

# **AUCKLAND REGIONAL HOLDINGS**

## **Long-Term Funding Plan**

**For the period from  
1 July 2005 to 30 June 2015**

**As Amended and approved by the Auckland  
Regional Holdings Board, 20 September 2005**

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# **Auckland Regional Holdings Long-Term Funding Plan For the period from 1 July 2005 to 30 June 2015**

## **Summary**

This Long-Term Funding Plan (LTFP) is required under the Local Government (Auckland) Amendment Act 2004 (the Act) and has been prepared within the terms of the Act. It covers the period from 1 July 2005 to 30 June 2015 and has regard to the Auckland Regional Council's (ARC) draft Long-Term Council Community Plan 2005-14 (LTCCP). ARC and ARH understand that the ARC LTCCP will be revised within a year.

### **Regional Funding Context**

The level of required capital and operational expenditure on Auckland transport is material and can be expected to increase with time. New increases in Government transport funding are planned to come to an end in 2015. The funding demand is certainly in excess of the national contribution and increases in local contributions to future funding are expected by central Government. The ARC draft LTCCP contains elements of the required expenditure over the short-term (5 years) but also has optimistic funding assumptions:

- rates funding growing at a compounded 5% year on year over 10 years, and
- Land Transport New Zealand (LTNZ) funding almost quadrupling over 10 years from \$51m to \$193m, a compounded growth of 14% per annum.

No other material source of funding for transport has been identified that ARH is aware of, or comprehensive plans developed, to meet this potential future funding deficit.

The only other current source of funding available, outside of ARC rates and LTNZ, is from Auckland Regional Holdings (ARH). ARH therefore believes that it is in the long-term interests of the Region for it to provide a sustainable source of funding to the ARC.

### **General Policies**

- ARH will distribute net income and surplus investment capital necessary to assist with short-term urgent transport infrastructure investment needs after meeting its operating expenses and assuring the long-term revenue generating capacity of its investment base.
- ARH will distribute capital to meet all legacy Infrastructure Auckland (IA) grant commitments, predominantly to Territorial Local Authorities (TLAs). These were \$244m as of 30 June 2004 with \$191m grant commitments remaining as at 30 June 2005.

### **Distributions**

- In line with the policies above ARH recommends a conservative approach to managing its assets and the quantum of income or capital available for distribution to the ARC over the short and longer term.
- However, having regard to the short-term requirement for accelerated expenditure on transport infrastructure as indicated in the ARC's draft LTCCP, over sustained funding in the longer term, ARH has increased planned distributions of income and capital to meet the distribution requirements in the LTCCP
- ARH will distribute \$192m to the ARC in the 2005/6 and \$1,016m over the next 10 years. \$304m will be available for distribution in the subsequent 10 years.

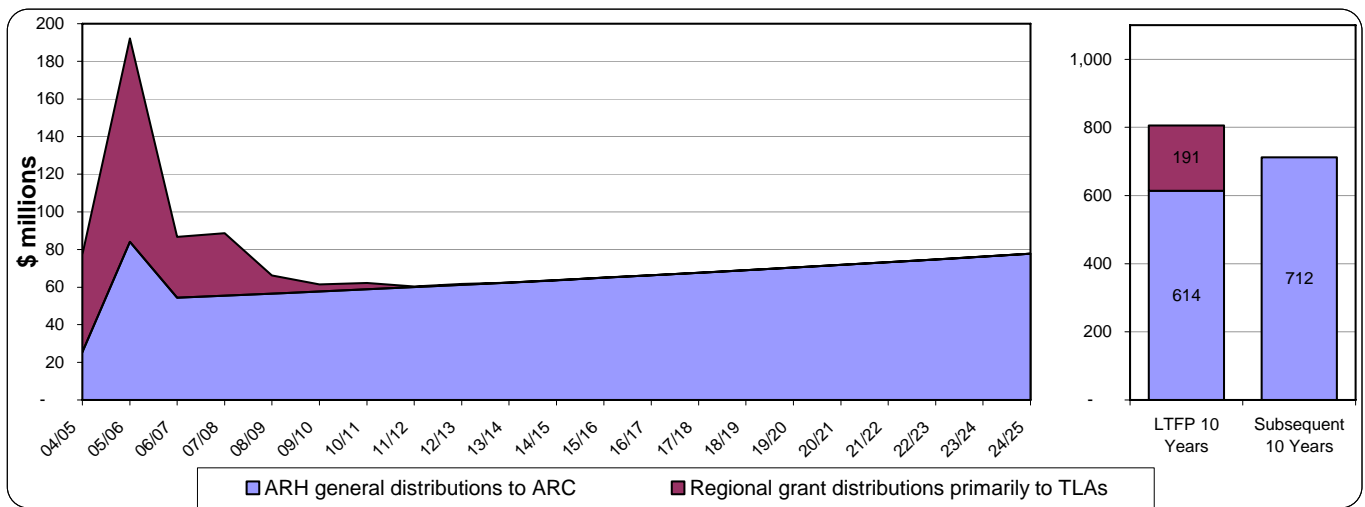
## ARH Policy and Recommended Distributions

The ARH policy to balance short term available funding with longer term funding for growing transport and stormwater capital and operational funding requirements delivers recommended distributions of \$192 million to the ARC in the 2005/6 year and distributions of \$805 million over the ten year period (Table 1). This recommended quantum of distributions is equivalent to that provided for in the ARH draft 2005-2015 LTFP.

**Table 1** ARH recommended distributions to ARC assuming ARH maintenance of revenue generating capacity over the long term

	05/06	06/07	07/08	08/09	09/10	10/11	11/12	12/13	13/14	14/15	10 yrs
ARH Distributions to ARC	192	87	89	66	61	62	60	62	62	64	805

**Figure 1** ARH recommended long-term distributions (20 years) assuming ARH maintenance of revenue generating capacity over the long term



\* Assumes distributions from 2014/15 of available cash and in accordance with maintaining revenue generating capacity of investments

## 2005-2015 LTFP Distributions

The ARC draft LTCCP 2005-14 reflects a higher level of ARH distribution compared with that recommended by ARH. ARH will meet the LTCCP schedule of required distributions and will borrow against its investments to meet the shortfall in investments that would exist assuming ARH's recommended distributions.

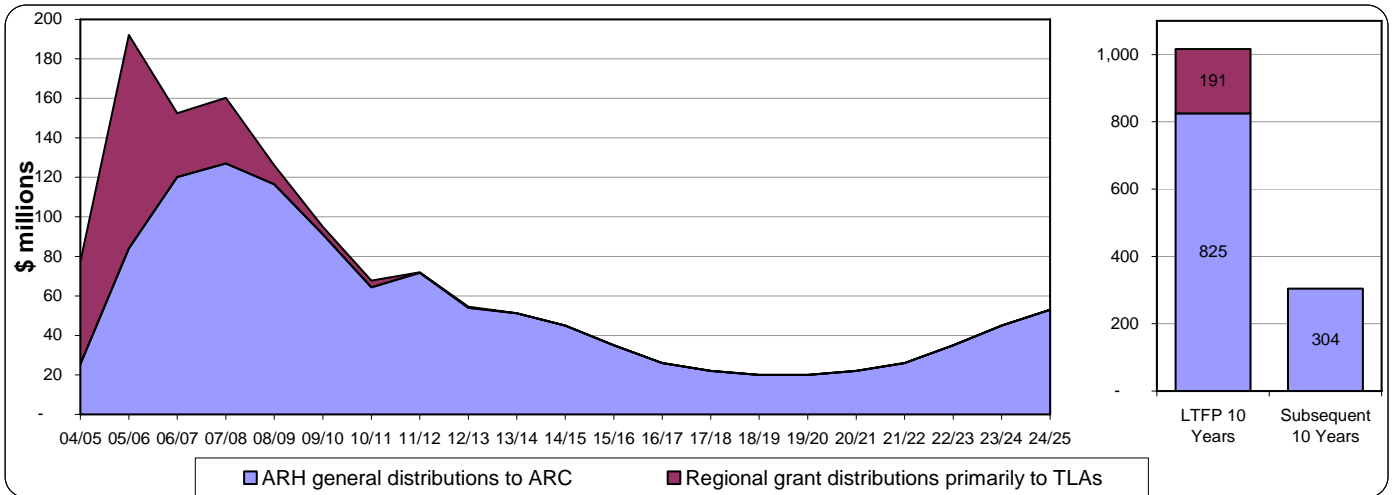
The accelerated distributions will mean a reduction in earnings available for distribution over the longer term.

**Table 2** ARH LTFP distributions to ARC assuming LTCCP draw downs

	05/06	06/07	07/08	08/09	09/10	10/11	11/12	12/13	13/14	14/15	10 yrs
ARH Distributions to ARC	192	153	160	126	95	68	72	54	51	45	1,016

ARH's forecasts of future financial performance and subsequent cash distribution are dependent on the underlying assumptions used. These assumptions will be reviewed regularly and as a result the forecasts may change.

**Figure 2** ARH 2005-2015 LTFP long-term distributions (20 years) assuming the LTCCP draw down



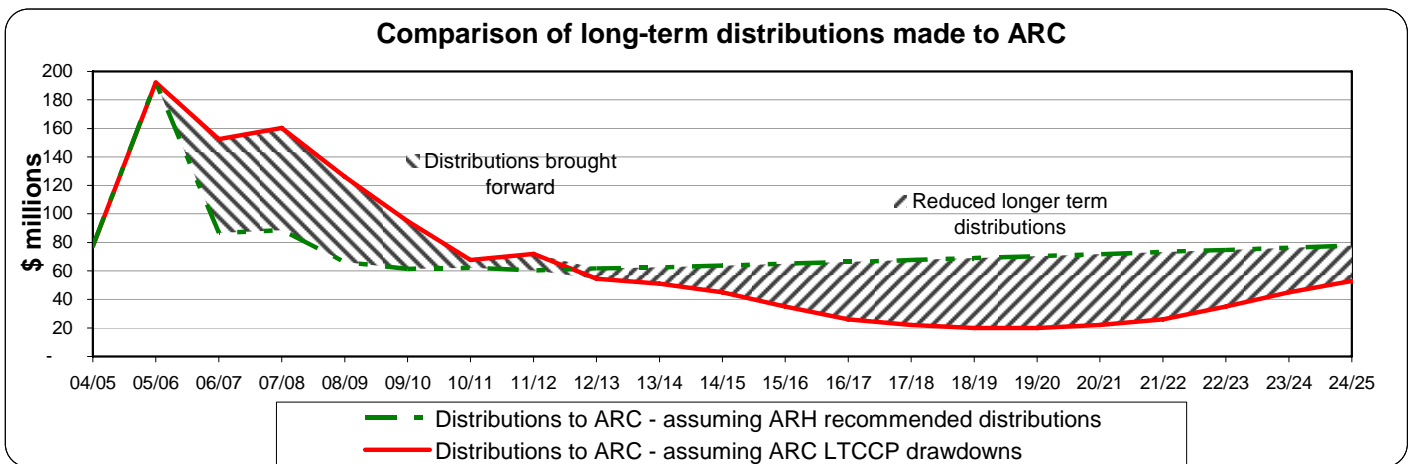
The ARC draft LTCCP and approved ARH 2005-2015 LTFP drawdown schedule compared with that assuming ARH's distribution policy and recommended distributions is detailed in Table 3 below.

**Table 3** ARH distributions to ARC

	05/06	06/07	07/08	08/09	09/10	10/11	11/12	12/13	13/14	14/15	10 yrs
ARC 2005-2014 LTCCP	192	153	160	126	95	68	72	54	51	45	1,016
ARH recommended distributions	192	87	89	66	61	62	60	62	62	64	805
Difference	-	66	72	60	34	6	12	(7)	(11)	(19)	211

The accelerated distribution drawdown, based on the LTCCP, will reduce revenue generating ability over time and result in distributions over the next 10 years being reduced by \$144 million.

**Figure 3** A comparison of the alternative draw downs over the longer term



## 1. Introduction

Auckland Regional Holdings (ARH) has a statutory obligation to present this Long-Term Funding Plan (LTFP) under the Local Government (Auckland) Amendment Act 2004<sup>1</sup>, hereafter known as the Act. A draft 2005-2015 LTFP was prepared within the terms of the Act and was delivered to the Auckland Regional Council (ARC) on 28 February 2005. The draft LTFP was considered by ARC at its meeting of 20 April 2005, and referred back to ARH. An amended LTFP was approved by the ARH Board at its meeting of 24 May 2005 and was delivered to ARC on 27 May 2005. On 18 July ARH received notice from ARC that the Council had adopted a number of proposed changes to the final LTFP. This LTFP has been modified to reflect the ARC proposed changes, to reflect the ARH acquisition of the 20% minority interest in Ports of Auckland Limited (POAL), and to take into account the latest financial information for 04/05 and 05/06.

This LTFP covers the ten-year period from 1 July 2005 to 30 June 2015. It has regard to the Auckland Regional Council's (ARC) draft Long-Term Council Community Plan (LTCCP). It outlines ARH's investment and distribution policies, provides ARH's financial forecasts for the next ten years, the assumptions on which they are based, the projected distribution of funds from ARH to ARC over that period, the investment return risk that the organisation is subject to, and its investment, treasury, and liability management policies. Actual outcomes will vary from the forecasts if the assumptions used in the plan are not realised over time or are varied in any way.

The ARC has the right to comment<sup>2</sup> on, and modify the LTFP by resolution by including or omitting provisions, after consulting the ARH Board. The ARC must provide its reasons for proposing any modification. The ARH Statement of Intent (SOI) for the period 1 July 2004 to 30 June 2007<sup>3</sup> (as amended) states that the ARH LTFP will be made available to the ARC as soon as available before 30 June 2005<sup>4</sup> and should be made available to the public as an annexure to the LTCCP prepared by the ARC.

## 2. Background

### a) Legal Context

Part 2 Section 6 of the Act sets out the purpose of the Act.

*Part 2 Auckland Region land transport and stormwater:*

*The purpose of this Part is to-*

- a) *assign to the Auckland Regional Council principal responsibility for-*
  - a. *setting the strategy for the Auckland regional land transport system; and*
  - b. *integrating the planning, funding and development of the Auckland regional land transport system; and*
  - c. *stormwater funding in the long-term interest of the Auckland Region (to the extent that this function was, before the commencement of this Act, the responsibility of Infrastructure Auckland); and*

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<sup>1</sup> Local Government (Auckland) Amendment Act 2004, section 21(1)

<sup>2</sup> Local Government (Auckland) Amendment Act 2004, section 21(3)-(5)

<sup>3</sup> ARH 1 July 2004 to 31 June 2007 SOI as approved by ARC on 27 September 2004 Amendment notification of 28 January 2005

<sup>4</sup> A draft SOI for the period 1 July 2005 to 30 June 2008 has been approved by the ARH Board and will become operative from 1 July 2005.

- b) *establish the Auckland Regional Transport Authority and Auckland Regional Holdings to assist the Auckland Regional Council to discharge that responsibility ;and .....*

Section 19(1) of the Act sets out two objectives for ARH:

- (a) *“Act in the long-term interests and for the benefit of the Auckland Region; and*
- (b) *Without limiting paragraph (a), manage its assets prudently.”*

Section 19(2) contributes principles which ARH must observe in performing its functions:

- (a) *ARH should collaborate and co-operate with ARC and ARTA to achieve the overall objectives of ARC; and*
- (b) *ARH should undertake any commercial activities in accordance with sound business practice; and*
- (c) *ARH should ensure prudent stewardship and the efficient and effective use of resources; and*
- (d) *ARH should exhibit a sustainable development approach in its decision-making by taking into account—*
  - (i) *the social, economic, and cultural well-being of people and communities; and*
  - (ii) *the need to maintain and enhance the quality of the environment; and*
  - (iii) *the reasonably foreseeable needs of future generations; and*
- (e) *ARH should have clear accountability for the way that it contributes to an integrated, safe, responsive, and sustainable land transport system for the Auckland Region; and*
- (f) *ARH should be a good employer within the meaning of clause 36 of Schedule 7 of the principal Act; and*
- (g) *ARH should operate in a financially responsible manner and, for this purpose, ---*
  - (i) *endeavor to maintain its long-term financial viability; and*
  - (ii) *prudently manage its assets and liabilities.*

## **b) Regional Funding Context**

The ARC is responsible for developing the strategy for Auckland’s regional land transport system, Auckland Regional Transport Authority (ARTA) for giving effect to that strategy, and ARH to assist with funding of the land transport system<sup>5</sup>. In recognition of these roles ARH is appropriately and necessarily interested in the long-term funding plans for the Region.

The regional funding requirement for capital and operational expenditure on transport is very significant. The 2003 Regional Land Transport Strategy (RLTS) suggested that the Region faces a funding gap of \$2.4 billion over the next 10 years<sup>6</sup>. This scale of funding requirement was reinforced by the Joint Officials Group (JOG) process, a joint initiative representing all central and local government entities with a transport funding interest.

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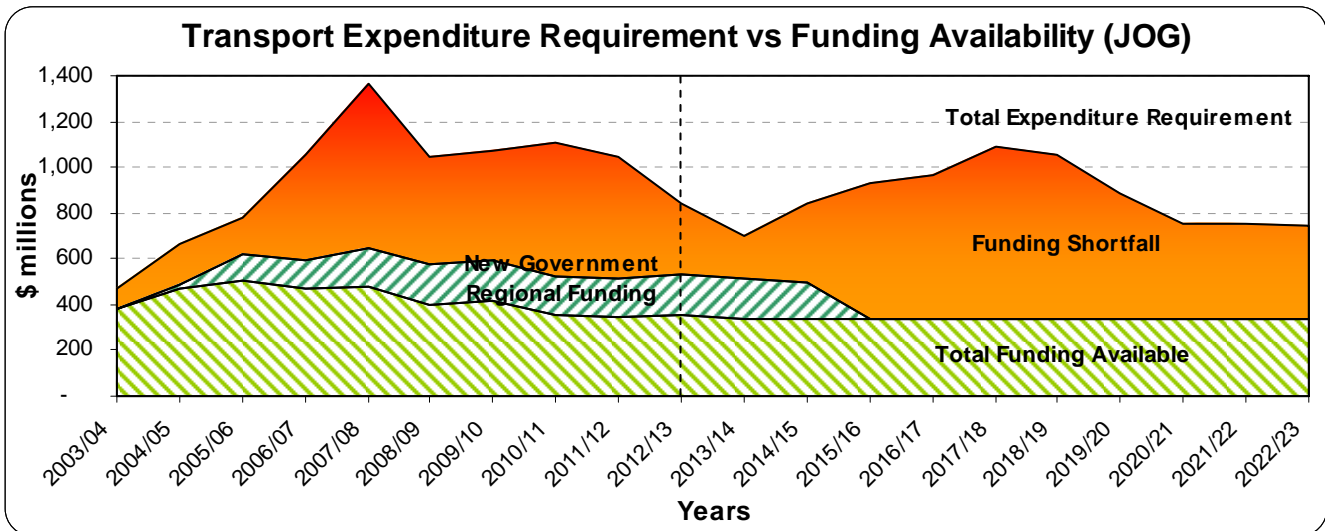
<sup>5</sup> ARH funds delivered to ARC are to be applied predominantly to transport and stormwater in accordance with section 34 of the Act.

<sup>6</sup> Page 96, Auckland Regional Land Transport Strategy 2003

The JOG process, upon more robust review, indicated a probable funding shortfall in the order of \$5.2 billion<sup>7</sup>.

Given the projected population growth in the Auckland Region, the community expectations for transport system improvements, and the already planned improvements to the transport system, the expenditure and funding requirements are more likely to increase than decrease with time.

**Figure 4** Level of expenditure requirement and funding shortfall indicated by JOG (real \$ terms)



Data Source: JoG report 2003

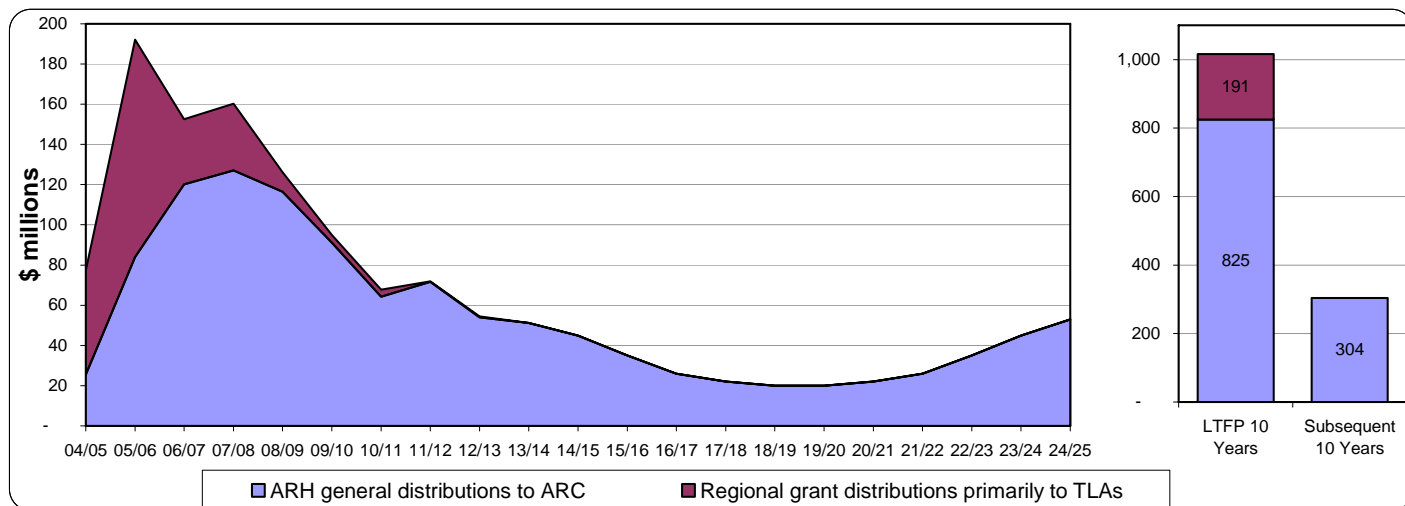
The Region has progressed governance structures and improved funding to assist in addressing the Region’s transport issues yet recent changes are still not sufficient to meet the total sum of the long-term transport infrastructure investment and operational service expenditure demands.

- The demand for expenditure, both on capital infrastructure and for increased and more costly operating services, is significantly in excess of the currently identified funding supply.
- New central Government regional funding is only an interim funding measure and is planned to come to an end in 2015.
- The ARC draft LTCCP has the following optimistic funding assumptions:
  - rates funding growing at a compounded 5% year on year over 10 years, and
  - Land Transport New Zealand (LTNZ) funding almost quadrupling over 10 years from \$51m to \$193m, a compounded growth of 14% per annum. This appears to be significantly in excess of that provided for in the LTNZ National Land Transport Programme.
- No other material source of funding for transport, as far as ARH is aware, has been identified, or comprehensive plans developed, to meet this potential future funding deficit.

<sup>7</sup> Page 21, Auckland Transport and Strategy Funding Project, Joint Officials Group (JOG) Final Report, December 2003

The ARC draft LTCCP contains a level of draw down of funds from ARH investment capital which is not sustainable in the future.

**Figure 5** Forecast LTFP distributions assuming LTCCP draw downs for 2004-2014 (20 years)



All these factors indicate a serious regional funding shortfall in the future.

### 3. Distribution Policies

#### a) General Policy

ARH has carefully considered the intention and wording of the Act and interprets section 19(1) as meaning that ARH must manage its business so as to sustain its revenue generating capacity to the ARC for the long-term. However, ARH recognizes the expectation and the need for a significant regional contribution in the short-term, along with further central government funding, for the accelerated funding of approved transport infrastructure projects. ARH will do its best in collaboration with the ARC to meet the ARC's requirements.

ARH's general policy is to distribute net income and surplus investment capital necessary to meet short-term urgent transport infrastructure investment needs after meeting its operating expenses and assuring the long-term regional revenue generating capacity from its investment base.

ARH, at its 1 July 2004 establishment, had an asset base consisting of \$371 million in treasury investments, excluding that required to meet legacy IA transport and stormwater grant commitments to the TLAs, and direct equity investments of \$647 million<sup>8</sup> being primarily the Ports of Auckland Limited (POAL) investment.

Since that time, and prompting this amendment to the 2005-15 ARH LTFP, ARH has acquired the 20% minority interest holding in POAL for \$169.6m in cash. On 30 June 2005 ARH's 80% pre-existing holding in POAL was revalued to the acquisition price paid for the remaining 20%, \$8.00 per share. As of 30 June ARH had 8.1% of the remaining 20% on its balance sheet (the remainder was recognized in the month of July). As a result, at 30 June 2005, ARH had an asset base consisting of \$365 million in treasury

<sup>8</sup> Based on a share price on 30 June 2004 of \$7.05 cents per share.

investments, excluding that required to meet legacy IA transport and stormwater grant commitments to the TLAs, direct equity investments of \$806 million<sup>9</sup> being primarily the Ports of Auckland Limited (POAL) investment, and an obligation of \$101.3m to purchase the remaining 11.9% POAL minorities.

ARH in producing this LTFP has determined that:

- ARH can best play a constructive role within the ARC Group by optimising current investments, the returns from them, and the opportunities created through that investment base;
- It is in the long-term interests of the Auckland Region that resources held by ARH contribute to “an integrated, safe, responsive and sustainable land transport system for the Auckland Region”;
- It is in the long-term interests of the Auckland region that ARH at least sustain the real revenue generating capacity to provide funding to the Region; and
- This ARH policy balances the short-term demand for accelerated investment in transport and stormwater infrastructure and the requirement to act in a sustainable and prudent manner in the longer term interests of the Region.

This LTFP contains sufficient flexibility to assist with all reasonable immediate funding requirements of the Group, in so far as these are known at this time, while also enabling ARH to undertake the initiatives required to meet ARH’s responsibilities and to maximise the return on ARH investments over the longer term.

This distribution policy will help ensure that:

- i) Each generation through time is treated equitably, by giving each generation equivalent access to the income generated from ARH’s investment base;
- ii) ARH can continue to provide a funding source for Auckland’s substantial infrastructure investment and transport operating needs into the future;
- iii) Auckland will continue to benefit from ARH’s unique value creation opportunities;
- iv) Funds will be available in the future to assist with maintaining and replacing Auckland’s land transport infrastructure (an obligation that will grow over time); and
- v) ARH has funds available to respond to appropriate commercial opportunities as they arise.

ARH consider that sustained long-term revenue generation is in the long-term interests of the Region, is consistent with prudent asset management, is in accordance with ARH’s operating principles, and best enables ARH to discharge its roles and responsibilities under the Act.

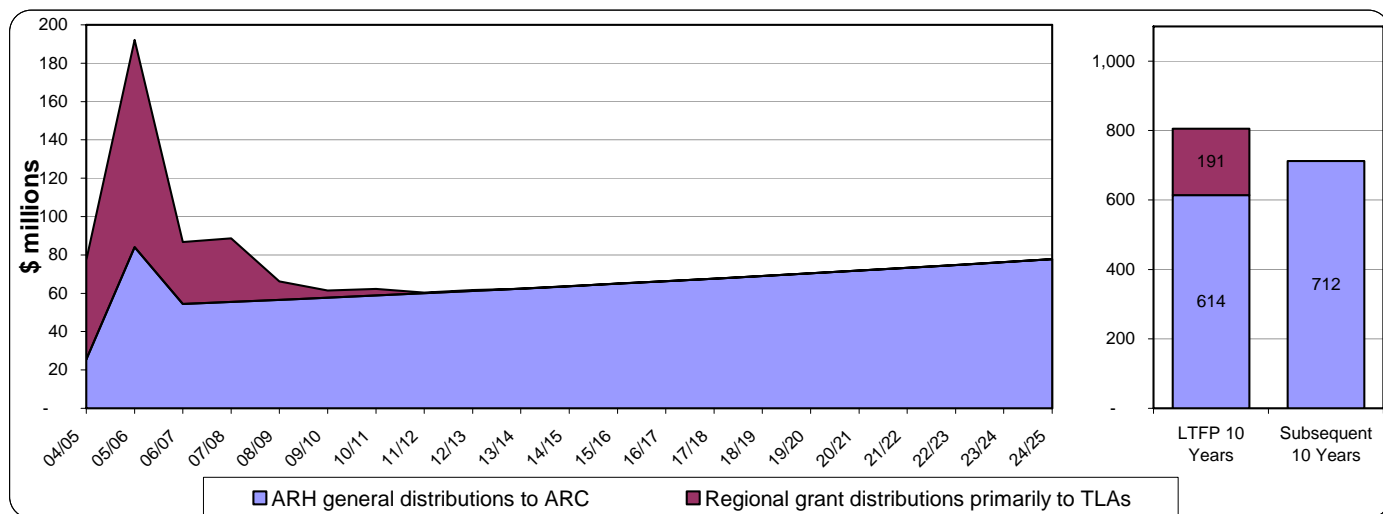
Hence ARH recommend the following distributions to ARC to assure maintenance of revenue generating capacity over the long-term as noted in the distribution policy above.

**Table 4** ARH recommended long-term distributions (20 years) assuming ARH maintenance of revenue generating capacity over the long-term

	05/06	06/07	07/08	08/09	09/10	10/11	11/12	12/13	13/14	14/15	10 yrs
ARH Distributions to ARC	192	87	89	66	61	62	60	62	62	64	805

<sup>9</sup> Based on a revalued share price on 30 June 2005 of \$8.00 cents per share.

**Figure 6**



Under normal circumstances ARH would take a conservative approach to managing its assets and the quantum of income or capital distributions available to the ARC over the short and longer term. However, having regard to the short-term requirement for accelerated expenditure on transport infrastructure as indicated in the ARC's draft LTCCP, over sustained funding in the longer term, ARH will increase planned distributions to that required in the LTCCP.

This LTFP provides for distributions of \$192 million to the ARC in the 2005/06 year and distributions of \$1,016 million over the ten year period to June 2015 predominantly for the Region's transport and stormwater needs.

**b) Practical Application of the Policy**

ARH's distribution policy is general and long-term in nature. The situation may vary from year to year and policy may also need to be varied to reflect changed circumstances.

The following points outline how the ARH policy will be applied in practice:

- i) Market prices and accounting values of ARH's equity and fixed income investments are likely to vary from year to year, and ARH will take a long-term view in assessing expected investment returns, distributions of income and capital that can be made available to ARC, and when income reinvestment may be required to sustain the revenue generating capacity in real terms;
- ii) ARH will reserve sufficient funds to meet the legacy IA transport and stormwater grant commitments (grants liabilities were \$244 million as of 30 June 2004, the date of ARH's establishment. Remaining grant commitments as at 30 June 2005 amounted to \$191 million);
- iii) To facilitate ARC's planning and budgeting process, ARH will commit to have available and distribute whatever figure is in the current LTFP for the first 12 months of the plan, even if over this period the ARH portfolio underperforms relative to the assumptions in the LTFP and it is necessary to pay out capital as well as income to meet the distribution commitment;

- iv) Over the longer term ARH will orchestrate its activities and develop its LTFP with the intention to distribute income and surplus capital as necessary to meet the ARC's 2005-14 LTCCP distribution schedule provided in this plan. ARH will take a long-term view of the mechanisms employed to best meet this schedule whilst following the policy described above;
- v) In the case of iv) above, if it is determined that distributions of capital are necessary to meet urgent short-term ARC funding demands then borrowing may be employed to maintain the revenue generating capacity of the investment base;
- vi) In the case of iii) and v) above, or any other circumstances where revenue generating capacity is diminished relative to ARH's long-term targets for revenue generation in real terms, the first call on ARH's income in subsequent years will be to replenish the investment base and its expected revenue returns; and
- vii) In some years, ARC may not have immediate need for all of the surplus income available to be distributed by ARH. In these circumstances the funds will be reinvested and remain available to the ARC in subsequent years (but subject to the other principles outlined above).

ARH has noted distribution commitments in ii) above and in section 4 below relating to legacy IA transport and stormwater grants existing at 30 June 2004. Other than for what remains of these commitments, ARH's distributions of income will not be linked to expenditure by ARC or ARTA on particular projects. ARH's distributions are a pool of funds available to the ARC. The ARC determines how these funds are best allocated.

ARH's forecasts of future financial performance and cash distributions are dependent on the underlying assumptions used and the performance of the underlying investments. These assumptions will be reviewed regularly and as a result the forecasts may change. However, ARH's commitment to point iii) above will remain even if assumptions change.

### **c) ARC Position**

ARH acknowledges the ARC's view that *"the ARC has a wider role than ARH, and is required to consider the reasonably foreseeable needs of future generations in promoting the social, economic, environmental, and cultural well-being of the Auckland region. The ARC believes that it is in the long-term interests of the Auckland region for ARH to provide funding at higher levels than those required to sustain real revenue generating capacity, and this is reflected in the LTCCP. In addition, the ARC has signalled that further increases in distributions during the period of this LTFP may be required to accelerate a number of significant public transport infrastructure projects, for which the benefits to the region outweigh the opportunity costs of foregoing revenue."* ARH has accordingly recorded that view in this LTFP.

## **4. ARC Long-Term Council Community Plan (LTCCP)**

The ARH LTFP must have regard for the ARC draft LTCCP<sup>10</sup>. Specifically;

### Section 21 Long-Term Funding Plan

1. *Having regard to ARC's long-term council community plan, ARH must deliver to ARC a draft long-term funding plan on or before 1 March in each year.*
2. *The long-term funding plan must -*

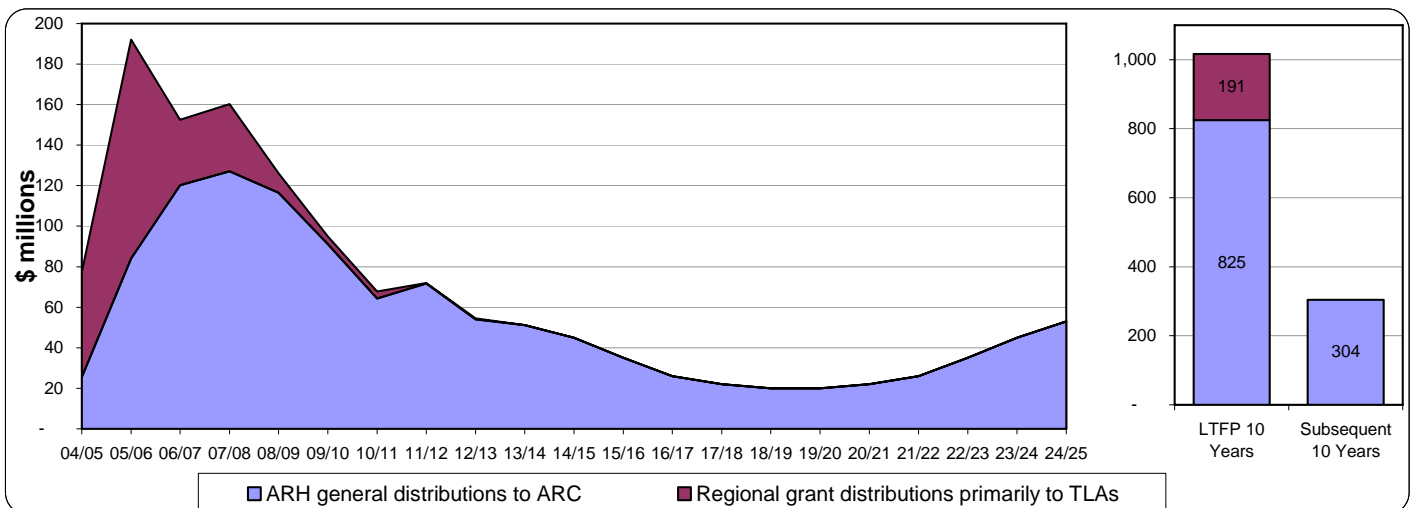
<sup>10</sup> in accordance with section 21(1) of the Act.

- a. include the following matters:
    - i. forecasts of the funds required by ARC from ARH; and
    - ii. forecasts of funds, both capital and income, that will be available for distribution by ARH to ARC; and
3. ARH must –
- a. consider any comments on the draft long-term funding plan that are made to it by ARC within 2 months after 1 March; and
  - b. deliver the long-term funding plan to ARC on or before 30 June.

ARH has had its first opportunity to have specific regard for the ARC's LTCCP following the release of ARC's 'Draft for consultation' 2005-2014 LTCCP on 6 April 2005. As required under the Act ARH has considered the impact of the LTCCP and specifically the proposed level of ARC draw downs of ARH funds.

The LTCCP required draw downs are \$211m more than recommended under the policies described above and in the draft ARH 2005-2015 LTFP submitted 28 February 2005 .

**Figure 7** ARH distributions to ARC<sup>11</sup>



\* Assumes distributions from 2014/15 of available cash and in accordance with maintaining revenue generating capacity of investments

In the interests of balancing the ARC's short-term requirement for accelerated transport infrastructure expenditure with longer term transport and stormwater funding ARH will make distributions as required in the LTCCP. ARH will borrow against its investments to meet the increased distributions and also the consequential reduction in earnings available for distribution over the long-term. Before ARH enters into a borrowing policy it will consult with the ARC.

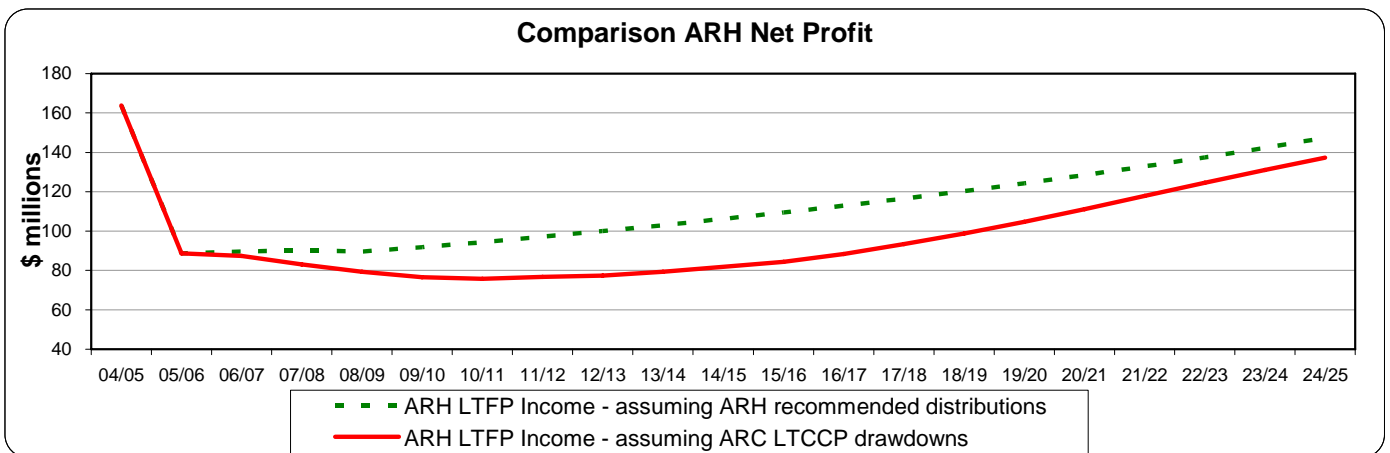
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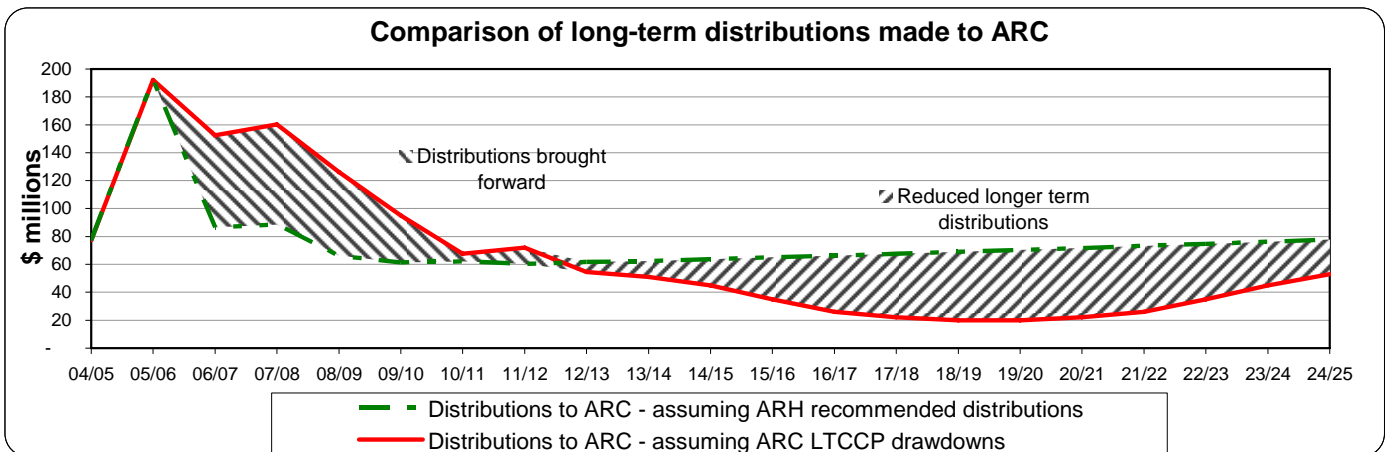
<sup>11</sup> Distributions to ARC are from ARC draft LTCCP through to 2013/14 and forecast according to ARH distribution policy and free cash available thereafter.

Inclusive of legacy IA grant commitments, the ARC draft LTCCP and this LTFP indicates a funding supply from ARH over the next ten years of \$1,016m. Delivering \$1,021m in funding to ARC in ten years as planned will reduce long-term funding availability. Specifically:

- reduce ARH's non-POAL asset base by \$355m, or 100%, for a net increase of \$211m available expenditure over 10 years,
- reduce long-term distributions to the Region from \$72m to \$30m p.a.,
- increase the risk of not delivering the indicated returns from the ARH investment portfolio, and
- would limit investment flexibility and opportunities to earn efficient high returns in the future.



The impact of this accelerated draw down schedule will result in a reduced funding availability over the long-term as shown below.



## 5. New Capital Investments

Separate from the distribution policies above, ARH may from time to time invest capital directly in infrastructural assets, or be granted assets for nominal consideration.

ARH's policies in relation to any future investment or granting of assets are as follows:

- If ARH's investment capital (i.e. funds other than distributions that would normally flow to ARC under the policies outlined above) is invested in an asset, then ARH will require that:

- a) It has the usual ownership rights to that asset and can manage any risk associated with that asset in a commercially prudent manner; and
  - b) It earns a cash return on the capital invested commensurate with the risk class and economic life of the asset.
- ii) If ARH is granted assets (e.g. from ARTA) in which ARH has not invested capital then ARH:
- a) Will require that ownership rights and the responsibility for risk management are clearly established;
  - b) Will not seek to earn a return on the value of the asset unless it is agreed with the ARC that it is appropriate to do so.

For assets in both i) and ii) asset stewardship requires a focus on:

- the need for long-term sustainable outcomes and asset maintenance over the long-term; and
- ARH's ability to provide funding to the ARC and the regional community.

ARH is aware that for different asset classes there will be different optimal solutions to support sustainable outcomes.

## 6. Key Assumptions

### Planned Investments

- On 1 April 2005, ARH made an offer for the remaining listed shares in Ports of Auckland Limited. Purchase of the 20% minority interests in POAL was concluded, at \$8.00 per share, on 5 August 2005.
- The successful conclusion to the offer will not adversely impact ARH's ability to meet the distributions in the ARC's 2005-14 LTCCP that will be available to the ARC in this plan.

### Investment Yield

- The total return (cash dividends and capital appreciation) on POAL shares currently owned is assumed to be 8% p.a. throughout the forecast period, calculated off a share price of \$8.00 at 30 June 2005 and then off the forecast opening market value of the shares each year thereafter.
- POAL dividend payments are based on the March 2005 actual payment of 15.0 cents per share and projected September 2005 payment of 15.0 cents per share, growing over the period at a rate of 6.0% p.a. thereafter. Growth in dividend payments has been capped at a maximum dividend yield of 5.35%.
- ARH, for the purposes of this plan, has not forecast any one-off cash distributions from POAL given the competitive challenges facing the business going forward.
- The pre-tax nominal returns from ARH non equity financial assets for the current financial year ending 30 June 2005 was approximately 7.0%. This 7.0% return, derived from the current investment strategy to have non equity financial assets invested in bank bills, is forecast to continue until 1 July 2006.

- For the purposes of planning, the forecast return on these funds for the 10 years from 1 July 2006 on is 8.1% p.a.<sup>12</sup>. The split between cash and capital returns will be dependent on a range of market factors and the specific operative investment strategy.

### Expenses

- ARH considers that strong value management of the investment portfolio and strong risk management is a minimum statutory requirement. The ARH approved 2005-2006 administration budget of \$3.7 million, excluding diversified portfolio management fees, is appropriate for the current and planned investment initiatives for 2005-2006.
- For the remainder of the 10 year period of the LTFP the investment management and overhead costs have been adjusted to remove one-off budgeted costs of approximately \$0.2 million and are assumed to increase at the rate of inflation.
- Direct investment fund management fees are a factor of investment policy and could range from 7 to 50 basis points. If the ARH asset base increases in size and/or complexity, fund management fees could increase in real terms to reflect this. The forecast management fees for 2005-2015, for an actively managed diversified portfolio, is 0.5% of funds under management.

### Inflation

- The forecasts in this LTFP are presented in nominal terms. The assumed inflation rate is 2.0% p.a. which is the mid point of the Reserve Bank's price stability policy target for increases in the Consumer Price Index of between 1% and 3%. 2% has also been determined as appropriate for long-term investment return scenario modelling.

### Distribution Commitments

ARH will commit to distribute funds to the ARC sufficient to meet the following obligations and expenses:

- The ARC stormwater liabilities and ARTA transport liabilities that arise from the former IA grant commitments. The commitments amounted to \$244.3 million at the establishment of ARH. The remaining distribution commitment as at 31 March 2005 was \$191.3 million.
- A general income distribution of up to \$84.0 million in the year to 30 June 2006, if called by the ARC. This sum being the estimated required distribution by the ARC as communicated 7 March 2005 plus an additional \$4.3 million in planned but undrawn general ARC distributions carried over from the 2004/05 financial year in accordance with distribution policy 3.b)vii).

### Asset Transfers to ARH

No allowance has been made in this plan for the transfer to ARH of assets from other parties.

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<sup>12</sup> Mercer Investment Consulting estimate (21 December 2004) of the likely achievable average return from an actively managed diversified investment fund over the period of the LTFP.

A more detailed description of these assumptions, and other financial and non financial information to assist with a better understanding of these forecasts, is provided in Appendix B.

## 7. Financial Forecasts

Table 6 below summarises ARH's 10 year forecasts based on the assumptions outlined in Section 5 above and in Appendix B. The forecasts are shown in greater detail in Appendix A. Table 6 shows:

- ARH's forecasts of sources and level of income and expenses;
- Distributions to the ARC, comprising existing ARH funding commitments and other future available distributions; and
- The value of the investment base over time.

**Table 6** Summary of ARH Financial Forecasts

	04/05 Fcst Yr	05/06 Plan Yr	06/07 Plan Yr	07/08 Plan Yr	08/09 Plan Yr	09/10 Plan Yr	10/11 Plan Yr	11/12 Plan Yr	12/13 Plan Yr	13/14 Plan Yr	14/15 Plan Yr	Total Plan
<b>ARH Investment Yield</b>												
POAL Dividends	34	33	35	37	39	41	44	46	49	52	55	432
Diversified Fund Total Yield	45	29	24	21	18	17	17	17	17	17	17	193
POAL Share Capital Growth	87	31	36	37	37	38	38	39	39	39	39	375
<b>Total Gross Yield</b>	<b>167</b>	<b>93</b>	<b>95</b>	<b>95</b>	<b>94</b>	<b>97</b>	<b>99</b>	<b>102</b>	<b>105</b>	<b>108</b>	<b>112</b>	<b>1,000</b>
Admin & Funds Management Costs	(3)	(4)	(5)	(5)	(5)	(5)	(5)	(5)	(5)	(5)	(5)	(50)
Funding Cost	-	-	(2)	(7)	(10)	(15)	(18)	(20)	(22)	(24)	(24)	(143)
<b>Net ARH Yield</b>	<b>164</b>	<b>89</b>	<b>87</b>	<b>83</b>	<b>79</b>	<b>77</b>	<b>76</b>	<b>77</b>	<b>77</b>	<b>79</b>	<b>82</b>	<b>806</b>
<b>Distributions</b>												
Regional Transport & Stormwater Grants <sup>(1)</sup>	52	108	32	33	10	4	3	0	1	-	-	191
General ARC Distributions	25	84	120	127	116	91	64	72	54	51	45	825
<b>Total Distributions</b>	<b>77</b>	<b>192</b>	<b>153</b>	<b>160</b>	<b>126</b>	<b>95</b>	<b>68</b>	<b>72</b>	<b>54</b>	<b>51</b>	<b>45</b>	<b>1,016</b>
<b>Value of Investment Base</b>												
Direct Equity Investments	805	938	974	1,011	1,048	1,086	1,125	1,163	1,203	1,242	1,281	
Non-direct Equity Investments	353	230	224	219	215	211	209	208	208	210	218	
Less Borrowing	-	(5)	(68)	(145)	(215)	(263)	(288)	(320)	(336)	(349)	(360)	
<b>Total Investment Capital</b>	<b>1,158</b>	<b>1,163</b>	<b>1,130</b>	<b>1,086</b>	<b>1,049</b>	<b>1,034</b>	<b>1,046</b>	<b>1,051</b>	<b>1,074</b>	<b>1,103</b>	<b>1,139</b>	

\*1 A total of \$245 million of ARH's liquid funds were "reserved" to meet the regional transport and stormwater grant commitments existing at 1 July 2004. Grant commitments remaining 31 March 2005 \$206.3 million

The forecasts show:

- Total distributions over the 10 year period of \$1,016 million. The ARH distributions made, and planned, since inception totalling \$1,093 million;
- An ARH portfolio gross yield of over \$112 million in nominal terms in the year 2015, with the potential to generate this every year thereafter under ARH's policies as described in this LTFP; and
- The revenue generating capacity being maintained in real terms over the long-term.

## 8. Key Risks

The key risks to the forecasts in this plan being achieved relate primarily to the actual capital appreciation and cash return achieved in any one year and over the cumulative period of the plan. If the forecast returns from either the POAL equity investment or from the diversified fund are not achieved, a quantification of the funding distribution impact can be seen below in Table 7.

**Table 7** Sensitivity Analysis

### Sensitivity of 'Funds Available for Distribution' to a change in investment yield

	Change in Funding Available for Distribution	
	Yield reduction of 1% in 2005/06 <u>05/06 Yr change</u> \$m	Yield reduction of 1% all plan ten years <u>10 Yr cum. plan change</u> \$m
1% Reduction in Diversified Portfolio yield	(4.1)	(34.3)
1% Reduction in POAL yield (capital growth)	(8.7)	(138.3)
1% Reduction both POAL & Diversified Portfolio yield	(12.8)	(172.6)

Table 7 demonstrates that;

- i) a 1% reduction in the achieved yield from the diversified portfolio would result in a reduction of funds available for distribution of approximately \$5.5 million in any one year;
- ii) a 1% reduction in the achieved yield from both the diversified portfolio and from the POAL equity investments would result in a reduction of funds available for distribution of approximately \$19.9 million in any one year; and
- iii) a 1% reduction in the achieved yield from both the diversified portfolio and from the POAL equity investments over the term of the plan would result in a total reduction of funds available for distribution of over \$151.7 million.

## 9. Investment and Treasury Management Policies

ARH's investment policy will be shaped by the following key factors:

- i) The need to maintain sufficient liquidity to meet ARH's distribution commitments in the first 12 months of the LTFP;
- ii) ARH's responsibility to maximise total returns (both cash yield and capital appreciation), within prudent risk limits, for the long-term benefit of the Auckland region;
- iii) The general policy of at least maintaining the real revenue generating capacity of the investment base for the long-term; and
- iv) The large proportion that POAL shares represent of ARH's total asset portfolio.

## 10. Liability Management Policy

ARH currently has no bank debt or other interest bearing financial liabilities to third parties. The main liabilities entered into by ARH are the reserves held to meet legacy IA transport and stormwater grant commitments and the one year distribution commitments made in the LTFP.

The liability management policy provides assurance to external parties and stakeholders that liabilities will be able to be met as they fall due.

To this end, ARH will:

- i) At all times maintain sufficient accessible funds to cover on demand the total quantum of current liabilities and identified contingent liabilities that may fall due over the subsequent 12 months; and
- ii) Ensure that no additional liability obligations are created that could cause ARH to be in contravention of i) above.

## 11. Ratio of Consolidated Funds

The ARH SOI requires that ARH set a ratio of consolidated ARH equity to total assets in determining its investment and borrowing policies for its LTFP. ARH will ensure the ratio of ARH equity<sup>13</sup> to the total assets<sup>14</sup> of ARH is greater than 50% at all times, consistent with a prudent view of the management of regional assets.

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<sup>13</sup> Consolidated equity means the sum of the amount of opening balance vested equity, retained earnings, accumulated losses, revenue and capital reserves of ARH.

<sup>14</sup> Total assets means the sum of the net book values of fixed assets, investments, intangible assets, and current assets (excluding the value of funds identified to fund the IA grant commitments) less current liabilities as disclosed in the ARH's Statement of Financial Position prepared on a consolidated basis and in accordance with generally accepted accounting practice.

## Appendix A

### Appendix A – Financial Statements

#### Statement of Forecast Financial Performance (Year ending 30 June)

(\$000's)	04/05 Fcst Yr	05/06 Plan Yr	06/07 Plan Yr	07/08 Plan Yr	08/09 Plan Yr	09/10 Plan Yr	10/11 Plan Yr	11/12 Plan Yr	12/13 Plan Yr	13/14 Plan Yr	14/15 Plan Yr	Total 10 Years
<b>Revenues</b>												
POAL Dividends - Ordinary	26,628	32,756	34,721	36,804	39,012	41,353	43,834	46,464	49,252	52,207	55,340	431,745
POAL Dividends - Special <sup>(1)</sup>	7,717	-	-	-	-	-	-	-	-	-	-	-
Diversified Fund Total Yield	45,068	28,803	23,850	21,306	18,219	17,432	16,951	16,709	16,609	16,599	17,007	193,484
Other Income	-	-	-	-	-	-	-	-	-	-	-	-
<b>Total Revenue</b>	<b>79,413</b>	<b>61,559</b>	<b>58,571</b>	<b>58,110</b>	<b>57,231</b>	<b>58,785</b>	<b>60,785</b>	<b>63,173</b>	<b>65,861</b>	<b>68,807</b>	<b>72,347</b>	<b>625,229</b>
<b>Direct Costs of Funds Management</b>	<b>(566)</b>	<b>(382)</b>	<b>(1,654)</b>	<b>(1,486)</b>	<b>(1,260)</b>	<b>(1,223)</b>	<b>(1,198)</b>	<b>(1,193)</b>	<b>(1,184)</b>	<b>(1,190)</b>	<b>(1,237)</b>	<b>(12,007)</b>
<b>Gross Margin</b>	<b>78,848</b>	<b>61,176</b>	<b>56,918</b>	<b>56,624</b>	<b>55,971</b>	<b>57,562</b>	<b>59,587</b>	<b>61,981</b>	<b>64,677</b>	<b>67,617</b>	<b>71,109</b>	<b>613,222</b>
<b>Overheads</b>												
Administration, depreciation, Amortisation	(2,179)	(3,681)	(3,589)	(3,659)	(3,639)	(3,710)	(3,784)	(3,859)	(3,936)	(4,014)	(4,094)	(37,965)
Interest Costs	-	-	(2,195)	(7,020)	(10,135)	(15,060)	(18,440)	(20,160)	(22,420)	(23,516)	(24,448)	(143,394)
<b>Total Overheads</b>	<b>(2,179)</b>	<b>(3,681)</b>	<b>(5,785)</b>	<b>(10,679)</b>	<b>(13,774)</b>	<b>(18,770)</b>	<b>(22,224)</b>	<b>(24,019)</b>	<b>(26,355)</b>	<b>(27,530)</b>	<b>(28,541)</b>	<b>(181,359)</b>
<b>Net Surplus before Taxation</b>	<b>76,668</b>	<b>57,495</b>	<b>51,133</b>	<b>45,945</b>	<b>42,198</b>	<b>38,792</b>	<b>37,363</b>	<b>37,961</b>	<b>38,322</b>	<b>40,087</b>	<b>42,568</b>	<b>431,863</b>
Taxation	-	-	-	-	-	-	-	-	-	-	-	-
<b>Net Surplus</b>	<b>76,668</b>	<b>57,495</b>	<b>51,133</b>	<b>45,945</b>	<b>42,198</b>	<b>38,792</b>	<b>37,363</b>	<b>37,961</b>	<b>38,322</b>	<b>40,087</b>	<b>42,568</b>	<b>431,863</b>
ARC Grant Distributions	(243,129)	-	-	-	-	-	-	-	-	-	-	-
General ARC Distributions	(25,464)	(83,974)	(120,206)	(127,065)	(116,496)	(91,168)	(64,336)	(71,632)	(53,929)	(51,118)	(45,000)	(824,924)
<b>Net Surplus after Distributions</b>	<b>(191,925)</b>	<b>(26,479)</b>	<b>(69,073)</b>	<b>(81,120)</b>	<b>(74,298)</b>	<b>(52,376)</b>	<b>(26,973)</b>	<b>(33,671)</b>	<b>(15,607)</b>	<b>(11,031)</b>	<b>(2,432)</b>	<b>(393,061)</b>
POAL Share Equity Appreciation	80,564	31,158	36,284	37,106	37,195	37,830	38,375	38,815	39,132	39,307	39,319	374,520
Other Subsidiary Capital Appreciation	6,533	-	-	-	-	-	-	-	-	-	-	-
<b>Net Change in Accumulated Funds &amp; Reserves</b>	<b>(104,828)</b>	<b>4,679</b>	<b>(32,789)</b>	<b>(44,014)</b>	<b>(37,104)</b>	<b>(14,547)</b>	<b>11,402</b>	<b>5,144</b>	<b>23,525</b>	<b>28,276</b>	<b>36,888</b>	<b>(18,540)</b>
Interest servicing / POAL dividend (maximum 75%)		0%	6%	19%	26%	36%	42%	43%	46%	45%	44%	

2004/05 ARC distributions may be carried forward

## Appendix A

### Statement of Forecast Financial Position (as at 30 June)

(\$000's)	2004 June	04/05 Fcst Yr	05/06 Plan Yr	06/07 Plan Yr	07/08 Plan Yr	08/09 Plan Yr	09/10 Plan Yr	10/11 Plan Yr	11/12 Plan Yr	12/13 Plan Yr	13/14 Plan Yr	14/15 Plan Yr
<b>Assets</b>												
<b>Current Assets</b>												
Cash	6,295	1,521	1,888	1,814	3,881	3,158	2,434	1,697	926	2,135	3,319	2,424
Diversified Portfolio - current portion		187,118	91,502	90,735	65,942	61,700	61,576	59,855	61,205	61,328	58,570	59,741
ACVL Loan Asset	11,739	12,833	13,357	13,357	13,357	13,357	13,357	13,357	13,357	13,357	13,357	13,357
Receivables & Prepayments	17	17	17	17	17	17	17	17	17	17	17	17
<b>Total Current Assets</b>	<b>18,051</b>	<b>201,490</b>	<b>106,764</b>	<b>105,923</b>	<b>83,197</b>	<b>78,232</b>	<b>77,384</b>	<b>74,927</b>	<b>75,506</b>	<b>76,837</b>	<b>75,263</b>	<b>75,539</b>
<b>Non Current Assets</b>												
Furniture, Fittings & Equipment	48	34	240	147	54	52	51	50	50	49	49	49
Diversified Portfolio - non-current portion	615,862	369,211	226,226	188,986	174,035	165,392	158,393	155,079	152,766	150,971	154,821	162,991
Investments in Subsidiaries												
ACVL	29,155	35,626	35,626	35,626	35,626	35,626	35,626	35,626	35,626	35,626	35,626	35,626
NDSL	22,957	23,019	23,019	23,019	23,019	23,019	23,019	23,019	23,019	23,019	23,019	23,019
POAL	597,868	747,781	880,222	916,506	953,612	990,807	1,028,636	1,067,011	1,105,826	1,144,958	1,184,265	1,223,584
Other												
<b>Total Non-Current Assets</b>	<b>1,265,890</b>	<b>1,175,671</b>	<b>1,165,333</b>	<b>1,164,284</b>	<b>1,186,346</b>	<b>1,214,896</b>	<b>1,245,725</b>	<b>1,280,785</b>	<b>1,317,287</b>	<b>1,354,623</b>	<b>1,397,780</b>	<b>1,445,269</b>
<b>Total Assets</b>	<b>1,283,941</b>	<b>1,377,161</b>	<b>1,272,097</b>	<b>1,270,207</b>	<b>1,269,543</b>	<b>1,293,128</b>	<b>1,323,109</b>	<b>1,355,711</b>	<b>1,392,792</b>	<b>1,431,460</b>	<b>1,473,043</b>	<b>1,520,808</b>
<b>Liabilities</b>												
<b>Current Liabilities</b>												
ACVL - Advance	350	700	700	700	700	700	700	700	700	700	700	700
NDSL - Advance	20,137	20,137	20,137	20,137	20,137	20,137	20,137	20,137	20,137	20,137	20,137	20,137
Operating Creditors & Accruals	646	7,001	403	403	403	403	403	403	403	403	403	403
Legacy IA Grant Commitments	244,293	191,343	83,199	50,841	17,660	7,997	4,233	858	521	-	-	-
<b>Total Current Liabilities</b>	<b>265,426</b>	<b>219,180</b>	<b>104,438</b>	<b>72,080</b>	<b>38,900</b>	<b>29,236</b>	<b>25,472</b>	<b>22,098</b>	<b>21,760</b>	<b>21,240</b>	<b>21,240</b>	<b>21,240</b>
<b>Non Current Liabilities</b>												
Borrowing		-	5,000	68,257	144,787	215,139	263,431	288,006	320,281	335,945	349,251	360,128
<b>Total Non Current Liabilities</b>	<b>-</b>	<b>-</b>	<b>5,000</b>	<b>68,257</b>	<b>144,787</b>	<b>215,139</b>	<b>263,431</b>	<b>288,006</b>	<b>320,281</b>	<b>335,945</b>	<b>349,251</b>	<b>360,128</b>
<b>Total Liabilities</b>	<b>265,426</b>	<b>219,180</b>	<b>109,438</b>	<b>140,337</b>	<b>183,687</b>	<b>244,376</b>	<b>288,903</b>	<b>310,104</b>	<b>342,041</b>	<b>357,184</b>	<b>370,490</b>	<b>381,368</b>
<b>Total Net Assets</b>	<b>1,018,515</b>	<b>1,157,980</b>	<b>1,162,659</b>	<b>1,129,870</b>	<b>1,085,856</b>	<b>1,048,753</b>	<b>1,034,206</b>	<b>1,045,608</b>	<b>1,050,751</b>	<b>1,074,276</b>	<b>1,102,552</b>	<b>1,139,440</b>
<b>Total Accumulated Funds &amp; Reserves</b>	<b>1,018,515</b>	<b>1,157,980</b>	<b>1,162,659</b>	<b>1,129,870</b>	<b>1,085,856</b>	<b>1,048,753</b>	<b>1,034,206</b>	<b>1,045,608</b>	<b>1,050,751</b>	<b>1,074,276</b>	<b>1,102,552</b>	<b>1,139,440</b>
<b>NOTES:</b>												
Total Diversified Investment Portfolio (DIP)	615,862	556,330	317,729	279,722	239,977	227,092	219,969	214,934	213,972	212,299	213,391	222,732
<b>Total Equity / Total Assets ratio</b>		<b>98.0%</b>	<b>97.9%</b>	<b>93.0%</b>	<b>86.9%</b>	<b>81.7%</b>	<b>78.5%</b>	<b>77.2%</b>	<b>75.5%</b>	<b>75.0%</b>	<b>74.8%</b>	<b>74.9%</b>

## Appendix A

### Statement of Forecast Cashflows (Year ending 30 June)

(\$000's)	04/05 Fcst Yr	05/06 Plan Yr	06/07 Plan Yr	07/08 Plan Yr	08/09 Plan Yr	09/10 Plan Yr	10/11 Plan Yr	11/12 Plan Yr	12/13 Plan Yr	13/14 Plan Yr	14/15 Plan Yr	Total 10 Years
<b>Cashflow from Operating Activities</b>												
<b>Operating Income &amp; Expenses</b>												
POAL Dividends - Ordinary	26,628	32,756	34,721	36,804	39,012	41,353	43,834	46,464	49,252	52,207	55,340	431,745
POAL Dividends - Special	7,717	-	-	-	-	-	-	-	-	-	-	-
Diversified Fund Income <sup>(1)</sup>	43,973	28,279	23,850	21,306	18,219	17,432	16,951	16,709	16,609	16,599	17,007	192,960
Working Capital, Change / Unpresented chqs	6,355	(6,598)	-	-	-	-	-	-	-	-	-	(6,598)
Miscellaneous Operational Capex	-	(275)	(16)	(16)	(16)	(16)	(16)	(16)	(16)	(16)	(16)	(419)
Administration Payments	(2,165)	(3,612)	(3,480)	(3,550)	(3,621)	(3,693)	(3,767)	(3,842)	(3,919)	(3,998)	(4,078)	(37,560)
Diversified Fund Direct Costs	(566)	(382)	(1,654)	(1,486)	(1,260)	(1,223)	(1,198)	(1,193)	(1,184)	(1,190)	(1,237)	(12,007)
<b>Net Operating Cashflows</b>	81,943	50,168	53,421	53,058	52,334	53,852	55,804	58,122	60,742	63,603	67,016	568,121
<b>Net Operating Cashflow</b>	81,943	50,168	53,421	53,058	52,334	53,852	55,804	58,122	60,742	63,603	67,016	568,121
<b>Cashflow from Investing Activities</b>												
Capital realisations / sale of subsidiaries	-	-	-	-	-	-	-	-	-	-	-	-
Equity Acquisitions	(69,349)	(101,284)	-	-	-	-	-	-	-	-	-	-
Proceeds on Repayment of Advance	350	-	-	-	-	-	-	-	-	-	-	-
<b>Net Investing Cashflows</b>	(68,999)	(101,284)	-	-	-	-	-	-	-	-	-	-
<b>Cashflow from Financing &amp; Distribution Activities</b>												
Borrowings	-	5,000	64,000	79,000	74,000	54,000	32,000	41,000	26,000	25,000	24,000	424,000
Repayment of Borrowings	-	-	(743)	(2,470)	(3,648)	(5,708)	(7,425)	(8,725)	(10,336)	(11,694)	(13,122)	(63,872)
Borrowing Interest Costs	-	-	(2,195)	(7,020)	(10,135)	(15,060)	(18,440)	(20,160)	(22,420)	(23,516)	(24,448)	(143,394)
ARC grant distributions	(51,786)	(108,144)	(32,358)	(33,181)	(9,663)	(3,764)	(3,374)	(337)	(521)	-	-	(191,343)
General ARC Distribution	(25,464)	(83,974)	(120,206)	(127,065)	(116,496)	(91,168)	(64,336)	(71,632)	(53,929)	(51,118)	(45,000)	(824,924)
<b>Net Financing &amp; Distributions Cashflow</b>	(77,250)	(187,118)	(91,502)	(90,735)	(65,942)	(61,700)	(61,576)	(59,855)	(61,205)	(61,328)	(58,570)	(799,533)
<b>Net Cash Inflow / (Outflow)</b>	(64,306)	(238,234)	(38,081)	(37,677)	(13,608)	(7,848)	(5,771)	(1,733)	(464)	2,275	8,446	(231,411)
<b>Opening Cash / Diversified Portfolio Balance</b>	622,156	557,851	319,616	281,535	243,858	230,250	222,403	216,631	214,898	214,434	216,709	
<b>Closing Cash / Diversified Portfolio Balance</b>	557,851	319,616	281,535	243,858	230,250	222,403	216,631	214,898	214,434	216,709	225,155	

(1) Assumed to be all cash income for the purpose of this cash flow statement.  
2004/05 ARC distributions may be carried forward

## **Appendix B – Financial Assumptions**

This appendix documents the key financial assumptions in the 2005-2015 ARH LTFP.

### **General**

All elements of the plan have been prepared on a nominal value basis rather than in real value terms.

The plan financials work from a base of the ARH 30 June 2005 actual financial results with best estimates made of the expected financial returns from the 2005/06 financial year and return assumption made for the rest of the LTFP.

The assumed inflation rate is 2.0% p.a. which is the mid point of the Reserve Bank's price stability policy target for increases in the Consumer Price Index of between 1% and 3%.

Where debt borrowing has been undertaken for the purposes of increasing potential distributions to the ARC this debt is assumed to be repaid over a period of twenty years and has an interest rate of 7%.

The convention adopted with respect to transaction recognition is 'cash accounting' rather than 'accrual accounting'. A material example being the receipt of POAL dividends, which are recognised in the Balance Sheet at the time of distribution rather than at time of announcement.

Consistent with ARH's current income tax exempt status, no income tax is payable or receivable throughout the term of the plan.

### **Financial Instruments and Diversified Fund Investment Portfolio**

#### Forecast Returns Year ending 30 June 2005

Actual return of 7.2%, recognised in the LTFP all as cash, for the year ending 30 June 2005.

#### Return 1 July 2005 to 30 June 2015

The assumed return on the diversified investment portfolio for the first twelve months of the LTFP is 7.0%, being the projected return on short-term cash and Bank Bills. From 1 July 2006 to 2015 there is a planned reallocation to diversified investments with a forecast return of 8.1% p.a.<sup>15</sup> The split in return between cash yield and capital growth is not known at this stage. For planning purposes ARH assumes that any capital growth in this liquid fund can be converted into cash.

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<sup>15</sup> Mercer Investment Consulting estimate (21 December 2004) of the likely achievable average return from an actively managed diversified investment fund over the period of the LTFP.

## Funds Management Fees 1 July 2005 to 30 June 2015

The management fee rate achieved is a function of the portfolio risk profile, asset allocation policy, and fund management practice adopted. The rate as a percentage of the fund quantum could be anywhere between 7 and 50 basis points.

Funds management charges on a diversified growth fund is expected to be approximately 50 basis points (0.5%) of the total diversified non-equity investment portfolio.<sup>16</sup>

### Cash Advances by 100% Subsidiaries

Subsidiary loan funds advanced have been invested in ARH's liquid cash and bond portfolios where they are assumed to return the same investment yield as outlined above. For the purposes of the plan, recognition of the interest return on subsidiary advances is through the overall ARH liquid portfolio fund investment yield.

<b>\$ 000's</b>		
Advances to ARH by subsidiaries	30/06/05	
NDSL	20,137	Maintained for term of plan
ACVL	<u>700</u>	Maintained for term of plan
Total	<u>20,837</u>	

### **Other Investments and Subsidiaries**

Full consolidation of subsidiary financials has not been undertaken for the purposes of preparing the LTFP.

#### Ports of Auckland Limited (POAL)

##### *Capital Value*

The investment in POAL is valued at the company's share price that existed at the time of delisting, \$8.00 per share. This figure is also the same as that reflected in the audited financial statements as at 30 June 2005. ARH from 5 August 2005 holds 106,005,191 shares in POAL and no sales of any of the shares in POAL have been forecast.

The total return on investment in POAL is assumed to be 8.0% p.a. This return on investment is delivered to ARH by way of dividend streams and capital value appreciation calculated on the most recent recognised share value, as noted above.

##### *Dividends*

POAL dividend payments are based on the March 2005 actual payment of 15.0 cents per share and projected September 2005 payment of 15.0 cents per share, growing over the ten year period at a rate of 6.0% p.a. thereafter. This POAL dividend growth rate is based upon POAL's estimated growth in net earnings per share (6%) while also assuming that the POAL dividend payout policy remains unchanged.

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<sup>16</sup> Mercer Investment Consulting (21 December 2004).

### America's Cup Village Limited (ACVL)

ACVL is assumed to have a net asset value of \$35.6 million, net of an interest bearing loan from ARH of \$12.8 million. This net asset value is assumed to be maintained in nominal terms in perpetuity for the purposes of the plan. The value of ACVL is based on the net asset value of the company shown in its financial statements to 30 June 2005.

### Northern Disposal Systems Limited (NDSL)

The NDSL investment and its advance to ARH are assumed to be maintained in nominal terms throughout the period of the plan.

The only substantive financial asset held by NDSL is the non interest bearing advance to ARH. The assumed return on these advanced funds is discussed above under the heading 'Cash Advances by 100% Subsidiaries'.

## **Overheads**

ARH considers that strong value management of the investment portfolio and strong risk management is a minimum statutory requirement. The ARH 2005-2006 administration budget of \$3.7 million, excluding diversified portfolio management fees, is appropriate for the current and planned investment initiatives for 2005-2006.

For the remainder of the 10 year period of the LTFP the investment management and overhead costs have been adjusted to remove one-off budgeted costs of approximately \$0.2 million and are assumed to increase at the rate of inflation.

## **Distribution Commitments**

ARH will distribute funds at least to meet the following commitments.

### ARC Transport and Stormwater Grant Commitments

ARH will fund the ARC stormwater liabilities and ARTA transport liabilities that arise from the legacy IA grant commitments (a total \$244.3 million existed on ARH establishment). Grant commitments remaining as of 30 June 2005 was \$191.3 million. These grant liabilities represent a "constructive obligation" on ARH due to the undertaking in this plan to provide the grant funding.

ARH has notionally reserved capital, received on establishment of ARH, to be made available to the ARC to meet these legacy IA grant commitments.

### General Distributions to the ARC

Beyond the specified grant commitments, ARH will make further income and capital general distributions to the ARC under the policies outlined in Section 3 of the LTFP and as forecast in Section 6.

The distributions available in total over the 10 years of the plan are a result of the above assumptions and having had regard to the ARC draft LTCCP.

It is important to note that investment returns and performance may differ in any year, and over time, from that which is forecast and that distributions available over the longer term are subject to change.

## Appendix C - ARH Specific Risk Profile

ARH has developed a risk profile of its current investment holdings in accordance with delivering best practice investment management, in meeting its statutory objectives, and in meeting its 1 July 2005 – 30 June 2008 SOI targets.

The broad approach taken in developing a risk profile has been to:

- i.) Undertake a stochastic/probability analysis of the risk return characteristics of the individual investment components, the individual investment component correlations, and also of the portfolio investments as a whole, given a range of increasing exposure to growth assets in the portfolio.
- ii.) To undertake scenario analysis of the micro and macro economic conditions which could alternatively prevail over the term of the plan and how such conditions would impact on the ARH risk profile.

To assist with this process ARH has engaged Mercer Investment Consulting (Mercer IC) to investigate and report on the stochastic elements of the ARH financial assets risk profile.

The assumptions made by Mercer IC in developing a risk profile are broadly consistent with those noted elsewhere in this LTFP. At the date of presenting this LTFP the Mercer IC Risk Profile report was still in draft form and is being updated to take account of ARH investment initiatives being progressed.

### Risk Profile Conclusions

Any consideration of risk necessarily has to determine an appropriate timeframe over which volatility should be assessed. ARH has adopted a 50 year planning horizon<sup>17</sup> in accordance with the long-term nature of its statutory objectives and consistent with the ARC Regional Growth Strategy time horizon.

The analysis shows that although there is a healthy overall return expectation over the longer term and that, if well managed the potential upside is strong. However, there are also significant possibilities for poor investment returns over shorter investment horizons. Commitment to a sizeable investment base and investment over this longer time frame is critical to achieving higher returns with confidence.

The financial results are mainly a consequence of the size of the holding in POAL and its value in relation to the value of the total financial assets. In particular, adopting an extremely financially conservative strategy for the non-POAL portion of the assets has little, if any, risk mitigation effect on the riskiness of the assets overall. That is, from a risk perspective, portfolios with increasing proportions of growth investments still have similar downside potentials but with increased upside potentials compared to those portfolios with little growth investments<sup>18</sup>.

In this case it is not a matter of having all of one's eggs in one basket. ARH has stewardship of one large egg and lots of smaller, discretionary ones. The risks inherent in the smaller eggs can be spread using lots of baskets but it is still the largest one (POAL) which predominates risk characteristics in the total investments

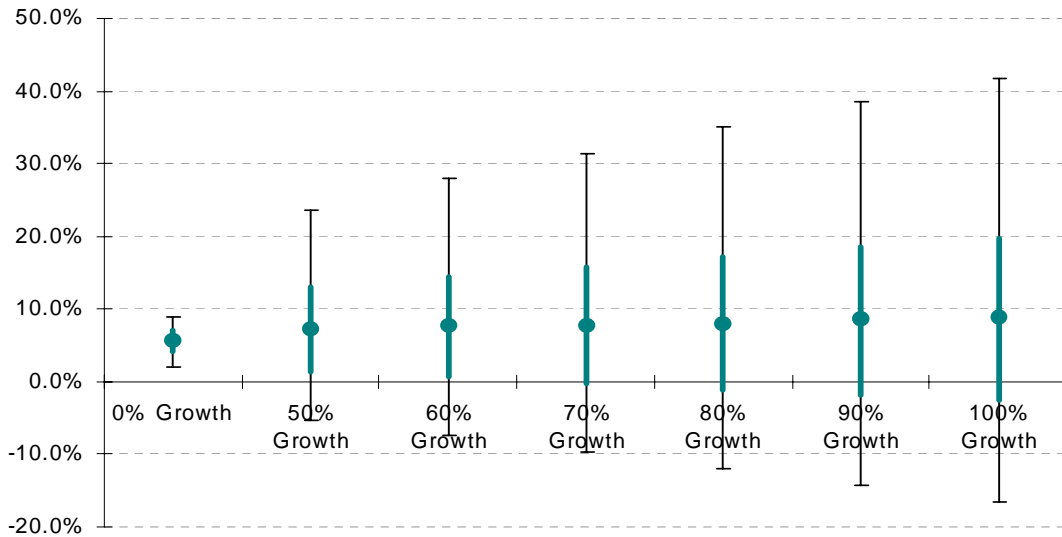
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<sup>17</sup> Stochastic analysis has been undertaken to a maximum of 20 years. Modelling of timeframes greater than this period are of little practical value due to minimal reduction in volatility convergence on the mean and due to much greater uncertainty in the macro/micro economic environment being consistent with the 'Base Case' scenario conditions assumed for this modelling.

<sup>18</sup> With increasing proportions of growth investments of up to 80% in the non-POAL investment portfolio.

value. With a longer term investment horizon it still makes sense to grow the smaller eggs in a prudent fashion.

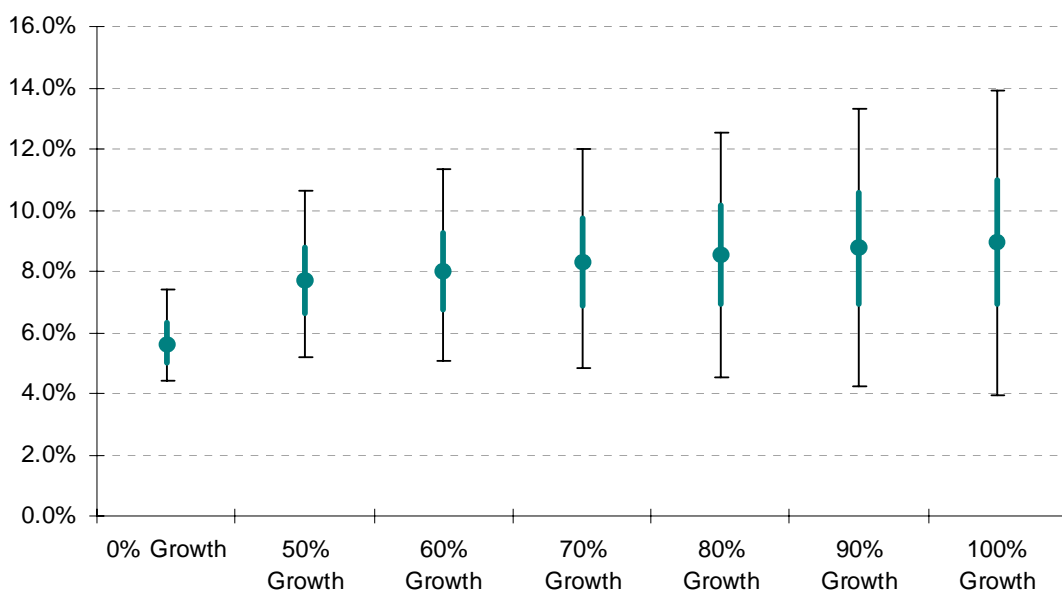
Base Case - Distribution of trial mixes after 1 year



Source: Mercer IC

The graph demonstrates that, in the most likely scenario or 'Base Case' set of micro and macro conditions, the one year return from total ARH financials assets could range from 2.0% to 8.8% and from -16.5% to 41.7% as a result of a 0% growth diversified non-POAL portfolio and a 100% growth diversified non-POAL portfolio respectively. In financial terms this potential volatility represents a possible one year investment return range of between \$24 million and \$104 million for a 0% growth diversified non-POAL portfolio and of between a \$195 million loss and a \$492 million gain for a 100% growth diversified non-POAL portfolio.

Base Case - Distribution of trial mixes after 20 years



A similar analysis over a 20 year time frame demonstrates that the return from total ARH financials assets could range from 4.4% to 7.5% (average return each year over 20 years of between \$53 million and \$90 million) and from 4.0% to 14.0% (average return each year over 20 years of between \$48 million and \$167 million) as a result of a 0% growth diversified non-POAL portfolio and a 100% growth diversified non-POAL portfolio respectively.

The Mercer IC risk profile report did not seek to establish, given this profile, what would be an appropriate minimum level of risk or minimum level of return for ARH.

### **Risk / Return Policy**

ARH's investment portfolio has a number of constraints relative to an investment fund not operating within a similar statutory framework or for the wider benefit of the regional community. ARH will actively manage individual investment risk and develop risk mitigation strategies as appropriate to work within the given constraints.

Given new information available and the Mercer IC findings, particularly with respect to how the introduction of further growth investments (with their associated greater return), adds relatively little additional risk to that already existing in the total investment portfolio, ARH is likely to adopt a greater proportion of growth assets in its portfolio. Indeed, the return volatility profile over the longer time horizon (20 years) clearly shows the benefit of reduced return downside risk through introducing further growth assets into the portfolio. It suggests that, with a sufficiently long time horizon, ARH would be unlikely to consider growth asset exposure in its diversified portfolio below 40%.

Unless there is a strategic imperative not to do so ARH is likely to avoid further equity exposure to the sectors in which POAL operates other than where such further equity investment directly enhances the fundamental value of the existing investments or is considered necessary in assisting ARH to meet its objectives.

This policy does not restrict ARH from taking advantage of short term market conditions to improve investment yield where such asset allocation decisions do not increase the overall risk profile of total investment assets.

Within this broad framework ARH, will, over the next few months, continue to finalise the details of its investment and treasury management policies and to determine appropriate risk and return measures and targets.