove 1 or more of the proposed CCO's. However, Council considers that to attract investors and from a liability and management perspective the proposed structure is preferable.
11. Overall, Council's preferred option is to establish the 3 CCOs as set out in this Proposal.

CONSULTATION PLAN AND MAKING SUBMISSIONS

12. Council welcomes your views on the establishment of the 3 CCOs.
13. Anyone can make a submission regarding the proposed incorporation of the 3 CCOs and we encourage you to tell us your views.
14. For information about making a submission, members of the public can visit Council's website (<http://www.hamilton.govt.nz>). Alternatively, simply write us a letter telling us what you agree with, what you don't agree with and why.
15. The period for making written submissions open [insert start date] and closes 4.30 pm on [insert finish date]. Submissions should be sent to [insert address].

Appendix A
Structure



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Attachment 2

Item 16