# CentrePort Risk Management Plan

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## 1. Introduction

GWRC has a significant investment in its 76.9% ownership of CentrePort. Based on CentrePort's equity value of $153.9 million, this equates to a value for GWRC share of approximately $118 million.

CentrePort's primary role is to operate a successful and sustainable port. However in the past few years CentrePort has developed and commenced executing plans for property development on land not required for the port. This has changed the risk profile of CentrePort. Property development requires different (and additional) skills in both CentrePort's Board of Directors and management. It also requires a significant amount of capital.

At the same time the operating environment for port companies is becoming increasingly complex and the level of inter-port competition is intensifying. Factors such as fewer and bigger ships calling at fewer ports, changes in the internal transport market and changes in the demand for port services are all impacting on CentrePort.

GWRC received some $3.7 million from CentrePort in 2005/6 from dividends and subvention payments. This represents 6% of our rates in that year. In other words GWRC rates would need to increase by that amount, without that contribution.

Therefore, GWRC's investment in CentrePort is important to the Council not only because of its size and contribution to the rate line but also because of its importance to the Wellington region as a port.

Any investment of this nature carries with it a degree of risk. This paper outlines the structures and process's that GWRC have put in place to manage that risk at an appropriate level. It also looks at the future risks of continued ownership of CentrePort and the strategies that GWRC have or will undertake to mitigate them.

GWRC's risk in its ownership of CentrePort cannot be hedged to the extent that any risk could be considered low. This plan in itself cannot reduce the risk of ownership. Port operations and property development have a level of inherent commercial risk that GWRC will be exposed to no matter how good the risk management strategies. The exposure to this risk is exacerbated by the Council having a high percentage of its investments concentrated in CentrePort – the Council does not have the ability to diversify its investment portfolio, which would be the standard mechanism to reduce investment risk. This constraint on the Council's risk management strategy must be acknowledged.

GWRC risk management strategies are based around a number of areas namely:

- Ownership structure
- GWRC investment policy
- Corporate governance
- GWRC policy on appointment of directors
- Shareholder's and director briefings with CentrePort
- CentrePort's constitution

These are discussed in more detail below:

## 2. Ownership Structure.

GWRC owns 76.9% of CentrePort Ltd, the other 23.1% is owned by Horizons Regional Council. GWRC, in owning in excess of 75% of the shares, controls the Company and its constitution. The Council has to be conscious of the rights of the minority shareholder in exercising its own rights, but in reality there is not much it cannot do with 76.9% of the shares that it could do if it owned 100% of the shares.

Owning in excess of 75% of the voting shares places the Council in a very powerful position and, in practical terms, is the most important risk management "asset" at its disposal.

GWRC's ownership is held by Port Investments Limited (PIL), a wholly owned subsidiary of WRC Holdings Ltd, which in turn is a wholly owned subsidiary of GWRC. These companies are Council Controlled Trading Organisations (CCTO) under the Local Government Act 2002. However, CentrePort Ltd is not a CCTO as it comes under the Port Companies Act 1988. Under this Act only two Councillors/Council employees are permitted to act as Directors of CentrePort. The reasoning for this provision is to limit the amount of political interference within the Port Company. However, the shareholders of CentrePort still appoint all of the Directors of CentrePort.

GWRC set up this structure to ensure an appropriate split between public good and commercial assets, as well as managing the risk of its investment in CentrePort. It provides a degree of separation between the Council and the commercial operations of CentrePort. This allows, among other things, external commercial expertise to be included in the governance arrangements. This is discussed further under Governance.

## 3. GWRC Investment Policy

GWRC is required under the Local Government Act 2002 to have a Treasury Management Policy which includes a section on GWRC's investment policies. These set out GWRC's objectives for its investments including how they will be managed.

In brief these objectives are:

- manage investments in accordance with the Local Government Act 2002.
- exercise the care, diligence and skill that a prudent person of business would exercise in managing the affairs of others.
- maximise investment income within a prudent level of risk.

Within the context of the Treasury Management Policy, risk is managed with reference to CentrePort by:

- appointment of suitably qualified external directors.
- formal briefings to shareholders twice a year (both Directors and Councillors).
- appointment of GWRC's Chief Financial Officer (CFO) as reporting officer for GWRC on CentrePort.
- monthly reports from CentrePort to the shareholders
- input into CentrePort's Statement of Corporate Intent.
- use of external advisors where there is limited in-house experience.
- quarterly meetings between GWRC and CentrePort management
- informal meetings with CentrePort as and when required.
- appointment of GWRC's Chief Executive to the Board of CentrePort.

## 4. Corporate Governance

In respect of the ownership of CentrePort there are three level of governance namely:

- CentrePort Board of Directors
- PIL Board of Directors
- The Council

Each of them has different functions to undertake. The CentrePort Board of Directors are charged with:

- operating the company in the best interests of the company and its shareholders
- appointing the Chief Executive

- liaising with the shareholders
- deciding on the strategic direction of the company
- monitoring operating and strategic performance
- approving transactions that CentrePort's management cannot approve.

The CentrePort Directors have an important stewardship responsibility to prudently manage the Company's assets to at least maintain the value of the capital the shareholders have invested in the Company.

The PIL Board of Directors takes a much higher level view of CentrePort's performance and operations. They appoint the Director's to the CentrePort Board and approve major transactions that require shareholder approval. In addition they monitor the performance of CentrePort on a regular basis and have input into CentrePort's Statement of Corporate Intent. In some respects the Directors of PIL are acting as agent for the ultimate shareholder, GWRC, exercising the rights of a shareholder to hold the Directors of CentrePort accountable for the performance of the Company. The Directors of PIL are accountable to Council for discharging the shareholder rights and responsibilities.

The Council of GWRC are not required to approve CentrePort transactions as shareholders but do provide an overview on major transactions where there may be public consideration.

GWRC set up its CCTO structure to ensure that there is:

- appropriate separation of management and governance of its investments
- imposing commercial disciplines on the CCTO's
- separation of GWRC's investment and commercial assets from its public good assets .

GWRC also wished to bring external director's to the board of its CCTO's to access their commercial skills and knowledge. The external directors bring a set of skills to the board table that compliment the other directors. This structure enhances the commercial monitoring and advisory capacity to both CentrePort and GWRC.

By itself, this structure does not reduce risk but does give a suitable framework to ensure that the risks of ownership can be managed appropriately.

## 5. Current Directors

The current Directors of CentrePort are:

Nigel Gould (Chair)

Malcolm Johnson (Deputy Chair)

David Benham

Richard Janes

Jim Jefferies

Warren Larsen

Mark Pedersen

Apart from David Benham (CEO of GWRC) none of the CentrePort director's are Councillors or Council employees. All of them have extensive business experience. Their particular areas of experience covers finance, property and general management.

The current Directors of PIL are:

Ian Buchanan (Chair)

Rick Long

Terry McDavitt

Margaret Shields

Anne Shields

Anne Blackburn

Peter Blades

Ann Blackburn and Peter Blades are the external directors. That is to say they are appointed because they are not Councillors. They both have general business background and understand corporate governance.

## 6. Policy on appointment of Directors

The Directors of CentrePort are appointed for three years and come up for re-election after that time. However, the shareholders can at any time rescind the appointment. There is no maximum term for the appointment for directors including the Chairman. The length of time that a director is Chair of a company is an important governance issue which the shareholder is currently addressing. In doing so the shareholder will need to balance off a number of issues, namely:

- the desire to keep institutional knowledge; and
- the desire to have new blood around the board table.

The GWRC has a policy for the appointment of directors to its CCTO's and CentrePort.

In brief this outlines the process to be undertaken, and sets out the criteria for selection of directors.

Under this policy directors are required to have the following key attributes:

- independence
- integrity
- competence
- previous experience as a director
- ability to analyse, judgement
- common sense.

In respect of PIL and CentrePort, GWRC utilises the Institute of Directors and the Ministry of Women's Affairs to provide potential candidates for either Board.

This is done to ensure that candidates are selected with the appropriate skills for the particular Board.

In respect of CentrePort, GWRC has been conscious of the requirement to add property development experience to the Board. To that end Mark Pedersen was appointed to the Board in 2005.

## 7. Shareholder's Briefings

The shareholders in CentrePort, PIL and GWRC have regular briefings with CentrePort management and Directors.

The purpose of these meetings is to ensure that the shareholders are kept fully informed and there are no surprises. These meetings are held at management, Director and Council levels.

The frequency of the meetings is as follow:

- Management briefings, between GWRC/Managers and CentrePort held quarterly.
- Council Briefings, CentrePort Directors and management brief Councillors twice yearly.
- Meetings between the Board of PIL and CentrePort are held twice yearly.

In addition there are regular informal meetings between CentrePort and the shareholder. It is the shareholders' expectation that through these various meetings, the Company keeps the shareholder fully informed of key issues and, importantly, will ensure that the shareholder is notified in advance of major issues arising.

The Council is very conscious of the need for appropriate separation between management and shareholders. These briefings and meetings are about appropriate flow of information, recognising that the Council owns 76.9% of the Company. They are not about the Council being involved in decisions that are the rightful domain of management and directors of CentrePort.

## 8. CentrePort Constitution

PIL has recently changed CentrePort's constitution, reflecting that the Council has effective control over the constitution by virtue of its 76.9% shareholding. This was done to lower the threshold for shareholder approval of major transactions CentrePort were undertaking. Previously the threshold was aligned to the thresholds contained in the Companies Act. This meant that CentrePort could spend up to $100 million without shareholder approval. This was considered too high by the shareholder and new limits were put in place. In addition, as CentrePort is considered part of our borrowing group for credit rating purposes, this was also addressed in the new constitution.

The major changes are to lower the threshold at which point CentrePort requires shareholder approval for certain transactions, coupled with limits on CentrePort's borrowings.

The new levels are:

- Enter into any transaction or series of related transactions with a value in excess of 15% of total assets or where the value is in excess of $30 million.
- Enter into any agreement to increase borrowings by either 25% of existing borrowings or where the value exceeds $20 million.
- Give any security over the company's assets which exceed 5% of the total assets of the company or where the value is in excess of $10 million.
- Sell any land.

The changes to the Constitution do not limit or hedge the risk of GWRC's investment in CentrePort. However, they do provide another level of decision making which should reduce the probability of a poor decision being made on a major project.

## 9. Potential restructuring of CentrePort.

CentrePort's increasing investment in property has caused some concerns for the CentrePort directors and shareholders as to whether CentrePort's current structure is appropriate.

The major issue is whether CentrePort's management and Board of Directors have sufficient expertise in property to successfully achieve significant investments in property. Also, it is uncertain whether the current structure is appropriate given the capital required for the property development.

To that end a subcommittee of CentrePort's board has been established to review various options for restructuring. The shareholders will be extensively involved in the restructuring. This process is likely to take several months.

While it is too early to conclude on any final structure, it will involve greater property expertise and focus being introduced. In addition it will ensure that the port operations will continue to have the resources and attention for a successful port.

This restructuring will address one of the major issues facing CentrePort and its Shareholders.

## 10. Future Risks

CentrePort is entering into an environment which is likely to be more uncertain than previously. More competition between ports, larger ships, fewer visits and amalgamation of shipping lines are some of the challenges facing the port side of the operation. In respect of the property development there are issues with the level of expertise within CentrePort, opposition from other property developers and the risk of a downturn in the property market.

In addition, in respect of the company as a whole, there is a risk that they may lose focus on a particular area of the company when there is a major project being undertaken in the other area of the company.

The above issues are addressed in more detail below.

### 10.1 Increased port competition/Larger ships/Fewer visits

CentrePort has a growth strategy in respect of its port operations. This is exhibited in their strategic plan and the recent acquisition of the two new container cranes. The company believes that this is the best approach to meet the increased competition in a smaller market (fewer ship visits). The port does have some significant advantages over other ports in its location and that it is a natural deep water port. However it does also have some disadvantages, especially the issue of not having a natural catchment of export industries nearby. To overcome this they wish to make the port a natural hub for exports from the top of the South Island to the lower half of the North Island.

From a shareholder perspective the risk mitigation strategies are:

- appointment of suitably qualified directors at CentrePort
- encouraging rigorous investment appraisal of any major investment proposals for the port operations to ensure that the shareholders' capital is being allocated to the highest value opportunities (note the reduced threshold for shareholder approval)
- formal and informal channels of communication to ensure shareholder is kept fully informed
- potential restructuring of the company to ensure sufficient focus is kept on the port operations.

### 10.2 Property Development

CentrePort intends to develop port land for property development. This of itself brings a number of issues for the shareholder and the company to consider. These include the level of expertise within CentrePort to develop and manage the property, the large capital requirements to develop the land and potential opposition from other property developers. As CentrePort borrows more for this development this may impact on the credit rating of the shareholder. There are also issues with a downturn in the property market.

From a shareholder perspective the risk mitigation strategies are:

- to review the company structure to ensure there is sufficient expertise and resources
- any new proposed structure will need to allow for the possibility of new capital being introduced, to reduce the large debt requirements for the developments
- CentrePort's constitution requires shareholder approval for transactions over a certain amount, including approval of new borrowings
- no speculative buildings are allowed, all new developments must be largely let to blue chip tenants on long term leases
- use of fixed price construction contracts and the employment of outside expertise when required.

## 11. Conclusions

CentrePort is a major investment of GWRC. It operates in a competitive commercial environment and provides around 6% of our rates through dividends and subvention payments.

GWRC risk management strategy is centred on three key areas:

- ownership of 76.9% of the Company, giving the Council control of the Company and its constitution
- governance through appointment of suitably qualified directors.
- regular reporting and flow of information to the shareholders.
- financial limits on CentrePort to ensure shareholder approval are required for major transactions.

CentrePort is an important investment for GWRC and its ratepayers. As with any investment there is a degree of risk. However the structure and processes that GWRC have put in place will ensure that this risk is managed appropriately.