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# Amendment to the Selwyn District Council Long Term Plan 2012/2022

## Introduction

The Council has amended its Long Term Plan 2012-22 so that it can liquidate its subsidiary company, Selwyn Investment Holdings Limited (SIHL). The amendment will allow the assets held by SIHL, including cash balances and its shareholding in SICON Limited and Orion New Zealand Limited to be transferred into the direct ownership of the Council.

## Background

SIHL was established in the mid-1990s (originally in the name of Selwyn Council Trading Enterprises Limited) to manage the Council's investments in SICON Limited, Selwyn Plantation Board Limited and Orion New Zealand Limited. The role of the company was to provide oversight of the operations of the Council's investments and allow them to operate at arm's length from Council.

This approach proved to be successful with SIHL delivering substantial dividends over a sustained period of time. In the mid-2000s SIHL became a more active investor and made two company acquisitions, KB Irrigation Limited and Ferguson Brothers Limited. These two companies have since merged with SICON Limited to form a single contracting operation.

Over the past two years Selwyn Plantation Board Limited (SPBL) has been going through a process to realise its assets with the intention of returning funds to its shareholders (SIHL and Christchurch City Holdings Limited). This process is now almost complete and the company will be wound up in the next few months. SIHL intends to formally liquidate SPBL so that it will no longer exist and all its assets will be transferred to its two shareholders.

Following the wind up of SPBL, the SIHL group assets will comprise mainly of the 100% shareholding in SICON Limited a minority (10.725%) shareholding in Orion New Zealand Limited plus the proceeds from the liquidation of SPBL (estimated to be \$42 million).

In response to these changes, and with the support of the Council, SIHL has restructured its operations. It is now governed by a board made up of three elected Councillors and its operational and administrative work is carried out by Council staff. This has reduced SIHL's operating costs by \$400,000 per year to just over \$100,000 per year plus the cost of Council staff time. Under the current structure the future role of SIHL will be relatively limited. It will include:

- High level oversight of SICON Limited's operations
- High level oversight of Orion New Zealand Limited's operations
- Management of any SIHL cash investment balances
- Administration of its own affairs, including board meetings, payment of dividends and preparation of accountability documents (quarterly reports, annual report, annual budget, Statement of Intent)
- Reporting to the Council

The Council intends to liquidate SIHL early in its 2013/14 financial year. The effect of the proposal will be to transfer SIHL's cash balances and its shareholding in SICON Limited and Orion New Zealand Limited to the Council. The value of these assets is estimated to be:

	\$
Cash and other net current assets*	31,000,000
SICON Limited shareholding**	9,121,436
Orion New Zealand Limited shareholding***	67,788,000
Loan to SICON Limited	360,000
<b>Total</b>	<b>108,269,436</b>

\* This is the estimated proceeds from the liquidation of SPBL of \$42 million, less an \$11 million special dividend paid to the Council in February 2013, leaving \$31 million to be transferred on the liquidation of SIHL.

\*\* This is the value of the net assets of SICON Limited as at 30 June 2012.

\*\*\* This is SIHL's valuation of its shareholding in Orion New Zealand Limited as at 30 June 2012.

The Council is intending to liquidate SIHL because its role has reduced significantly. Following the liquidation of SPBL, and the amalgamation of KB Irrigation Limited and Ferguson Brothers Limited into SICON Limited, SIHL will retain only two equity investments plus a cash balance and a loan to SICON.

The Council's view is that the cost of maintaining SIHL is not justified by its current role. SICON Limited has a professional board and the oversight of SICON may be done equally effectively through a sub-committee of Councillors. Similarly, liaison with Orion New Zealand Limited may be done equally effectively through a sub-committee of Councillors.

In assessing whether to liquidate SIHL the Council identified three options:

- **Option 1** – retain SIHL in its current form
- **Option 2** – enhance SIHL's role
- **Option 3** – liquidate SIHL and transfer all the assets of SIHL to the Council. This is the Council's preferred option.

## Assessment of options

Option	Assessment
Option 1: <i>Retain SIHL in its current form.</i>	<p><b>Advantages:</b> By retaining SIHL in its present form the Council will retain the holding company structure established in the 1990s. This structure was set up to ensure that the Council's investments were managed at arm's length from the Council. This allows a separation between the service considerations of the Council and the management of the subsidiary companies. This separation can help drive financial performance and reduce the risk of 'interference' in the operation of the subsidiaries.</p> <p><b>Disadvantages:</b> Although the cost of operating SIHL has been reduced substantially it is still quite expensive (over \$100,000 per year plus Council staff time). It is unlikely that the benefit that may be gained from the arm's length management of investments justifies the costs involved. It is possible that these costs could be reduced further, but in practice there is always an underlying compliance cost associated with Council Controlled Trading Organisations.</p>
Option 2: <i>Enhance SIHL's role.</i>	<p><b>Advantages:</b> The liquidation of Selwyn Plantation Board will result in around \$42 million of cash being available for reinvestment. This could provide substantial funds for SIHL to manage a portfolio of investments and the holding company structure would provide the opportunity to bring in specific management and governance expertise. If successfully managed this approach may generate dividends over and above those that could be gained through more passive investment through cash and bonds.</p> <p><b>Disadvantages:</b> Although active investment management may bring financial benefits, it also brings higher costs and higher risks. This is the model that was pursued by the Council and SIHL in the mid-2000s and is the model that the Council decided was no longer appropriate when it resolved to restructure SIHL in September 2011. The cost of enhancing SIHL's role is likely to be in the region of \$400,000 above existing costs (based on costs incurred in 2010-11). The difficult financial national economic conditions of recent years are continuing and nothing has changed that indicates that a return to more active investment will necessarily bring additional financial rewards over and above the costs and risks associated with such an approach.</p>
Option 3: <i>Liquidate SIHL and transfer all the assets of SIHL to the Council.</i>	<p><b>Advantages:</b> In September 2011 the Council supported the restructuring of SIHL's operations to become a more passive investor. Following the restructure the cost of operating SIHL were reduced from over \$500,000 per year to just over \$100,000 per year plus Council staff time. Most of this relates to the administrative and compliance costs of operating SIHL and adds little value to the financial performance of the Council group of companies. Liquidation would save the direct costs of operating SIHL plus some of the Council staff time. Some staff time would remain as the investment of cash funds and liaison with SICON and Orion, and reporting to the Council would continue.</p> <p><b>Disadvantages:</b> SIHL was established to provide for the arm's length management of the Council's investments. If SIHL is liquidated the investments would be managed directly by the Council. There is a risk that more direct management may result in less effective management of those investments. For example, if the Council took a less commercial approach towards the investments it may secure lower returns. Also, the Council would need to establish arrangements to monitor its investments, for example through the establishment of an investment and risk management committee.</p>

The Council favoured option 3, liquidate SIHL and transfer all the assets of SIHL to the Council. It considered that this was the most financially advantageous for ratepayers as it will reduce unnecessary costs whilst retaining effective oversight of its equity investments. Also, the additional cash balances will increase the financial returns available to fund the Council's activities.

## Impact on the Long Term Plan

The liquidation of SIHL will affect the assumptions and forecasts set out in the Long Term Plan. In overall terms the impact on the prospective financial information provided in the Council's Long Term Plan is not material, but will have an overall positive effect on the Council's financial performance.

A comparison of the Long Term Plan forecasts for the Council's income from interest and dividends compared with the updated forecasts based on the liquidation of SIHL are set out below. The table shows that the funding from interest and dividends will be higher if SIHL is liquidated rather than retaining SIHL. The difference arises mainly due to the saving in SIHL's operating costs plus a saving in income tax on interest revenue that would be paid by SIHL. The forecasts are also different as the assumptions underpinning the dividend forecasts and interest revenue have been updated since the LTP was adopted by the Council in June 2012. The assumptions relevant to the amendment used in the two sets of forecasts are set out after the table.

## Comparison of the Long Term Plan forecasts with the forecasts allowing for the liquidation of SIHL

### Forecast interest and dividends from investments compared with the Long Term Plan 2012-22

	2012/13	2013/14	2014/15	2015/16	2016/17	2017/18	2018/19	2019/20	2020/21	2021/22
	\$000	\$000	\$000	\$000	\$000	\$000	\$000	\$000	\$000	\$000
<b>Interest and dividends from investments</b>										
Long Term Plan forecasts	5,772	6,487	6,758	6,460	6,615	6,775	6,939	7,228	7,832	8,317
Forecasts assuming the liquidation of SIHL		6,710	7,118	7,024	7,163	7,307	7,454	7,725	8,310	8,774
Increase in funding		223	360	564	548	532	515	497	478	457

The increase in forecast interest and dividends from investments shown in the table will affect the financial forecasts in the LTP. It will increase the other operating funding shown in the internal Council services funding impact statement (page 96 of the LTP), other revenue in the prospective statement of comprehensive income (page 112 of the LTP), cash flows from operating activities in the prospective statement of cash flows (page 115 of the LTP) and interest and dividends from investments in the Council funding impact statement (page 147 of the LTP).

It will also increase the cash balances in the prospective statement of financial position (page 114 of the LTP), with the increase in funding accumulating into the cash balance each year, matched by an increase in general reserves. The liquidation of SIHL will also reduce the Council's investments in council controlled organisations by approximately \$22 million with a corresponding increase in other financial assets.

As the changes described above are not material to the overall financial forecasts in the LTP the Council has not restated the prospective financial information shown in the LTP.

## Assumptions for Long Term Plan forecasts

Assumption	Level of uncertainty	Risk	Potential impact if assumption is wrong
That the dividends from equity investments will be \$4.7m in 2013/14 and thereafter increase in line with general prices.	Moderate	There is a risk that dividends will be higher or lower than forecast depending on the performance of SIHL's subsidiaries.	If dividends are lower than those assumed, the Council may need to increase its rates or reduce its expenditure. Conversely, higher dividends may mean rates are lower than they would otherwise have been.
That SIHL will undertake a share buy back in 2012/13 that will return \$20 million of capital to the Council and this sum will be invested by the Council as a cash investment.	Moderate	There is a risk that the share buyback will be delayed or will not take place.	If the share buyback is delayed or does not take place the Council's investment returns will be lower than forecast. This will be offset by higher dividend returns as the funds will be retained and invested by SIHL.
That cash investments will generate a return of 4.5% in 2013/14 and 5% thereafter.	Moderate	There is a risk that returns on investments will be higher or lower than forecast because actual investment balances and interest rates may vary from those used in the forecast.	If investment returns are lower than those assumed, the Council may need to increase its rates or reduce its expenditure. Conversely, higher investment returns may mean rates are lower than they would otherwise have been.

## Assumptions for liquidation of SIHL forecasts

Assumption	Level of uncertainty	Risk	Potential impact if assumption is wrong
That SIHL will be liquidated in 2013/14 and its assets will transfer to the Council. This will include a special dividend of \$11m in 2012/13 and a cash balance of \$31m in 2013/14, plus SIHL's shareholdings in SICON Limited and Orion New Zealand Limited. It is assumed that \$42m will be invested by the Council as a cash investment.	Low	There is a risk that the liquidation will not be approved by the Council.	If the liquidation does not take place SIHL's assets will not transfer to the Council and returns from investments and dividends will be lower than those assumed. This means the Council will not have the opportunity to determine how to utilise the additional funds and returns.
That the dividends from equity investments will be \$4.5m in 2013/14, \$4.4m in 2014/15 and thereafter increase in line with general prices.	Moderate	There is a risk that dividends will be higher or lower than forecast depending on the performance of Council's shareholding investments.	If dividends are lower than those assumed, the Council may need to increase its rates or reduce its expenditure. Conversely, higher dividends may mean rates are lower than they would otherwise have been.
That cash investments will generate a return of 4.0% in 2013/14, 4.5% in 2014/15 and 5% thereafter.	Moderate	There is a risk that returns on investments will be higher or lower than forecast because actual investment balances and interest rates may vary from those used in the forecast.	If investment returns are lower than those assumed, the Council may need to increase its rates or reduce its expenditure. Conversely, higher investment returns may mean rates are lower than they would otherwise have been.

## Monitoring arrangements for the assets transferred from SIHL

SIHL has been responsible for managing its investments, including its cash balances and shareholdings in SICON Limited and Orion New Zealand Limited. Its oversight arrangements for its shareholdings in SICON Limited and Orion New Zealand Limited included:

- Reviewing quarterly, six monthly and annual reports prepared by the companies
- Regular meetings with representatives of the companies
- Attending Annual General Meetings of the companies
- Reviewing each company's annual Statement of Intent
- Making appointments to each company's Board of Directors (as allowed by SIHL's shareholding).

Once SIHL is liquidated, the Council will establish arrangements to replicate this oversight at a Council level. This is likely to be carried out through a sub-committee of Council. Where appropriate, the Council or sub-committee may take advice from Council staff or external experts in relation to these activities.

## Amendments to the Long Term Plan

Once the liquidation of SIHL is implemented, the Council will directly own and control the assets previously held by SIHL, including cash balances of around \$42 million. The financial forecasts prepared for the liquidation assume that these funds are invested to generate cash returns.

The amendment does not include plans for the any utilisation of the cash balance or additional returns. Decisions on proposals to utilise the funds will be taken by the Council as part of future Annual Budget and Long Term Plan processes. Any use of the cash balance would reduce the investment returns that are available to fund the Council's activities.

The Council's financial strategy includes reference to SIHL within the section on investment revenue. It indicates that the objective of holding the investment in SIHL is to secure a financial return to the Council and ratepayers. The strategy also includes a target investment return of 4% on the fair value of SIHL. The transfer of SIHL assets to the Council will not change the underlying strategy of holding the assets to secure a financial return to the Council and ratepayers, or of seeking a return on the equity investments in SICON Limited and Orion New Zealand Limited of 4% of fair value. As such, the liquidation of SIHL does not involve a change to the Council's financial strategy.

The Council's investment policy refers to SIHL in section 3.1, Equity (page 255 of the Long Term Plan). This section of the policy has been changed to reflect the liquidation of SIHL. The changes (using track changes) are set out below. The changes represent an updating of the policy to reflect the liquidation of SIHL but do not change the underlying intent of the policy to manage equity investments in a way that maximises returns and increases the economic value of the investments.

The Council's significance policy includes its equity in SIHL as a strategic asset (page 193 of the Long Term Plan). A council can only decide to transfer ownership or control of a strategic asset to or from the council if it is allowed for in the Long Term Plan. SIHL has been removed from the list of strategic assets in the significance policy.

Conclusion

The Council is intending to liquidate SIHL as it will maximise the returns available from its investments through the transfer of SIHL's assets to the direct control of the Council. The liquidation will achieve a reduction in unnecessary costs whilst retaining effective oversight of its equity investments.

The Council will establish arrangements for the effective management of these investments, probably through a sub-committee of Council. The cash funds transferred to the Council will be invested to generate a financial return.

The Council has not made any decisions for the use of the cash balance that would transfer, and any such proposals would need to be considered as part of future Annual Plan or Long Term Plan processes. Any use of the cash balance would reduce the investment returns that are available to fund the Council's activities.

Amendment to the Investment Policy (page 255-256 of the Long Term Plan)

Investment classes

3.1. Equity  
3.1.1. ~~Selwyn Investment Holdings Limited (SIHL) manages +~~ The Council manages its equity investments. ~~It does so~~ in a way that ensures the commercial imperatives are the guiding objectives of each investment.  
~~SIHL~~ The Council currently holds the following equity investments:

- Orion Group Limited (10.725% owned)
- SICON Limited (100% owned)
- Transwaste Canterbury Limited (3% owned). This investment reflects the Council's contribution to the construction of a regional landfill.
- ~~— Selwyn Plantation Board Limited (60.68% owned)~~
- ~~— Ferguson Brothers Limited (100% owned)~~

~~The Council also holds an equity investment in Transwaste Canterbury Limited. This investment reflects the Council's contribution to the construction of a regional landfill. The Council's shareholding is 3%.~~

3.1.2. General policy on management of its investment

Policy Statement	All equities will be managed to maximise returns and increase the economic value of the investment.
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The Council's policy is ~~for SIHL~~ to maximise its returns to the Council through the management of its equity investments. The Council does not have any specific policies in relation to the investments ~~held by SIHL~~, although the shareholding in ~~both SIHL and Orion~~ are ~~is~~ considered a strategic assets under Section 90 of the Local Government Act 2002. The general policy of ~~SIHL~~ the Council in the management of its investments is to maximise the returns and to increase the economic value of each investment it currently holds or will hold in the future.

The way to maximise the returns on each investment is to optimise dividend flows consistent with maintenance and enhancement of shareholder value. ~~This additional income to SIHL will enable a higher dividend/payout to its shareholder (Selwyn District Council).~~  
There are various means that an investment can increase its dividend pay-out to ~~SIHL~~ the Council.

~~SIHL~~ The Council ensures that each investment adds economic value over the longer term to enable the Council to use these investments as security for funding special projects of the Council. With a higher economic value (i.e. increases the value of the investment) it enables the Council to borrow more external funds if required, subject to prudent ratios being maintained. In all circumstances the general policy on management of its investments ~~is viewed by SIHL as~~ is what is best for ~~SIHL and~~ the Council in the long term including the individual investment.

3.1.3. Procedures to manage each investment

~~SIHL~~ The Council has several procedures in place to manage the investments it controls. The most important procedure is to review and approve each investment's Statement of Intent (SOI) and business plan yearly. This enables ~~SIHL~~ the Council to review the direction of each company/investment and have an input into these documents to ensure the investment does maximise its returns

to the shareholders. At this point in time ~~SIHL~~ the Council can also review the financial data included in each SOI to ensure the optimum result is achieved for the Council ~~SIHL and its shareholder~~.

Other procedures included:

- Reviewing quarterly, six-monthly and annual reports from each investment. These reports are analysed and compared with the annual budgets and SOI's of each investment. Any variations or other explanations required are brought to the attention of the Board of that investment.
- Regular meetings with the Chairman of the Board and Chief Executive of each investment to review their operations and future developments in the Company. These meetings are normally held each quarter of the year.
- Attending all Annual General Meetings and Special Meetings held by each company.
- Having professional advisors within and outside the Board to review the financial reports and markets within the industry to ensure that each investment is performing to the market standards.

The exact procedures that are used for each investment depend whether ~~SIHL~~ the Council is holding the investment for a short or long term.

#### 3.1.4. Risks associated with investments

~~SIHL~~ The Council assesses the risk of each investment based on the market risks for that type of industry. The market risks associated with each investment are noted to ensure that the returns are consistent with the risk taken. Market risks would include competitors' market share, competitors' strength and weakness and other external factors. e.g. Government.

Other types of risks are associated with the investment itself such as the expertise of the Board of Directors, products the company is producing, future investments made by the company, market share and structure of the company (both financial and organisational). These risks can be assessed by the financial returns of the company (i.e. the dividend ~~SIHL~~ received ~~s~~ from the ~~its~~ investment).

~~SIHL's~~ The Council's on-going risk management procedures include:

- Appointment to the Board of Directors of each company, external directors with expertise.
- Approving on an annual basis the investment's Statement of Intent and business plan.
- All other procedures as listed under management of investments.

**Statement to the readers of**  
  
**Selwyn District Council's**  
**adopted amendment to the long-term plan on 26 June 2013, for the ten years**  
**commencing 1 July 2012**

**Purpose of Statement**

The primary purpose of this statement is to inform readers that we have no role to report, and do not give an opinion, on Selwyn District Council's (the District Council's) adopted amendment to enable the District Council to liquidate its subsidiary, Selwyn Investment Holdings Limited.

This statement informs readers about the District Council's process of amending its LTP for the ten years commencing 1 July 2012 and the extent, and limit, of our involvement in that process.

**The District Council's process of amending its LTP commencing 1 July 2012 and our involvement**

The District Council adopted its LTP for the ten years commencing 1 July 2012 on 27 June 2012. The Auditor-General appointed me, Ian Lothian, using the staff and resources of Audit New Zealand, to report on her behalf on the LTP adopted on that date.

We expressed an unqualified opinion on the District Council's LTP for the ten years commencing 1 July 2012 in our report dated 27 June 2012. We considered that the LTP adopted on 27 June 2012 provided a reasonable basis for long term integrated decision-making by the District Council and for participation in decision-making by the public and subsequent accountability to the community about the activities of the District Council.

In forming our overall opinion, we reported on specific matters required by section 94(1) of the Local Government Act 2002 (the Act).

In a Statement of Proposal dated 13 March 2013 the District Council proposed an amendment to its LTP for the ten years commencing 1 July 2012 to enable the District Council to liquidate its subsidiary, Selwyn Investment Holdings Limited.

We expressed an unqualified opinion on this Statement of Proposal in our audit report dated 13 March 2013.

We considered that the information within the Statement of Proposal, about the proposed amendment to the LTP and any consequential amendments to the LTP that would be required if it was amended in the manner proposed, was fairly presented, and that the District Council had complied with the applicable requirements of the Act in preparing the Statement of Proposal.

In forming our overall opinion, we reported on specific matters required by section 84(4) of the Act.

On 26 June 2013 the District Council adopted the proposed amendment to its LTP for the ten years commencing 1 July 2012 as described in the Statement of Proposal mentioned above. The District Council has prepared the adopted amendment to reflect the amendments to the LTP adopted by the District Council on 26 June 2013, and any consequential amendments. The



The District Council has not prepared an amended LTP that incorporates the amendment adopted on 26 June 2013. Consequently, to form a view of the LTP of the District Council for the ten years commencing 1 July 2012, the content of the adopted amendment should be considered in conjunction with the LTP of the District Council type adopted on 27 June 2012.

**We do not give an opinion on the District Council's adopted amendment. There is no legislative requirement for us to report on the adopted amendment by the District Council and we have not performed an audit of the adopted amendment. Consequently we have not updated our audit report that was attached to the LTP adopted on 27 June 2012.**



Ian Lothian  
Audit New Zealand  
On behalf of the Auditor-General  
Christchurch, New Zealand

**Matters relating to District Council's adopted amendment to the LTP subsequent to this report.**

This report dated 27 June 2012 relates to the Long Term Plan (the LTP) for the 10 years commencing 1 July 2012, approved by the District Council on 27 June 2012. Subsequent to this, the District Council adopted an amendment to its LTP for the 10 years commencing 1 July 2012 to enable the District Council to liquidate its subsidiary, Selwyn Investment Holdings Limited on 26 June 2013. The District Council has not prepared an amended LTP that incorporates the amendment adopted on 26 June 2013. Consequently, to form a view of the LTP of the District Council, the content of the LTP to which this report relates should be considered in conjunction with District Council's adopted amendment. There is no legislative requirement for us to report on the adopted amendment and we have not done so.