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Tēnā koe Dan

STATEMENT OF EXPECTATIONS

Hawke's Bay Regional Council ('**Council**') is very excited to set for Hawke's Bay Regional Investment Company ('**HBRIC**') its first Statement of Expectations under an enhanced mandate for HBRIC. For this document, we have used the term the Group, when referring to Council and HBRIC assets or interests collectively ('**the Group**').

This Statement of Expectations ('**SOE**') sets out the priorities and expectations of Council to inform the development of HBRIC's draft Statement of Intent ('**SOI**') for the year ended 30 June 2025.

The SOE has been prepared in accord with the Local Government Act 2002 s.64B and has been informed by the proposed changes that are anticipated to the refreshed FY23/24 Investment Strategy. The Investment Strategy is being considered in the Long-Term Plan workshops ahead of Council adopting a 2024-33 Long Term Plan.

The work to date on the Council's Investment Strategy has been shared with the Board of HBRIC during the Council decision making process. Council acknowledges the contribution of the Board and Executive in this process. Council is looking forward to working with and supporting HBRIC as the refreshed Investment Strategy is implemented.

History of HBRIC

Hawkes Bay Regional Investment Company was established in 2012 to provide appropriate separation of Council's investment assets from its core service functions. HBRIC is a Council Controlled Trading Organisation ('**CCTO**') under the Local Government Act 2002.

The asset of HBRIC on establishment was the shareholding in the Napier Port Holdings Limited ('**the Port**'). In 2019 HBRIC sold down its shareholding in the Port to the current 55% shareholding. The proceeds from the sale of shares ('**the Future Investment Fund**') are held across both Council and HBRIC for the benefit of the region, as a long-term endowment.

Under legislation, Council is required to review and adopt a Significance and Engagement Policy. The policy determines what assets of the Group are considered Strategic Assets under the Local Government Act section 5 and includes some of the Group's Investment Assets. The shareholding in the Port is a Strategic Asset under both Council policy and the Local Government Act. The inflation adjusted proceeds of the Future Investment Fund are also considered a Strategic Asset.

Council also lists the shareholding in HBRIC as a Strategic Asset.

Our Economic Environment

The period leading into this Statement of Expectation has been a challenging one for Council. In FY23 inflation is running at over six percent, putting significant cost pressure on Councils service delivery functions. Rising interest rates has Council facing higher costs to service Council debt.

In February 2023, Cyclone Gabrielle hit the region causing significant damage to Council infrastructure and the wider region. The cyclone has added significant costs to Council in this year and then into the future through additional debt servicing.

These events highlight the importance of a building resilience into the Group, and the value of deriving a constantly growing income stream from those assets. It is in the resilience of the Groups investment assets and constantly growing income stream from these assets that Council sees HBRIC's function.

An Expanded Role

In the June meeting of Council, Council endorsed the role of HBRIC as the Investment Manager for the Group's investment assets. This role includes management of HBRIC's own assets (such as the Port and other investments), but also include oversight of Councils investment assets including Forestry, Investment Property and Managed Funds.

The primary role of HBRIC is to maximise the commercial benefit for Council, and thereby the region, via a constantly growing dividend, while Council retains its primary goal of serving the community.

Council has added two independent Directors to the HBRIC Board to support this outcome.

Council anticipates that with the Group's Investment Assets under management of circa \$500 million that HBRIC will have sufficient scale to support specialist skills to benefit the Group and achieve operational benefits through removal of the duplication of roles. Council supports the HBRIC Board in building an appropriate team to support the Board in achieving the Groups objectives.

Management of Council Assets

Council holds some assets for commercial return that HBRIC will manage as part of the broader mandate.

The assets to be managed by HBRIC on behalf of Council include:

Managed Funds: Held for both long term investment returns (such as the Future Investment Fund) and the efficient management of Council reserves. HBRIC is expected to hold the Investment Management relationship with external parties. HBRIC will recommend to Council modifications to the Statement of Investment Policy and Objectives ('SIPO') to meet the risk and return expectations of Council, and to monitor and report on these returns.

Investment Property: Council holds several investment properties, both leasehold and freehold. HBRIC will manage any investment / divestment, contracts, and administration obligations on these assets to maximise the benefit to the Group.

Forestry: Council holds several forest assets, many as part of Council's core erosion and flood control, and research functions. HBRIC will manage and monitor the forestry assets, including carbon credits, for return and ongoing re-establishment of forestry assets.

The expectation of Council regarding service standards relating to these assets will be documented in a Contract for Management Services between the two Group entities. Council anticipates paying HBRIC for such services equivalent to the cost of historically operating those services inside Council.

Council is looking to transition management of the Managed Fund function on or after 1 December 2023. Other asset classes will be as at 1 July 2024 at the earliest date.

The Port of Napier

Council recognises HBRIC as the owner of the shareholding in the Port. The majority shareholding in the Port is a Strategic Asset of the Group. Any change in shareholding of the Port will require consultation with Council and require community engagement. The distribution from the Port to HBRIC ultimately makes up a significant portion of the Group revenue, and therefore a significant factor in the Council's ability to offer its current level of service.

Council expects HBRIC to work closely with the Port on shareholder matters in accord with the Port constitution. Council wishes to ensure that HBRIC understands the importance of the Port dividend to the ongoing services provided by Council.

Council will receive an update on the Port performance, Social Licence, and other material matters as part of a quarterly presentation by HBRIC to Council. Council acknowledges that the Port is publicly listed, and that information provided to Council by HBRIC will be mindful of the listing obligations.

Council desires that HBRIC identify ways to create a reserve portfolio, initially equivalent to one year's distribution from the Port, over the duration of the 2024 Long Term Plan, to buffer Council from the impacts of downturns such as we are currently seeing from Cyclone Gabrielle. HBRIC can build reserves from any distribution from the Port in excess of the levels forecast in support of the Council 2024 Long Term Plan or outperformance in other Group assets.

Relationship with Council

Council expects the relationship between HBRIC and Council to be on a 'no surprises' basis. The expectation of both entities should be of two-way open communication of material issues at both an Executive and Governance level.

Council will set an annual SOE to outline the broad objectives and mandate that Council expects from HBRIC and to be included in its Statement of Intent. Matters raised in the SOE are expected to be aligned with prior discussions between Council and HBRIC.

As the Investment Manager for the Group, Council will look to utilise the expertise held in HBRIC to support Council with matters of treasury or commercial business, on an as needed basis.

Council will continue to work with the Board of HBRIC to ensure Council appoints the best directors in accord with Council policy on Director Appointment and Board Remuneration.

Reporting to Council

Council expects the following reporting from HBRIC:

Quarterly: Council has a high interest in the successful development of HBRIC. Council will receive, in person from the HBRIC Board and Executive, four quarterly presentations a year.

Biannually: Council will receive a six-monthly written report on the performance of Council assets. This will include assessment of the key performance objectives, as defined in the Management Services Agreement, where HBRIC is managing Council assets.

Annual: A written Annual and Financial Report on HBRIC and Council assets, including financial and performance objectives, to a level sufficient for the Council Annual Report. Council notes that HBRIC is required to produce an audited Annual Report under legislation for its own assets.

The New Zealand Government has passed legislation on Climate Reporting disclosures. Council expects HBRIC to comply with the legislation and timeframes, and to learn from lead Crown entities.

Investment Mandate

Council expects HBRIC to manage and monitor a portfolio of assets that include the following:

Updated SIPO: The investment returns of the Group will be managed by a modified SIPO. The SIPO will focus on the non-Port assets of the Group. The setting the Strategic Asset Allocation as part of the SIPO, HBRIC will consider the distribution expectations of the Council, portfolio growth including reserves, HBRIC operating expenditure, CCTO and Council legal obligations, and the tax efficiency of the Group.

HBRIC will annually recommend the SIPO, including any changes, to Council for ratification and application to Council's own Investment Assets as managed by HBRIC.

Return Expectation: Council expects a blend of growth and income across the portfolio to achieve the distribution forecast to Council and inflation adjusted asset growth. The cash return expectation to Council has historically been set at 3% of Managed Funds with other assets having their own return profiles.

Council acknowledges that returns are volatile and that the SIPO will reflect a risk factor commensurate with the duration and use (if any) of investment asset proceeds. Cash expectations (for distribution) are assessed against annual return targets. Total investment returns will be assessed as gross on a rolling five-year basis. Inflation adjusted returns are reflected as net returns less distributions. For the purpose of managing reserves, inflation will be set at 2.5% per annum through the Long-Term Plan.

Initial draft targets have been set but are subject to revision as Council works through the 2024 Long Term Plan process and reflected in the final Statement of Intent for HBRIC.

The targets reflect Council's cash income expectations from the existing assets owned and to be managed by HBRIC under this SOE, less budgeted HBRIC costs. For the first three years of the LTP these are:

LTP 1 (2024)	LTP 2 (2025)	LTP 3 (2026)
\$12.5m	\$13.0m	\$13.5m

Management of Assets: Council expects HBRIC to manage Council investment assets for commercial gain. Where such an asset is deemed a Strategic Asset of Council, HBRIC will need to consider the nature of the asset and the purpose for which it is held. From time to time, assets such as commercial and leasehold properties, or forestry may retire, for valid reason and opportunities exist to sell. Instances of where a sale of investment asset is made, all proceeds will be reinvested or reserved for the purposes of reinvestment.

Changes in Capital: Council's Finance team will provide an annual update (within three months of year-end) on the status of any Council reserves that are expected to be backed by Investment Assets. This will include any planned expenditure of such reserves, addition of new reserves, any change in the duration of such reserves, and whether such reserves need to be inflation adjusted. HBRIC is expected to update the SIPO and any Asset Allocation changes and present the new SIPO to Council for adoption.

Regional Benefit: The primary objective of HBRIC, as a CCTO, is to make a commercial return for Council, demonstrated first and foremost through a growing distribution to Council, and secondly by growing the resilience of the asset base. Council wishes to see HBRIC become a respected partner in the investment community. Council supports HBRIC as a direct investor into the Region (an example being Food East) and reporting on these regional benefits.

Social Responsibility: Social and Environmental Responsibility and Responsible Investment is expected to be part of the fabric or culture of HBRIC, as determined and lived by the Board. The same framework is expected to be applied to the SIPO for both Group entities, aligned to larger NZ investment entities like the New Zealand Super Fund, but be reflective of the values of the Group and our place in the Hawke's Bay. Council expects HBRIC to apply a 'front page test' to any investment decision. No investment will be directly contrary to the objectives of the Council.

Debt: Council accepts that as part of enabling HBRIC to operate and HBRIC may need to create debt facilities and borrow for commercial reasons. New debt facilities and associated borrowing can be either in the name of HBRIC or through Council. In creating new facilities, HBRIC will inform Council and consider the impact on Council's credit rating of any additional facilities created.

Partnerships, Relationships and Co-Investment

With circa \$500 million of Group assets under management, HBRIC is expected to become a trusted partner and take a leadership role in the Hawke's Bay investment community.

Council expects HBRIC will actively consider co-investment with other local investment entities, including local iwi settlement trusts, as appropriate. Looking wider than the region, HBRIC should create trusted partner relationships with exemplary Crown, Local Government, Community, and Iwi investment entities.

Distribution to Council

The success of HBRIC is felt first and foremost by Council and the community via the distribution of cash to Council. Council has historically applied the distribution from HBRIC and income from other Council investment assets to offset General rates. In 2022/23 Annual Plan, every \$140,000 of investment derived income represented a 1% saving in general rates or provided Council the ability to provide additional services.

The distribution of cash to Council from the Groups investment assets is a blend of cash surpluses derived by HBRIC on assets of Council and made available to Council plus cash dividends received by Council from HBRIC. Council acknowledges that the declaration of any dividend by HBRIC is a decision of the Board of Directors of the company.

Council acknowledges that the current Group investment income is lower than that forecast in the 2021 Long Term Plan. Council does however require significant funds in the next three years to cover the impacts of Cyclone Gabrielle and wishes HBRIC to maximise the potential cash flow to Council in the first three years of the 2024 Long Term Plan.

Council requests that HBRIC bring to Council a draft Distribution Policy that is reflective of the unique blend of income from Council assets managed by HBRIC and HBRIC's own assets. Council wishes the following considerations to be included in this Policy:

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| <i>Cash distribution:</i> | The income stream available to Council must be represented as a cash distribution. |
| <i>Distribution Growth:</i> | Council seeks a model where HBRIC, through its management of investment assets, is seeking to increase the cash distribution continually and constantly to Council. |
| <i>New Reserves:</i> | Council seeks to grow resilience over the life of the 2024 Long Term Plan. Council wishes to see HBRIC grow resilience equivalent to one year's dividend from the Port, through the retention of capital gains and any surplus cash from Investment Assets over and above the distribution proposed in the Long-Term Plan. |

Looking Ahead

Council acknowledges the important contribution that HBRIC has made for the region since its inception. Council is very excited to work with HBRIC in this next stage of development of the HBRIC mandate, including future benefit from HBRIC as seen through the 2024/25 Statement of Intent and 2024 Long Term Plan.

Nāku iti noa, nā

A handwritten signature in blue ink, reading "H. Ormsby".

Hinewai Ormsby

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