

# **Auckland Regional Holdings**

## **Long-Term Funding Plan**

**For the period from  
1 July 2008 to 30 June 2018**

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# **Auckland Regional Holdings Long-Term Funding Plan For the period from 1 July 2008 to 30 June 2018**

## **Executive Summary**

The 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. This LTFP covers the 10-year period from 1 July 2008 to 30 June 2018. It has regard to the Auckland Regional Council's (ARC) 2008/2009 Annual Plan and Long-Term Council Community Plan 2006-2016 (LTCCP) Amendment.

### **Background**

Auckland Regional Holdings (ARH), a statutory, council-controlled organisation, focused on investment management, was established with the long-term intention of generating income to assist with funding the Auckland region's transport and stormwater expenditure requirements. The ARC is the sole direct economic beneficiary of ARH's distributions. Section 34 of the Act requires that at least 85% of ARH's funding to the ARC, whether of income or capital must be used by the ARC for transport or stormwater programmes in the Auckland region.

The LTFP is a snapshot in time. It is based on the best information available at that time comprising both historical and forecast data. As circumstances and the underlying economic environment materially change, the plan is adjusted accordingly.

ARH has achieved a gross annualised investment return of 9.8% over the four years since its inception on 1 July 2004. This LTFP reflects an anticipated continuing downturn in the economy, which has already negatively affected ARH's portfolio of assets. Longer term uncertainty could have a further adverse impact on ARH's forecast earnings and therefore potentially on its long term funding capability.

The introduction of a regional fuel tax has been factored into this plan and is reflected in the distributions required from the Auckland Regional Council. Although the Government has passed the necessary legislation to allow a regional fuel tax of up to 5c a litre, the amount and phasing of the tax has yet to be confirmed. The LTFP has assumed a high distribution requirement from the ARC in the first year to meet urgent transport and stormwater needs, with lower distributions in ensuing years. This reflects ARH shifting from funding short term high levels of capital to the long term support of public transport operating subsidies.

This LTFP includes an ARH forecast of dividends from Ports of Auckland Limited (POAL), which is facing a very tight trading environment with lower economic activity and reduced growth in both container and break bulk volume. This is expected to continue for some time and this plan contains a lower dividend forecast compared with the previous plan. The goal is for POAL to:

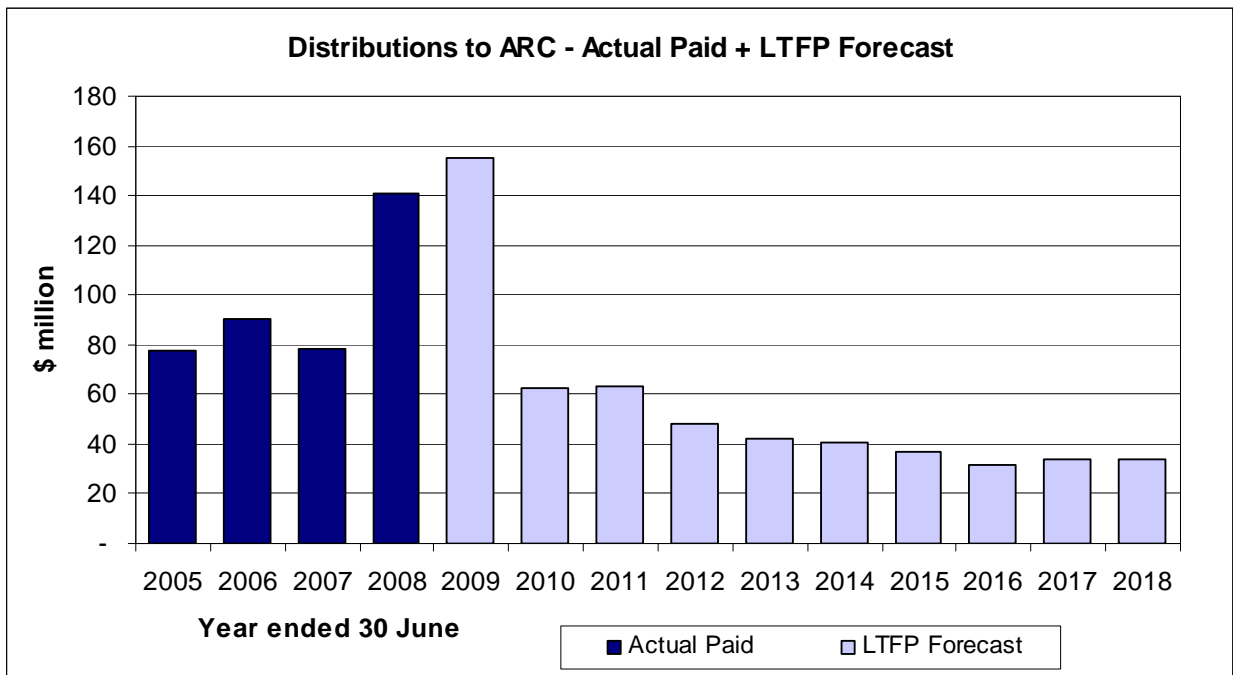
- Achieve its cost of capital over time which is necessary to provide New Zealand importers and exporters long-term certainty that efficient profitable capacity will be available; and
- Ensure the long term requirement for an efficient and optimally situated land and water interface for people and goods movement is provided.

These outcomes are required for the long term benefit of New Zealand as international trade is of critical importance to the national economy and this requires an internationally competitive, efficient and sustainable transport and port sector.

The logistics industry worldwide is undergoing major change and rationalisation. ARH as a long-term, intergenerational investor is very aware of the potential impacts of this change, as well as increasingly carbon constrained supply chains and long-term consequences of increasing real energy prices. In the light of these international trends, proactive changes will inevitably be required in the NZ logistics supply chain. ARH has previously publicly communicated its view that in principle some form of port rationalisation has strong merit. ARH is committed to playing its role in achieving the right outcome for the long-term benefit of New Zealand.

It is in the long-term interests of the region for ARH to provide a sustainable source of long-term funding to the ARC. The challenge is to provide funding certainty to the ARC while ensuring that the fund itself is sustainable in the long term. An uncertain economic climate creates pressure to perform in the shorter term. ARH has the capacity to seek other funding options to meet its commitments, if its forecast earnings under-perform, as long as the long-term sustainability of the fund is not compromised. As a prudent investor, ARH needs to be confident that its current and any future investments achieve an adequate return on capital. ARH has a 30-year investment horizon and 100 year planning horizon and has a diversified portfolio which is being actively managed to absorb short to medium-term investment volatility.

ARH's historical and forecast distributions to the ARC are shown below.



## ARH Investment Performance since Inception

ARH's gross cumulative annualised investment return for the four years since its establishment on 1 July 2004 to 30 June 2008 is 9.8% p.a. The annualised gross cash return for the total portfolio over the same period is 7.2%.

## Investment Summary

As at the start of the plan, 1 July 2008, the expected value of the ARH portfolio macro asset allocations is as set out in Table 1 below.

**Table 1:** Expected investment allocation at the start of the plan, 1 July 2008.

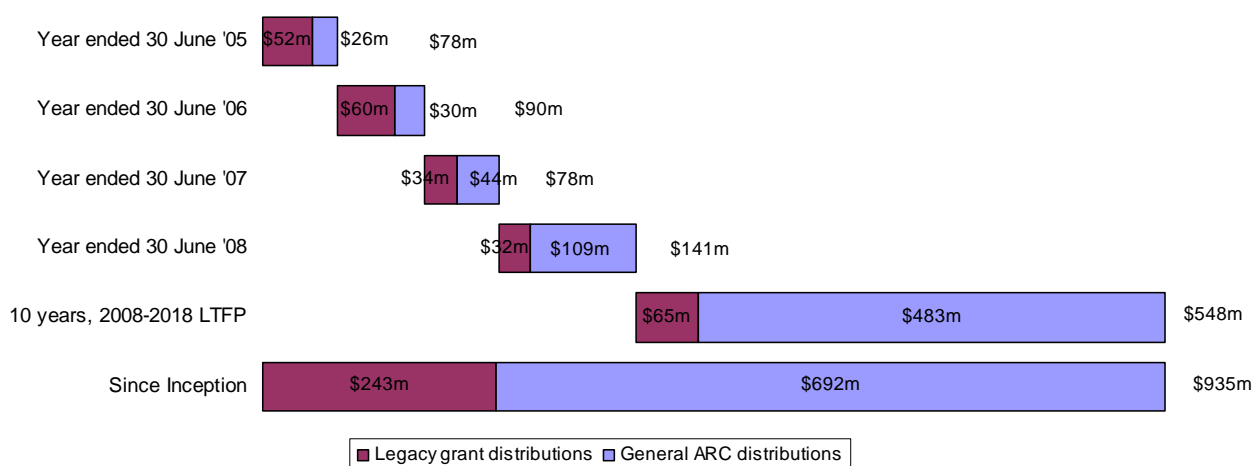
Investment	\$ million	Share	Asset Allocation Category
POAL - NZ Equity Non-Listed	587.8	44.3%	Transport infrastructure utility (POAL)
NZ Investment Property	219.6	16.6%	Waterfront property investment (incl ACVL & SCPL)
Diversified Financial Assets	298.8	22.5%	Global equities, global bonds and NZ cash
NZ Short-term Cash	219.1	16.5%	NZ cash short term market investment
<b>Total ARH Investments</b>	<b>1,325.2</b>	<b>100.0%</b>	

*Note: ARH's equity investment in POAL and its Investment Property are independently valued each year for the purpose of Annual Financial Reporting. The independent valuation as at 30 June 2008 will be reported in ARH's 2008 Annual Report.*

## Distributions to the ARC – actual and planned

From its establishment on 1 July 2004 to 30 June 2008, ARH has distributed \$387 million to the ARC. Over the next ten years, until 30 June 2018, a further \$548 million is expected to be distributed, bringing the total distributed to the ARC from 1 July 2004 to 30 June 2018 to \$935 million.

**Figure 1:** Performance to Date / Planned - Distributions to the ARC, Cash Basis



## Key ARH Policies

### Investment Management Policies

ARH investment policy is shaped by ARH's investment objectives and risk budget framework and will, of necessity, evolve with changes in circumstances and the underlying economic environment.

General portfolio investment policy:

- i) ARH will invest and manage its investment assets on a prudent and commercial basis consistent with sound business practice;
- ii) ARH will manage its investment portfolio to maximise ARH's long-term distributions to the ARC;
- iii) Consistent with the above, and as a long-term investor, ARH will maximise return on investment, both in cash return and through capital appreciation, over the longer term; and
- iv) ARH has a 30-year investment horizon. It will assume short and medium-term investment volatility to achieve superior investment returns over the long term.

Primary investment objectives:

- i) To outperform the NZ Government Bond index by 1.5% p.a. over ten-year rolling periods;
- ii) To maintain the real revenue-earning capabilities of total assets by outperforming inflation, as measured by the Consumer Price Index, by 5.5% p.a. over 20-year rolling periods;
- iii) For distributions, on a rolling ten-year basis:
  - Short Term, to pay to the ARC 100% of the planned distributions in the first three years of the LTFP, with a 95% probability of achievement;
  - Long Term, to pay to the ARC at least 90% of the planned distributions in years four to ten of the LTFP, with a 75% probability of achievement; and
- iv) To maintain the fund in a satisfactory financial condition by not exceeding the debt servicing criteria.

Distribution Policies

- i) ARH will distribute funds derived from investment returns, investment capital, or external debt 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; and
- ii) ARH will distribute funds to meet all legacy Infrastructure Auckland (IA) grant commitments, predominantly to local councils. These were \$243 million at 30 June 2004 with remaining grant commitments as at 30 June 2008 of \$65 million.

ARH has planned to provide funds to meet the distribution requirements in the ARC's 2008/2009 Annual Plan and LTCCP Amendment which includes the Government's recently enacted legislation to enable additional funding for public transport capital projects to be obtained through a regional fuel tax of up to 5 cents per litre. The timing and phasing of the regional fuel tax is yet to be confirmed. \$155 million (including IA grants) will be available for distribution to the ARC in 2008/2009, with a total of \$548 million over the 10 years of the plan.

# **Auckland Regional Holdings**

## **Long-Term Funding Plan**

### **For the period from 1 July 2008 to 30 June 2018**

#### **1. Introduction**

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. This LTFP covers the 10-year period from 1 July 2008 to 30 June 2018. It has regard to the Auckland Regional Council's (ARC) 2008/2009 Annual Plan and Long-Term Council Community Plan 2006-2016 (LTCCP) Amendment.

#### **a) Regional Funding Context**

ARH, the ARC and the Auckland Regional Transport Authority (ARTA) have important roles to play in the development of Auckland's regional transport system.

- Ultimate responsibility for the development of the regional land transport strategy rests with the ARC.
- ARTA's brief is to translate the ARC's transport strategy into an integrated land transport programme. This responsibility extends to the planning, funding and development of transport solutions.
- ARH was established with the long-term intention of generating income to assist with funding the Auckland region's significant transport and stormwater expenditure requirements.

The Auckland Regional Land Transport Strategy (ARLTS) estimated that the Auckland region needs to spend \$11 billion on transport between 2006 and 2016. Given the projected population growth in the Auckland region, the community expectations for transport system improvements and planned improvements to the transport system, the expenditure and ongoing funding requirements are likely to increase with time.

The ARC's 2006-2016 LTCCP identified a \$700m funding gap between the public transport funding available from the ARC and the funding required to implement the ARLTS strategy. Using rates to provide this funding would have required unaffordable rate rises of 17% every year for 10 years. Partly as a result of this, in 2007, the Government introduced draft legislation to enable regional fuel tax (RFT) schemes.

The Land Transport Management Amendment Act, which takes effect on 1 August 2008, contains provisions enabling the ARC to obtain Government approval for a regional fuel tax of up to 5c per litre, with the timing and phasing of this yet to be determined.

As the regional fuel tax can be spent only on capital projects, the ARH portfolio needs to be managed to provide long-term sustainable funding particularly for public transport operating subsidies. The staging and phasing of capital (public transport) programmes will determine the ultimate scope of such subsidies.

## **b) Statutory Requirements**

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;*
- (b) ARH should undertake any commercial activities in accordance with sound business practice;*
- (c) ARH should ensure prudent stewardship and the efficient and effective use of resources;*
- (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;*
  - (ii) the need to maintain and enhance the quality of the environment;*
  - (iii) the reasonably foreseeable needs of future generations;*
- (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;*
- (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) endeavour to maintain its long-term financial viability; and*
  - (ii) prudently manage its assets and liabilities.*

The functions of ARH, are defined in Section 20, and include:

- (a) Own, directly or indirectly, and manage assets (including funds) in the long-term interests of the Auckland Region;*
- (b) Provide funds to ARC in accordance with ARH’s long-term funding plan prepared under section 21;*
- (c) Make land transport assets available to assist ARTA to achieve ARTA’s objectives; and*
- (d) Undertake such other functions as are given to it by this Act or any other Act, or are authorised by its statement of intent.*

The required LTFP contents are defined in Section 21. An LTFP must:

- (a) *Relate to the 10-year period beginning on 1 July in the year it is delivered to ARC: and*
- (b) *include the following matters:*
  - (i) *Forecasts of funds required by ARC from ARH;*
  - (ii) *Forecasts of funds, both capital and income, that will be available for distribution by ARH to the ARC;*
  - (iii) *Forecasts of funds, both capital and income, that ARH intends to reinvest in existing or new activities;*
  - (iv) *The proposed source of those funds;*
  - (v) *Estimated cash flow projections for the period of the plan;*
  - (vi) *Estimated changes in the net worth of ARH for the period of the plan;*
  - (vii) *Such other financial and non-financial information as is necessary for a proper understanding of these forecasts;*
  - (viii) *An investment and treasury management policy; and*
  - (ix) *A liability management policy.*

This funding plan covers the 10-year period from 1 July 2008. ARH has extended its financial planning horizon to a rolling 20-year period while, for investment management purposes, it has a 30-year planning horizon. For overall strategic planning purposes, ARH utilises a 50-100 year time horizon<sup>1</sup>.

### **c) ARH Establishment Assets**

When it was established on 1 July 2004, ARH had an asset base of \$1,284 million. In December 2004 the ARH Board committed to funding existing Infrastructure Auckland (IA) transport and stormwater commitments to the local councils. This reduced ARH's net asset base to \$1,041 million. This consisted of \$391 million in portfolio investments, cash funds and loans, excluding that required to meet legacy IA transport and stormwater grant commitments (\$243.1 million) and direct equity investments of \$650 million, being primarily an 80% interest in POAL<sup>2</sup>. Other subsidiaries included America's Cup Village Limited (ACVL) and Northern Disposal Systems Limited (NDSL).

### **d) Core Investment Activity History to 30 June 2008**

- On 1 April 2005, ARH made an offer at \$8 per share for the remaining listed shares in POAL. Purchase of the 20% minority interests in POAL was concluded on 5 August 2005. The acquisition cost of \$169.6 million was funded through draw-down on cash investments (at 1 April 2005 cash investments amounted to \$634.3 million).
- On 30 June 2005, ARH's investment in POAL was revalued to \$8 per share (\$7.05 per share on ARH establishment 1 July 2004) resulting in an investment gain of \$80.6 million.
- A capital restructuring of POAL in December 2005 resulted in a special dividend being paid to ARH. The special dividend of \$120 million has been invested in existing managed investments. The net benefit to the ARH group to 30 June 2008 of this capital restructure is estimated at \$9.2 million.
- On 30 June 2006, ARH's investment in POAL was valued by PricewaterhouseCoopers at \$797.4 million, resulting in an investment gain of \$48.9 million.

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<sup>1</sup> Consistent with the Auckland Sustainability Framework (ASF).

<sup>2</sup> Based on a share price on 30 June 2004 of \$7.05 cents per share.

- In April 2006, ARH adopted its long-term investment objectives for which the ARC communicated its support in July 2006. ARH has subsequently progressed with the development of its detailed investment strategy in order to achieve these objectives.
- On 1 April 2007, ACVL and POAL transferred waterfront investment property with a fair value of \$284 million to ARH via an in-specie distribution. Remaining POAL waterfront investment property with a fair value of \$5.6 million was distributed to ARH in August 2007. A wholly-owned ARH subsidiary, Sea+City Projects Limited (SCPL) was concurrently appointed as a dedicated special-purpose agent management company acting on behalf of ARH. Land assets remaining within ACVL have been leased on long-term basis to ARH and are also managed by SCPL.
- On 29 June 2007 the Auckland City Council (Auckland City) announced the agreement to notify the District Plan for Wynyard Quarter which includes the development of the Wynyard precinct property owned by ARH. This LTFP includes the financial forecasts for ARH's investment property arising from this agreement.
- On 30 June 2007, ARH's investment in POAL was valued by PricewaterhouseCoopers at \$587.8 million.
- On 2 July 2007, ARH sold Wynyard precinct property, designated as public space in the notified district plan including 50% of the Headland Public Space, to Auckland City. Net cash proceeds received by ARH totalled \$59.8 million.
- In August 2007 the ARC acquired the remaining 50% of the Headland Public Space from ARH for \$23.5 million cash proceeds.
- The transition of \$300 million from NZ Short-term Cash Investments to the Diversified Financial Asset Portfolio was completed in November 2007.

#### e) ARH Performance from Inception until 30 June 2008

As shown in Table 2 below ARH's gross cumulative annualised investment return for the four years since its establishment on 1 July 2004 to 30 June 2008 is 9.8% p.a. The annualised gross cash return for the total portfolio over the same period is 7.2%.

**Table 2:** Performance to Date - Investment Return

Gross Returns		
NZD 000's	Closing Asset Value at 30 June 2008	Annualised Returns Since Inception to 30 June 2008 (4 Years)
Ports of Auckland	\$587,800	12.1%
Northern Disposals Systems Limited (to 31 March 2007)	\$0	2.0%
<b>New Zealand Equity - Non-listed</b>	<b>\$587,800</b>	<b>12.1%</b>
New Zealand Investment Property (from 1 April 2007)	\$184,986	5.1%
Sea + City Projects Limited (from 1 April 2007)	\$288	206.6%
America's Cup Village Limited	\$21,285	3.0%
America's Cup Village Limited - Loan	\$13,007	10.2%
<b>New Zealand Investment Property</b>	<b>\$219,566</b>	<b>6.8%</b>
<b>Diversified Financial Assets (from July 2007)</b>	<b>\$298,757</b>	<b>-0.5%</b>
<b>New Zealand Short Term Cash</b>	<b>\$219,073</b>	<b>7.9%</b>
<b>Total Portfolio</b>	<b>\$1,325,196</b>	<b>9.8%</b>

Note: ARH's equity investment in POAL and its Investment Property are independently valued each year for the purpose of Annual Financial Reporting. The independent valuation as at 30 June 2008 will be reported in ARH's 2008 Annual Report.

## f) Investment Summary

As at the start of the plan, 1 July 2008, the expected existing macro asset allocation is as set out in Table 3.

**Table 3:** Expected investment allocation at the start of the plan, 1 July 2008.

Investment	\$ million	Share	Asset Allocation Category
POAL - NZ Equity Non-Listed	587.8	44.3%	Transport infrastructure utility (POAL)
NZ Investment Property	219.6	16.6%	Waterfront property investment (incl ACVL & SCPL)
Diversified Financial Assets	298.8	22.5%	Global equities, global bonds and NZ cash
NZ Short-term Cash	219.1	16.5%	NZ cash short term market investment
<b>Total ARH Investments</b>	<b>1,325.2</b>	<b>100.0%</b>	

*Note: ARH's equity investment in POAL and its Investment Property are independently valued each year for the purpose of Annual Financial Reporting. The independent valuation as at 30 June 2008 will be reported in ARH's 2008 Annual Report.*

Figure 2 below shows the asset allocation of ARH's total investment portfolio from 1 July 2004 through to 30 June 2008.

**Figure 2:** Performance to Date - Investment Portfolio

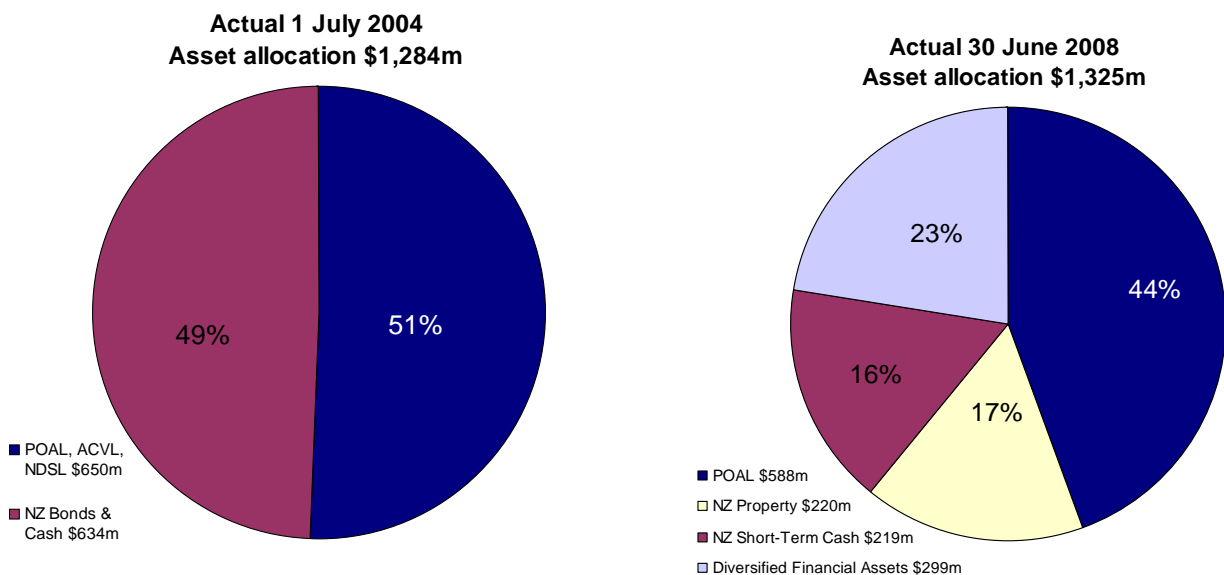
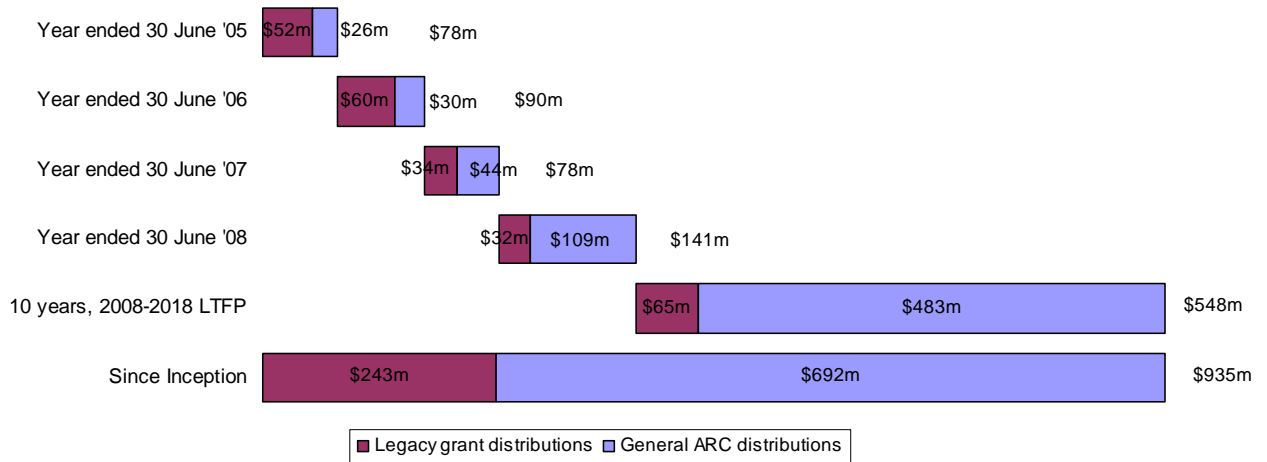


Figure 3 below shows the historical and planned distributions to the ARC on a cash basis.

**Figure 3: Performance to Date / Planned - Distributions to the ARC, Cash Basis**



## 2. Key Planning Assumptions in this LTFP

### Ports of Auckland Limited (POAL) NZ Equity – Non-Listed

- Assessments as to POAL future operating returns, and therefore cash dividends, are made in a manner consistent with ARH’s investment objectives of 95% certainty of distributions in years one to three and 75% certainty of achieving 90% of planned distributions in years four to ten (i.e. ARH providing ARC with higher levels of funding certainty in the first three years versus years four to ten).
- The total return (cash dividends and capital appreciation) on POAL shares is assumed to be 8% p.a. throughout the plan period. This return on investment is delivered to ARH by way of dividend streams and capital value appreciation. Independent POAL valuations will be undertaken every year to determine the capital return on the POAL investment.
- This LTFP assumes POAL’s ordinary dividend payout policy is to pay at least 75% of after-tax profits in two instalments at the half-year and full-year end.
- This LTFP includes an ARH forecast of dividends from Ports of Auckland, which is facing a very tight trading environment with lower economic activity and reduced growth in both container and break bulk volume. This is expected to continue for some time and this plan contains a lower dividend forecast compared with the previous plan. The goal is for POAL to:
  - Achieve its cost of capital over time which is necessary to provide New Zealand importers and exporters long-term certainty that efficient profitable capacity will be available; and
  - Ensure the inter-generational requirement for an efficient and optimally situated land and water interface for people and goods movement is provided.

These outcomes are required for the long term benefit of New Zealand as international trade is of critical importance to the national economy and this requires an internationally competitive, efficient and sustainable transport and port sector.

The logistics industry worldwide is undergoing major change and rationalisation. ARH as a long-term intergenerational investor is very aware of the potential impacts of this change as well as increasingly carbon constrained supply chains and long-term consequences of increasing real energy prices. In the light of these international trends, proactive changes will inevitably be required in the NZ logistics supply chain. ARH has previously publicly communicated its view that in principle some form of port rationalisation has strong merit. ARH is committed to playing its role in achieving the right outcome for the long-term benefit of New Zealand.

## NZ Investment Property

### a) Waterfront Properties

- Rental and lease premium income on waterfront property will be directly managed by SCPL, a special-purpose, investment property and redevelopment management services company acting for ARH. This management company is accountable to a Board of Directors. All day-to-day management of the property assets will be handled by SCPL. Expected revenue and net earnings from the properties are based on projections prepared by independent property valuers.
- Capital appreciation on the waterfront investment properties is assumed to be 3.25%<sup>3</sup> p.a.

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

- Estimated yields on assets owned by ACVL are not, for the purpose of this LTFP, identified separately from other waterfront investment properties. Land and waterspace assets retained by ACVL are leased to ARH on a long-term lease.
- All rental and lease premium income will flow to ARH based on projections made by independent property valuers. Capital appreciation of the assets is assumed at 3.25%<sup>3</sup> p.a.
- ACVL is expected to pay an annual dividend to ARH based on after-tax operating profits.

### c) Sea+City Projects Limited (SCPL)

- SCPL manages the NZ investment property owned by ARH.
- SCPL's role includes the following
  - Conducting the master planning process for the project area according to the agreed urban design framework;
  - Project management of the Auckland City public infrastructure works for Wynyard Precinct which are jointly funded by ARH and Auckland City;
  - The management of ARH leasehold interests; and
  - The oversight of the management and construction of Te Wero Bridge with Auckland City.

## Diversified Financial Assets (DFA)

- The strategic asset allocation is 50% of the DFA fund invested in global equities, 40% in global bonds and 10% in NZ cash.

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<sup>3</sup> Source: Conservative view based on advice received from Seagar & Partners and Barratt-Boyes Jefferies Limited.

- Active management of the total portfolio is being undertaken to improve the probability of achieving ARH's objectives, while maintaining a total investment portfolio risk profile within risk tolerance parameters.
- The expected gross return over the ten years has been assumed at 9.7%<sup>4</sup> p.a.

#### NZ Short-Term Cash

- The 12-month gross return from ARH NZ short-term cash market investment assets for the financial year ending 30 June 2008 is 9.0%. ARH has assessed short term interest rates on its NZ short-term cash investments based on advice received from its fund managers. Long term, interest rates are assumed to return to a long run average of 6.2% p.a.<sup>5</sup>.

#### General

- All elements of the plan have been prepared on a nominal-value basis rather than in real-value terms.
- The plan's financial forecasts work from a base of the ARH 30 June 2008 actual financial results.
- Where debt borrowing has been forecast, for the purposes of funding distributions to the ARC, this debt is assumed to be repaid over a period of 20 years and has a long-term interest rate of 8.75% p.a.
- The convention adopted with respect to transaction recognition is 'cash accounting' rather than 'accrual accounting'. An example is the receipt of POAL dividends, which are recognised in the Income Statement at the time of distribution rather than at the time of announcement.
- Full consolidation of subsidiary financials has not been undertaken for the purposes of preparing the LTFP.
- ARH's current income tax exempt status means that, in general, no income tax is payable or receivable throughout the term of the plan. However, from 1 April 2007 ARH became a tax payer due to the Inland Revenue Department's (IRD) interpretation of ARH's interim port-related commercial undertaking (PRCU) assets. Under the IRD's interpretation, income tax is payable on rental income derived from investment property tenants whose main business is deemed to be a PRCU activity. This is at material variance with the intent of the Local Government (Auckland) Amendment Act 2004. ARH is working with the IRD to resolve this anomaly.
- Depending on the nature of the global equity and global bond investments in the diversified financial asset portfolio, ARH may pay tax in some overseas tax jurisdictions.

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<sup>4</sup> Mercer, ARH's appointed investment adviser, estimated in May 2008 that the likely expected gross average return over the period for the LTFP from a diversified financial investment portfolio with an indicative construction delivering market risk/return to achieve ARH's investment objectives and risk budget under passive management is 9.0% and under active management is 10.4%. For the purposes of this LTFP a mid point of the expected active and passive return of 9.7% has been assumed.

<sup>5</sup> Mercer's May 2008 estimate of the long run expected return on NZ Cash.

- The profile of distributions to the ARC in this LTFP reflects recently enacted Government legislation to enable additional funding for public transport capital projects to be obtained through a RFT of up to 5 cents per litre<sup>6</sup>.

## Expenses

- ARH considers that strong value management of the investment portfolio and robust risk management is a minimum statutory requirement. A 2008/2009 administration budget of \$2.6 million (GST inclusive), excluding investment management costs, is assumed. This equates to 0.19% of the total ARH investment portfolio, which is less than the ARH Board's adopted benchmark target that administration costs not exceed 0.25% p.a.
- For the remainder of the 10-year period of the LTFP, administration costs are assumed to increase at the rate of inflation.
- Direct-investment fund-management fees are forecast to be 65 basis points (0.65%) over the term of the Plan. As the ARH asset base increases in size and/or complexity, fund management fees will increase in dollar terms to reflect this.
- Waterfront investment property ongoing asset-management costs and specific development-related costs average \$4.2 million p.a. over the ten years of the LTFP. This level of expected expenditure reflects the complexity of the Wynyard precinct development.
- Lease management and leasing costs are included based on latest estimates from SCPL. ARH leases investment property from ACVL at market rates.
- Public infrastructure costs are initially capitalised to the waterfront investment property. Any costs capitalised which are not supported by an independent fair market valuation will be expensed to the income statement as part of the annual fair market value adjustment. For long-term planning purposes, appreciation of the waterfront investment property has been capped at 3.25%<sup>7</sup> p.a.
- Other investment-management costs relate to the delivery of forecast financial returns or the cost incurred to increase financial returns. In this regard, they are contingent upon investment strategy and particular investment activity.

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<sup>6</sup> Final timing and phasing yet to be determined.

<sup>7</sup> Source: Conservative estimate based on advice received from Seagar & Partners and Barratt-Boyes Jefferies Limited.

## Inflation

- The forecasts in this LTFP are presented in nominal terms. The assumed long-run inflation rate is 2.2% p.a. The NZ Government Treasury employs an inflation assumption of 2% (which is the mid-point of the Reserve Bank of New Zealand's price stability policy target for increases in the Consumer Price Index of between 1% and 3%) for its long-term financial modelling. However, Mercer<sup>8</sup> has found evidence, both historical and from current market readings, that long-term inflation expectations may be higher than 2%. The mid- to long-term assumption of 2.2% has been used by Mercer in its financial return assumptions and detailed modelling, and has been determined as appropriate for long-term investment return scenario-modelling.

### 3. Distribution Policies

#### a) General Policy

ARH interprets section 19(1) of the Act as meaning that it must manage its business to sustain its revenue-generating capacity to the ARC for the long term.

Therefore, ARH's general policy will be to distribute net income and surplus investment capital to meet short-term transport infrastructure funding needs after meeting its operating expenses and assuring the long-term revenue-generating capacity of its investment base.

This LTFP contains sufficient flexibility to assist with all reasonable immediate funding requirements of the ARC in so far as these are known at this time. It also enables ARH to meet its responsibilities and optimise the return on its investments over the longer term.

This distribution policy will help ensure that:

- i) Equivalent access to the income generated from ARH's investment base is available across the full term of this LTFP, and beyond to the longer-term financial planning and investment management horizons; and
- ii) ARH has funds available to respond to appropriate commercial opportunities as they arise.

ARH considers that sustained, long-term revenue generation is:

- i) in the long-term interests of the region;
- ii) consistent with prudent asset management;
- iii) in accordance with ARH's operating principles; and
- iv) best enables ARH to fulfill its roles and responsibilities under the Act.

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<sup>8</sup> Mercer, a wholly owned subsidiary of Marsh & McLennan Companies, Inc., is a global leader in HR and related financial advice, products and services. Mercer has more than 15,000 employees serving clients in over 180 cities and 41 countries and territories worldwide.

## **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 the policy may need to be varied to reflect changes in economic circumstances.

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

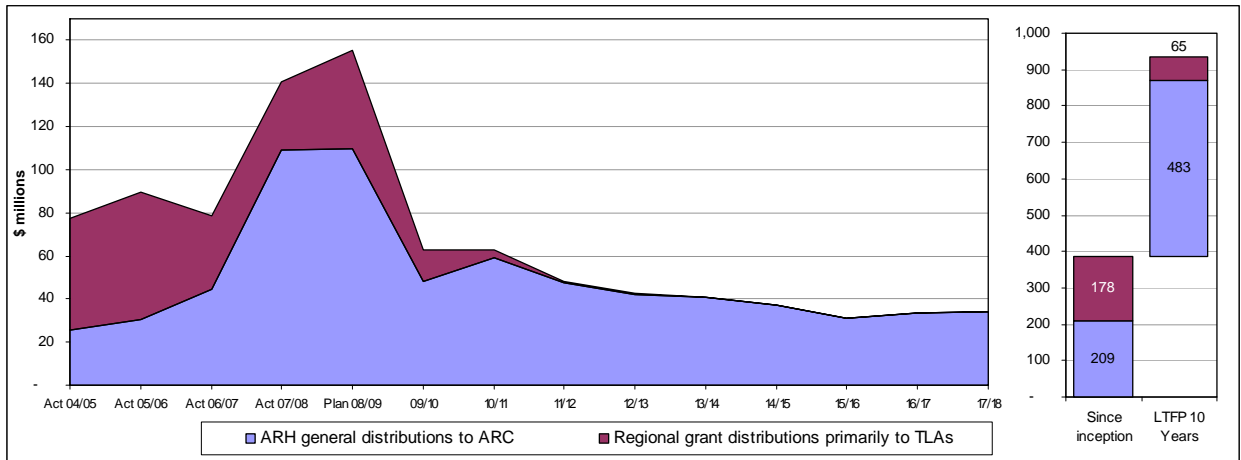
- i) ARH will reserve sufficient funds to meet the legacy IA transport and stormwater grant commitments (expected remaining grant commitments at the start of this plan, 1 July 2008, amount to \$65 million) and a general income distribution of up to \$110 million in the year to 30 June 2009, if called by the ARC
- ii) To facilitate the ARC's planning and budgeting process, ARH will endeavor to have available and distribute 100% of the planned distributions in the current LTFP for the first 12 months of the plan. This will occur 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;
- iii) If it is determined that distributions of capital are necessary to meet urgent short-term ARC funding demands then external funding may be employed to maintain the revenue-generating capacity of the investment base;
- iv) In the case of ii) and iii) 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
- v) In some years, the 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 i) relating to legacy IA transport and stormwater grants existing at 30 June 2004. Other than these commitments, ARH's distributions of income will not be linked to expenditure by the 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 has had regard to the ARC's 2008/2009 Annual Plan and 2006-2016 LTCCP Amendment. As required under the Act, ARH has considered the impact of the LTCCP draw-downs and has concluded, from information provided by the ARC, that this level and timing of ARH distributions can be accommodated when considered with other planning information and assumptions contained in this document. The ARH LTFP general distributions are consistent with draw-downs contained in the ARC's 2008/2009 Annual Plan. However, these may change depending on the outcome of the RFT process.

Figure 4 details the distributions as reflected in this LTFP and also the current forecast distribution profile for IA legacy grant commitments.

**Figure 4: ARH actual and planned distributions to the ARC**



This distribution profile may change if there are material changes in the economic circumstances.

#### 4. Investment Management Policies

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

- i) The need to maintain sufficient liquidity to meet ARH's distribution commitments with 100% confidence 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;
- iv) The objective of ARH to manage its investment portfolio to maximise ARH's long-run disbursements to the ARC; and
- v) The certainty that the POAL investment will continue to be a large proportion of ARH's total investment portfolio.

##### a) General Portfolio Investment Policy

- i) ARH will invest and manage its investment assets on a prudent and commercial basis consistent with sound business practice as applicable;
- ii) ARH will manage its investment portfolio to maximise ARH's long-term disbursements to the ARC;
- iii) Consistent with the above and as a long-term investor, ARH will maximise return-on-investment, both in cash return and through capital appreciation, over the longer term; and
- iv) ARH has a 30-year investment horizon. It will accept short and medium-term investment volatility in order to achieve superior investment returns over the long term.

## b) Investment Framework & Strategy

ARH has a defined investment framework comprising long-term investment objectives, a strategic risk budget, and fundamental investment principles. This investment framework provides the context in which ARH has developed its long-term investment strategy.

ARH has investments in the following four macro asset classes:

**Table 4: ARH Macro Asset Classes**

<b>Asset Class</b>	<b>Investment</b>
POAL – NZ Equity - Non-Listed	Ports of Auckland Limited (100% owned subsidiary company)
NZ Investment Property	Waterfront land, wharf and waterspace property holdings (Wynyard precinct, including ACVL's assets)
Diversified Financial Assets	50% Global Equities, 40% Global Bonds, 10% NZ Cash
NZ Short -Term Cash	Bank Deposits and Registered Certificates of Deposit (RCD)

### Specific investment objectives:

- i) To outperform the NZ Government Bond index by 1.5% pa, over ten-year rolling periods;
- ii) To maintain the real revenue-earning capabilities of total assets by outperforming inflation, as measured by the Consumer Price Index, by 5.5% pa over 20-year rolling periods;
- iii) For distributions, on a rolling ten-year basis:
  - Short Term, to pay to the ARC 100% of the planned distributions per the first three years of the LTFP, with a 95% probability of achievement,
  - Long Term, to pay to the ARC at least 90% of the planned distributions per years four to ten of the LTFP, with a 75% probability of achievement; and
- iv) To maintain the fund in a satisfactory financial condition, by not exceeding the debt servicing criteria for borrowings used to finance distributions:
  - Annual interest costs at no more than 40% of total expected earnings.

The associated risk management objective is:

- i) The strategic risk budget objective is 9%<sup>9</sup> p.a.  
(This relates to the risk tolerance for annual volatility of earnings within ARH's total investment portfolio).

### External Funding Facilities

ARH's overall investment strategy is dependent on realistic time horizons which require the capital base of the portfolio to be sustained while the investment plan is in operation. It is anticipated that from the year ended 30 June 2011 the profile of distributions to the ARC, as included in this LTFP will require ARH to borrow funds from external sources to preserve the corpus of its investment fund.

External funding may be required for purposes, including inter-generational equity management and purposes associated with investment portfolio management and holding structures, having regard to the statutory framework within which ARH must operate.

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<sup>9</sup> Currently under review.

ARH has determined its borrowing capacity in accordance with the debt servicing criteria embedded in its investment objectives. As a general principle, ARH's Board currently anticipates that approximately one-third of ARH's borrowing capacity may be used, if required, for funding planned distributions to the ARC and approximately two-thirds in the event of an adverse earnings year.

**c) NZ Investment Property Investment Policy**

The objectives in respect of the waterfront investment property are to:

- i) enable the creation of a world-class, mixed-use, urban waterfront redevelopment incorporating high-quality and accessible public spaces and high-quality private works;
- ii) give effect to the ARC's and Auckland City Council's Waterfront Vision 2040 statement of principles;
- iii) adhere to principles of sustainability, environmental, cultural and social responsibility;
- iv) while achieving i, ii, and iii, optimise the cash returns from the waterfront investment property and deliver long term value to stakeholders on a commercially-feasible and sustainable basis; and
- v) operate as a marketer of development sites and agent landlord rather than as a developer (other than by way of facilitating the public amenity and infrastructure works in relation to the site).

**d) Direct Equity Portfolio Investment Policy**

Given ARH's planned distribution profile, any significant direct-equity investment must have stable cash-yield expectations complemented with opportunities for substantial capital appreciation over the longer term.

**e) Diversified Financial Assets Investment Policy**

In 2007, ARH reallocated a significant portion of its short-term cash investments to the long-term DFA portfolio.

The DFA is a portfolio of liquid<sup>10</sup> financial assets. The DFA is instrumental in generating solid returns over the long term, while balancing the total portfolio from a diversification and risk management perspective.

Full details of the DFA policies are contained in ARH's Statement of Investment Standards, Policies, and Procedures for the DFA, which is available from ARH's website [www.arh.co.nz](http://www.arh.co.nz). Key policies are summarised below.

General policy

- Investment in the DFA shall be made in compliance with all laws and regulations applicable to ARH.
- The DFA investments will be managed with a view to ensuring that the DFA will have sufficient liquidity to meet expected cash flow requirements.
- Investment risk will be limited by appropriate diversification both within and between asset classes.

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<sup>10</sup> Liquid assets are marketable and are able to be turned into cash easily.

### Strategic asset allocation

- ARH has a strategic asset allocation policy that specifies the percentage of funds to be invested in each asset class within the DFA. The benchmark portfolio that the DFA returns will be monitored against over the long term is shown in Table 5.

**Table 5: Strategic asset allocation for the DFA**

<b>Asset Class</b>	<b>Strategic Allocation</b>
Global Equities (shares)	50%
Global Fixed Interest (bonds)	40%
New Zealand Cash	10%
<b>Total Portfolio</b>	<b>100%</b>
<b>Comprising:</b>	
Growth Assets	50%
Income Assets	50%
<b>Foreign Currency Exposure</b>	<b>25%</b>

Global Equities comprises separate allocations to large/mid capitalisation, small capitalisation and emerging markets equities. Global Fixed Interest comprises separate allocations to sovereign and non-sovereign debt (bonds).

- The exposures to the various asset classes will be monitored, taking into account the underlying exposures in any pooled investment vehicles and the impact of futures and options on an effective exposure basis.

### Foreign currency exposure

The Board's policy is to hedge 50% of global equities and 100% of global fixed interest back to New Zealand dollars. This will result in the DFA being 75% hedged (invested in New Zealand dollars), and 25% of the portfolio will be exposed to foreign currency. The foreign currency policy will be reviewed regularly and altered if appropriate.

### Investment Management Structure

- The DFA is managed by external specialist fund managers and ARH directly manages the relationships with those fund managers. The ARH benchmark portfolio allocation to fund managers as at 30 June 2008 is set out in Table 6.

**Table 6: ARH benchmark portfolio allocation to fund managers**

	<b>% DFA</b>
Newton Investment Management Limited (BNY Mellon)	20%
GMO Australian Limited	10%
AllianceBernstein New Zealand Limited	10%
AXA Rosenberg Investment Management Asia Pacific Limited	7.5%
Lazard Asset Management Pacific Co.	2.5%
<b>Global Equities (shares)</b>	<b>50%</b>
ING NZ Limited – Currency Overlay hedging 50% of global equities	
Goldman Sachs JB Were Managed Funds Limited	20%
BlackRock Investment Management (Australia) Limited	20%
<b>Global Fixed Interest (bonds)</b>	<b>40%</b>
ING NZ Limited	10%
<b>New Zealand Cash</b>	<b>10%</b>

### Risk management

- The risk budget for the DFA is consistent with ARH's overall long-term investment objectives.
- The quality of ARH's risk management procedures will be of best-practice standard.
- The Board will ensure that all fund managers adhere to specified investment-management guidelines and risk-management policies.
- The Directors are committed to implementing responsible investment to manage risk and to enhance the prospects of ARH achieving its investment objectives.

### Performance monitoring

- Manager performance will be monitored at least quarterly with an annual evaluation of rolling three-year results.
- Managers' roles will be reviewed by the Board on a regular basis. Factors taken into account in these reviews will include investment style, resources, organisational strength, investment performance relative to objectives, and any other factors considered relevant to the Managers' continuing ability to meet the applicable investment objectives.
- The Managers will report at least quarterly in accordance with a format agreed with the Board.
- Returns achieved by the appointed Managers will be assessed by the Board in relation to their stated objectives and the objectives of the DFA. Returns will also be compared with returns earned by an appropriate peer group.
- Performance for individual asset classes will be measured against appropriate indices.

## **5. Investment Activity Intentions**

ARH, as an investment manager, will always investigate and seek to take advantage of investment opportunities as and when they become available, as long as they are consistent with ARH's statutory mandate, investment and risk policies, and will assist the organisation in achieving its objectives.

Investment intentions will be reflected in the ARH LTFP from the point that there is a reasonable degree of certainty that the investment activity will be executed and the financial implications understood.

## **6. Treasury Management Policies**

ARH's treasury policy includes the following:

- i) Delegated account and signing authorities are maintained as appropriate under the responsibility and overview of the ARH Board and the Assurance and Risk Committee;
- ii) Working capital funds not held in the investment portfolios will be managed in accordance with sound business practice;
- iii) Regular projected cash flow schedules will be prepared so that surplus funds can be identified and transferred to the portfolios, following dividend or significant capital funds receipts;

- iv) Sufficient funds will be held in ARH's nominated Bank Call Account to cover short-term projected office expenditure payments and distributions to the ARC; and
- v) Funds not required to meet short-term cash flow will be transferred to the investment portfolios for investment.

## **7. Liability Management Policy**

ARH currently has no bank debt or other interest-bearing financial liabilities to third parties. The material liabilities entered into by ARH are the reserves held to meet legacy IA transport and stormwater grant commitments, the one-year distribution commitments made in the LTFP and remediation obligations associated with the Wynyard precinct.

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.

As stated in ARH's distribution policy in section 4. b) iii) above, where distributions are in excess of what would be recommended for sustained revenue generation over the long term, ARH will borrow against its investments to meet the additional distributions and also cover the consequential reduction in earnings. This LTFP assumes that external funding will be required for this purpose, with funds required to maintain the real revenue generating capacity of ARH's portfolio from the third year (2011) of the plan.

## **8. Summary ARH Financial Forecasts**

As at 30 June 2008, the ARH Balance Sheet reflected net assets (excluding IA legacy grant commitments) totaling \$1.348 billion consisting of POAL equity investment (non-listed) \$588 million, DFA \$299 million, NZ Short-term cash investments \$219 million and \$243 million in NZ Investment Property investments, the majority being property directly owned by ARH. The remaining legacy IA transport and stormwater grant commitments to the local councils totalled \$65 million. The 30 June 2008 Balance Sheet forms the base from which the forecast financial statements in this plan are based.

Table 7 below summarises ARH's 10-year forecasts based on the assumptions outlined earlier, specifically showing:

- 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 net assets over time.

The forecasts are shown in greater detail in the ARH entity financial statements provided in Appendix A.

**Table 7: Summary of ARH Financial Forecasts**

\$ million's	07/08	08/09	09/10	10/11	11/12	12/13	13/14	14/15	15/16	16/17	17/18	Total
	Forecast Yr	Plan Yr 1	Plan Yr 2	Plan Yr 3	Plan Yr 4	Plan Yr 5	Plan Yr 6	Plan Yr 7	Plan Yr 8	Plan Yr 9	Plan Yr 10	Plan
<b>ARH Investment Yield</b>												
<b>Gross Cash Yield</b>												
POAL Dividends	28	12	14	15	15	15	16	16	19	24	29	175
Other Dividends	1	1	1	1	1	1	1	1	1	1	-	7
NZ Investment Property Gross Yield	11	8	23	28	20	19	19	23	30	35	31	236
NZ Short-term Cash Investments Gross Yield	30	14	4	2	2	2	2	2	2	0	0	29
Diversified Financial Assets Gross Yield	(1)	28	31	31	31	32	33	33	34	37	42	331
<b>Total Gross Cash Yield</b>	<b>68</b>	<b>63</b>	<b>72</b>	<b>77</b>	<b>68</b>	<b>68</b>	<b>70</b>	<b>75</b>	<b>86</b>	<b>97</b>	<b>102</b>	<b>779</b>
<b>Capital Appreciation</b>												
POAL Capital Appreciation	(0)	36	38	38	41	44	47	51	51	50	49	445
NZ Investment Property Appreciation	2	(6)	(10)	(6)	(11)	(7)	(2)	0	(13)	(0)	7	(47)
<b>Total Capital Appreciation</b>	<b>2</b>	<b>30</b>	<b>28</b>	<b>32</b>	<b>30</b>	<b>37</b>	<b>45</b>	<b>51</b>	<b>38</b>	<b>50</b>	<b>56</b>	<b>398</b>
<b>Total Gross Yield</b>	<b>71</b>	<b>93</b>	<b>100</b>	<b>108</b>	<b>98</b>	<b>105</b>	<b>115</b>	<b>126</b>	<b>124</b>	<b>148</b>	<b>159</b>	<b>1,177</b>
<b>Admin &amp; Investment Management Costs</b>												
	(17)	(17)	(20)	(19)	(18)	(17)	(17)	(17)	(16)	(12)	(12)	(165)
<b>Net Pre-tax ARH Yield</b>	<b>54</b>	<b>76</b>	<b>80</b>	<b>89</b>	<b>79</b>	<b>85</b>	<b>95</b>	<b>105</b>	<b>104</b>	<b>132</b>	<b>143</b>	<b>988</b>
<b>Taxation</b>												
	(2)	(2)	(1)	(2)	(2)	(2)	(2)	(2)	(2)	(2)	(2)	(19)
<b>Net Post-tax ARH Yield</b>	<b>53</b>	<b>74</b>	<b>79</b>	<b>87</b>	<b>78</b>	<b>83</b>	<b>93</b>	<b>102</b>	<b>101</b>	<b>130</b>	<b>141</b>	<b>968</b>
<b>Distributions</b>												
Distributions for Legacy IA Grants <sup>(1)</sup>	(32)	(46)	(14)	(4)	(0)	(1)	-	-	-	-	-	(65)
General ARC Distributions	(109)	(110)	(48)	(59)	(48)	(42)	(41)	(37)	(31)	(34)	(34)	(483)
<b>Total Distributions</b>	<b>(141)</b>	<b>(155)</b>	<b>(63)</b>	<b>(63)</b>	<b>(48)</b>	<b>(42)</b>	<b>(41)</b>	<b>(37)</b>	<b>(31)</b>	<b>(34)</b>	<b>(34)</b>	<b>(548)</b>
<b>Value of Net Assets</b>												
POAL	587.8	624	661	699	740	784	831	881	933	983	1,033	
NZ Investment Property	242.6	243	247	250	253	258	260	264	274	281	288	
Diversified Financial Assets	298.8	327	357	358	365	373	382	392	400	436	486	
NZ Short-term Cash	219.1	74	17	4	5	4	5	5	5	4	5	
Less Legacy IA Grant Distributions	(65)	(19)	(5)	(1)	(1)	-	-	-	-	-	-	
<b>Total Net Investment Capital</b>	<b>1,283</b>	<b>1,248</b>	<b>1,279</b>	<b>1,307</b>	<b>1,337</b>	<b>1,378</b>	<b>1,430</b>	<b>1,495</b>	<b>1,565</b>	<b>1,662</b>	<b>1,768</b>	

\*1 A total of \$243 million of ARH's liquid funds were "reserved" in 2004 to meet the regional transport and stormwater grant commitments existing at 1 July 2004. Distribution commitments expected at 1 July 2008 are \$64.9 million.

The forecasts show:

- A total post-tax net ARH yield from all sources of \$968 million for the 10-year period of this LTFP. This compares with a total net ARH yield of \$898 million in the LTFP published in July 2007 (refer to Table 8 and accompanying commentary for explanation for the increase in expected yields);
- Planned ARH distributions over the 10-year period of this LTFP of \$548 million; and
- A \$485 million increase in the value of ARH's Net Assets over the period of this LTFP.

Table 8 below compares ARH's Net Yield in this updated plan with that shown in the 2007-2017 ARH LTFP published in June 2007.

**Table 8: ARH Net Yield**

	2007-2017 at Jun 07	2008-2018 at May 08	change
POAL Dividends	275	175	(100)
ACVL Dividends	7	7	(0)
NZ Investment Property Gross Yield	227	236	9
NZ Short-term Cash Investments Gross Yield	50	29	(21)
Diversified Financial Assets Gross Yield	314	331	17
<b>Total Gross Cash Yield</b>	<b>873</b>	<b>779</b>	<b>(95)</b>
POAL Capital Appreciation	279	446	167
NZ Investment Property Appreciation	(42)	(47)	(5)
<b>Total Capital Appreciation</b>	<b>237</b>	<b>399</b>	<b>162</b>
<b>Total Gross Yield</b>	<b>1,110</b>	<b>1,177</b>	<b>67</b>
Admin & Investment Management Costs	(127)	(165)	(38)
Funding Cost	(66)	(24)	42
<b>Net Pre tax ARH Yield</b>	<b>917</b>	<b>988</b>	<b>71</b>
Tax (PRCU)	(19)	(19)	(0)
<b>Net Post-tax ARH Yield</b>	<b>898</b>	<b>968</b>	<b>70</b>

The decrease shown in Table 8 for POAL dividends is explained in Section 2. "Key Planning Assumptions in this LTFP".

Investment property total yield has increased due to the project being one year advanced in the 2008-2018 LTFP compared to the 2007-2017 LTFP.

The 10 year NZ Short-term cash yield has decreased as the short-term cash investment fund has been drawn down to fund distributions.

The sale of public space to Auckland City and the ARC has been treated as a sale and leaseback transaction for accounting purposes. The increase in investment-management costs relates predominantly to lease rental expense on investment property public space areas (\$35 million) and notional imputed interest (\$8.5 million) on the remediation provision.

ARH's contribution to public infrastructure development costs, totalling \$111 million over the ten years of this LTFFP, are capitalised to the investment property asset and the fair value assessed by an independent property valuer at year end. Costs incurred not supported by the independent valuation are expensed to the Income Statement through the investment property fair value adjustment. The above table shows negative investment property appreciation of \$47 million which is due to the planned public infrastructure spend being greater than the expected investment property appreciation. Investment property appreciation has been capped at 3.25%<sup>11</sup> for financial forecasting purposes.

## 9. Key Risks

ARH will manage and mitigate both investment and organisation risk.

### Investment risk

- a) ARH continues to work closely with Mercer, leading international advisors in this area. With Mercer's assistance a strategic investment risk budget has been established. This risk budget provides a framework within which investment decisions can be made to meet ARH's returns objectives.
- b) The risk profile of ARH's entire investment portfolio is currently within its strategic risk budget. Therefore, ARH has capacity within its strategic risk budget to invest in asset classes that will generate higher returns while still maintaining an acceptable level of risk.
- c) To deliver long-term sustainable disbursements to the ARC, it is necessary for ARH to maintain an appropriate asset allocation across a range of asset classes which will ensure that return volatility is managed in a prudent manner.

### Organisation Risk

- ARH manages its organisation and operation risk through implementing best-practice, internal-control procedures, policies and guidelines, and through employing staff and advisors with appropriate skills and expertise. ARH will continue to assess and implement any necessary procedures to ensure it complies with best-practice governance standards.

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<sup>11</sup> Source: Conservative assessment based on advice received from Seagar & Partners and Barratt-Boyes Jefferies Limited.

## Appendix A: ARH Financial Statements

### Forecast Income Statement (Year ending 30 June)

Auckland Regional Holdings (parent)

(\$000's)

	07/08	08/09	09/10	10/11	11/12	12/13	13/14	14/15	15/16	16/17	17/18	Total
	Forecast Yr	Plan Yr 1	Plan Yr 2	Plan Yr 3	Plan Yr 4	Plan Yr 5	Plan Yr 6	Plan Yr 7	Plan Yr 8	Plan Yr 9	Plan Yr 10	10 years
<b>Revenues</b>												
POAL Dividends	22,764	12,248	13,505	15,066	15,002	15,319	15,874	15,912	19,079	24,189	29,200	175,394
POAL Dividends - Special	5,571	-	-	-	-	-	-	-	-	-	-	-
ACVL Dividend	585	729	768	768	768	768	768	768	768	768	-	6,876
NZ Short term Cash Investment Returns	28,609	12,548	3,100	624	236	236	236	236	236	236	236	17,922
Other Income	24	-	-	-	-	-	-	-	-	-	-	-
Investment Property Operating Receipts	10,619	8,282	22,629	28,126	19,552	18,716	19,430	23,117	30,008	34,740	31,381	235,980
ACVL Loan Interest Income	1,433	1,375	1,375	1,375	1,375	1,375	1,375	1,375	1,375	-	-	10,998
Diversified Financial Assets Total Yield	(1,230)	27,920	30,529	30,557	31,242	31,929	32,632	33,481	34,158	37,354	41,564	331,368
<b>Total Revenue</b>	<b>68,375</b>	<b>63,101</b>	<b>71,905</b>	<b>76,517</b>	<b>68,175</b>	<b>68,343</b>	<b>70,314</b>	<b>74,890</b>	<b>85,624</b>	<b>97,287</b>	<b>102,380</b>	<b>778,537</b>
<b>Investment Management Costs</b>	<b>(13,291)</b>	<b>(13,444)</b>	<b>(15,706)</b>	<b>(15,071)</b>	<b>(13,931)</b>	<b>(13,590)</b>	<b>(13,201)</b>	<b>(13,442)</b>	<b>(12,683)</b>	<b>(8,326)</b>	<b>(8,375)</b>	<b>(127,770)</b>
<b>Gross Margin</b>	<b>55,084</b>	<b>49,657</b>	<b>56,199</b>	<b>61,447</b>	<b>54,244</b>	<b>54,752</b>	<b>57,113</b>	<b>61,447</b>	<b>72,941</b>	<b>88,961</b>	<b>94,005</b>	<b>650,767</b>
<b>Overheads</b>												
Administration	(1,930)	(2,575)	(2,632)	(2,690)	(2,749)	(2,809)	(2,871)	(2,934)	(2,999)	(3,065)	(3,132)	(28,457)
Interest Costs	-	-	-	(162)	(1,302)	(2,951)	(3,870)	(4,079)	(3,998)	(3,909)	(3,813)	(24,085)
<b>Total Overheads</b>	<b>(1,930)</b>	<b>(2,575)</b>	<b>(2,632)</b>	<b>(2,852)</b>	<b>(4,051)</b>	<b>(5,761)</b>	<b>(6,741)</b>	<b>(7,014)</b>	<b>(6,997)</b>	<b>(6,974)</b>	<b>(6,945)</b>	<b>(52,542)</b>
Remediation Provision Imputed Interest Expense	(1,344)	(1,380)	(1,237)	(1,040)	(1,000)	(858)	(852)	(855)	(637)	(342)	(319)	(8,519)
Fair value adjustment Investment Property	2,379	(5,577)	(9,869)	(6,239)	(10,842)	(6,940)	(1,722)	359	(13,149)	(59)	6,989	(47,046)
Remediation and Investment Property Appreciation	1,035	(6,956)	(11,106)	(7,279)	(11,842)	(7,799)	(2,573)	(495)	(13,785)	(401)	6,671	(55,565)
<b>Net Surplus before Taxation</b>	<b>54,188</b>	<b>40,126</b>	<b>42,462</b>	<b>51,316</b>	<b>38,350</b>	<b>41,193</b>	<b>47,799</b>	<b>53,938</b>	<b>52,159</b>	<b>81,586</b>	<b>93,731</b>	<b>542,659</b>
Taxation	(1,528)	(1,780)	(1,214)	(1,825)	(1,753)	(1,804)	(1,858)	(2,121)	(2,236)	(2,302)	(2,474)	(19,367)
<b>Net Surplus after Taxation</b>	<b>52,660</b>	<b>38,346</b>	<b>41,248</b>	<b>49,492</b>	<b>36,597</b>	<b>39,389</b>	<b>45,941</b>	<b>51,817</b>	<b>49,923</b>	<b>79,284</b>	<b>91,257</b>	<b>523,292</b>
General ARC Distributions	(106,563)	(109,662)	(48,190)	(58,938)	(47,695)	(41,969)	(40,884)	(37,216)	(31,296)	(33,520)	(33,969)	(483,337)
<b>Net Surplus after Distributions</b>	<b>(53,903)</b>	<b>(71,316)</b>	<b>(6,943)</b>	<b>(9,446)</b>	<b>(11,098)</b>	<b>(2,579)</b>	<b>5,057</b>	<b>14,601</b>	<b>18,627</b>	<b>45,764</b>	<b>57,288</b>	<b>39,955</b>
POAL Share Equity Appreciation	(0)	35,956	37,645	37,846	40,938	43,896	46,853	50,562	51,440	50,446	49,471	445,053
Other Subsidiary Capital Appreciation	37	-	-	-	-	-	-	-	-	-	-	-
<b>Net Change in Accumulated Funds &amp; Reserves</b>	<b>(53,866)</b>	<b>(35,360)</b>	<b>30,702</b>	<b>28,399</b>	<b>29,840</b>	<b>41,317</b>	<b>51,910</b>	<b>65,163</b>	<b>70,067</b>	<b>96,210</b>	<b>106,758</b>	<b>485,008</b>

## Forecast Balance Sheet (as at 30 June)

### Auckland Regional Holdings (parent)

(\$000's)

	07/08	08/09	09/10	10/11	11/12	12/13	13/14	14/15	15/16	16/17	17/18
	Forecast Yr	Plan Yr 1	Plan Yr 2	Plan Yr 3	Plan Yr 4	Plan Yr 5	Plan Yr 6	Plan Yr 7	Plan Yr 8	Plan Yr 9	Plan Yr 10
<b>Assets</b>											
<i>Current Assets</i>											
Cash	3,897	2,000	2,000	2,000	2,000	2,000	2,000	2,000	2,000	2,000	2,000
NZ Short-term Cash Investments - current portion	117,518	25,685	12,571	-	-	-	-	-	-	-	-
Diversified Financial Assets - current portion	-	-	30,208	23,363	23,890	24,415	23,567	26,202	459	0	38,906
ACVL Loan Asset	15,107	15,107	15,107	15,107	15,107	15,107	15,107	15,107	15,107	15,107	15,107
Receivables & Prepayments	1,400	1,400	1,400	1,400	1,400	1,400	1,400	1,400	1,400	1,400	1,400
<b>Total Current Assets</b>	<b>137,922</b>	<b>44,192</b>	<b>61,286</b>	<b>41,870</b>	<b>42,396</b>	<b>42,922</b>	<b>42,074</b>	<b>44,709</b>	<b>18,966</b>	<b>18,507</b>	<b>57,412</b>
<i>Non Current Assets</i>											
Furniture, Fittings & Equipment	72	48	48	48	48	48	48	48	48	48	48
NZ Short-term Cash Investments - non-current portion	97,658	45,950	2,850	2,500	2,500	2,500	2,500	2,500	2,500	2,500	2,500
Diversified Financial Assets - non-current portion	298,757	326,677	326,999	334,193	341,545	349,059	358,123	365,403	399,102	436,456	446,729
ACVL Investment	21,285	21,285	21,285	21,285	21,285	21,285	21,285	21,285	21,285	21,285	21,285
SCPL Investment	288	288	288	288	288	288	288	288	288	288	288
POAL Investment	587,800	623,756	661,401	699,247	740,185	784,081	830,934	881,496	932,936	983,382	1,032,853
NZ Investment Property	184,986	190,885	196,975	203,264	209,757	216,460	223,382	230,529	237,908	245,527	253,393
Prepaid Property Rentals	38,203	32,657	27,656	23,190	18,968	15,105	11,241	7,377	4,696	4,104	3,513
<b>Total Non-Current Assets</b>	<b>1,229,049</b>	<b>1,241,545</b>	<b>1,237,501</b>	<b>1,284,014</b>	<b>1,334,576</b>	<b>1,388,826</b>	<b>1,447,802</b>	<b>1,508,926</b>	<b>1,598,763</b>	<b>1,693,591</b>	<b>1,760,608</b>
<b>Total Assets</b>	<b>1,366,971</b>	<b>1,285,737</b>	<b>1,298,787</b>	<b>1,325,885</b>	<b>1,376,972</b>	<b>1,431,748</b>	<b>1,489,876</b>	<b>1,553,635</b>	<b>1,617,729</b>	<b>1,712,097</b>	<b>1,818,021</b>
<b>Liabilities</b>											
<i>Current Liabilities</i>											
ACVL - Advance	2,100	2,100	2,100	2,100	2,100	2,100	2,100	2,100	2,100	2,100	2,100
Operating Creditors & Accruals	2,043	2,043	2,043	2,043	2,043	2,043	2,043	2,043	2,043	2,043	2,043
Lease income received in advance	229	76	0	-	-	-	-	-	-	-	-
Legacy Grant Commitments - current portion	45,595	14,442	4,043	337	521	-	-	-	-	-	-
<b>Total Current Liabilities</b>	<b>49,966</b>	<b>18,660</b>	<b>8,186</b>	<b>4,480</b>	<b>4,663</b>	<b>4,143</b>	<b>4,143</b>	<b>4,143</b>	<b>4,143</b>	<b>4,143</b>	<b>4,143</b>
<i>Non Current Liabilities</i>											
External Debt	-	-	-	3,703	26,066	41,392	47,064	46,177	45,208	44,151	42,997
Provision for Remediation	14,344	14,219	11,084	10,123	9,345	7,998	8,544	8,027	3,022	2,238	2,556
Legacy Grant Commitments - non-current portion	19,343	4,901	858	521	-	-	-	-	-	-	-
<b>Total Non Current Liabilities</b>	<b>33,688</b>	<b>19,120</b>	<b>11,942</b>	<b>14,346</b>	<b>35,411</b>	<b>49,390</b>	<b>55,608</b>	<b>54,204</b>	<b>48,231</b>	<b>46,389</b>	<b>45,554</b>
<b>Total Liabilities</b>	<b>83,654</b>	<b>37,781</b>	<b>20,128</b>	<b>18,826</b>	<b>40,074</b>	<b>53,533</b>	<b>59,750</b>	<b>58,347</b>	<b>52,373</b>	<b>50,531</b>	<b>49,696</b>
<b>Total Net Assets</b>	<b>1,283,317</b>	<b>1,247,957</b>	<b>1,278,659</b>	<b>1,307,059</b>	<b>1,336,899</b>	<b>1,378,215</b>	<b>1,430,125</b>	<b>1,495,289</b>	<b>1,565,356</b>	<b>1,661,566</b>	<b>1,768,324</b>
<b>Total Accumulated Funds &amp; Reserves</b>	<b>1,283,317</b>	<b>1,247,957</b>	<b>1,278,659</b>	<b>1,307,059</b>	<b>1,336,899</b>	<b>1,378,215</b>	<b>1,430,125</b>	<b>1,495,289</b>	<b>1,565,356</b>	<b>1,661,566</b>	<b>1,768,324</b>

## Forecast Cash flow Statement (Year ending 30 June)

Auckland Regional Holdings (parent)

(\$000's)

	07/08	08/09	09/10	10/11	11/12	12/13	13/14	14/15	15/16	16/17	17/18	Total
	Forecast Yr	Plan Yr 1	Plan Yr 2	Plan Yr 3	Plan Yr 4	Plan Yr 5	Plan Yr 6	Plan Yr 7	Plan Yr 8	Plan Yr 9	Plan Yr 10	10 Years
<b>Cashflow from Operating Activities</b>												
<i>Operating Income &amp; Expenses</i>												
POAL Dividends - Ordinary	22,764	12,248	13,505	15,066	15,002	15,319	15,874	15,912	19,079	24,189	29,200	175,394
ACVL Dividends	585	729	768	768	768	768	768	768	768	768	-	6,876
ACVL Lease Expense	(2,522)	(2,522)	(2,522)	(2,522)	(2,522)	(2,522)	(2,522)	(2,522)	(2,522)	-	-	(20,172)
ARH Investment Property Operating Revenues	10,408	8,129	22,553	28,126	19,552	18,716	19,430	23,117	30,008	34,740	31,381	235,751
ARH Investment Property Operating Expenses	(5,082)	(4,756)	(7,023)	(7,524)	(6,517)	(6,531)	(6,141)	(6,589)	(7,068)	(7,286)	(7,324)	(66,759)
ARH Investment Property Remediation Costs	-	(1,505)	(4,372)	(2,001)	(1,778)	(2,205)	(306)	(1,371)	(5,641)	(1,127)	-	(20,307)
ACVL Loan Interest Income	1,433	1,375	1,375	1,375	1,375	1,375	1,375	1,375	1,375	-	-	10,998
NZ Short-term Cash Investment Income	28,609	12,548	3,100	624	236	236	236	236	236	236	236	17,922
Diversified Financial Asset Investment Income	(1,230)	27,920	30,529	30,557	31,242	31,929	32,632	33,481	34,158	37,354	41,564	331,368
Other Income	24	-	-	-	-	-	-	-	-	-	-	-
Working Capital Change	(754)	-	-	-	-	-	-	-	-	-	-	-
Miscellaneous Operational Capex	(13)	(24)	(16)	(16)	(16)	(16)	(16)	(16)	(16)	(16)	(16)	(168)
Administration Payments	(1,882)	(2,527)	(2,616)	(2,674)	(2,733)	(2,793)	(2,855)	(2,918)	(2,983)	(3,049)	(3,116)	(28,265)
Investment Management Costs	(1,685)	(2,400)	(2,375)	(2,384)	(2,424)	(2,478)	(2,532)	(2,590)	(2,648)	(2,751)	(2,934)	(25,517)
<b>Net Operating Cash Flow</b>	<b>50,657</b>	<b>49,214</b>	<b>52,906</b>	<b>59,397</b>	<b>52,184</b>	<b>51,798</b>	<b>55,942</b>	<b>58,884</b>	<b>64,746</b>	<b>83,059</b>	<b>88,991</b>	<b>617,121</b>
<b>Cashflow from Investing Activities</b>												
Sale of Investment Property	83,300	-	-	-	-	-	-	-	-	-	-	-
Capitalised Management and Investigation Charges	(32)	-	-	-	-	-	-	-	-	-	-	-
Capitalised Property costs	(3,159)	(11,475)	(15,959)	(12,527)	(17,335)	(13,644)	(8,643)	(6,787)	(20,528)	(7,678)	(877)	(115,454)
ACVL repayment of capital	1,515	-	-	-	-	-	-	-	-	-	-	-
<b>Net Investing Cashflows</b>	<b>81,624</b>	<b>(11,475)</b>	<b>(15,959)</b>	<b>(12,527)</b>	<b>(17,335)</b>	<b>(13,644)</b>	<b>(8,643)</b>	<b>(6,787)</b>	<b>(20,528)</b>	<b>(7,678)</b>	<b>(877)</b>	<b>(115,454)</b>
<b>Cashflow from Financing &amp; Distribution Activities</b>												
External Debt	-	-	-	3,541	21,442	15,063	6,111	-	-	-	-	46,156
Repayment of Borrowings	-	-	-	162	921	263	(439)	(887)	(968)	(1,057)	(1,154)	(3,159)
Borrowing Interest Costs	-	-	-	(162)	(1,302)	(2,951)	(3,870)	(4,079)	(3,998)	(3,909)	(3,813)	(24,085)
<b>Net Financing Cashflow</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>3,541</b>	<b>21,061</b>	<b>12,375</b>	<b>1,802</b>	<b>(4,967)</b>	<b>(4,967)</b>	<b>(4,967)</b>	<b>(4,967)</b>	<b>18,912</b>
Legacy Grant Distributions	(32,161)	(45,595)	(14,442)	(4,043)	(337)	(521)	-	-	-	-	-	(64,938)
General ARC Distribution	(108,873)	(109,662)	(48,190)	(58,938)	(47,695)	(41,969)	(40,884)	(37,216)	(31,296)	(33,520)	(33,969)	(483,337)
<b>Total LTFP Distributions</b>	<b>(141,034)</b>	<b>(155,257)</b>	<b>(62,632)</b>	<b>(62,981)</b>	<b>(48,032)</b>	<b>(42,489)</b>	<b>(40,884)</b>	<b>(37,216)</b>	<b>(31,296)</b>	<b>(33,520)</b>	<b>(33,969)</b>	<b>(548,276)</b>
<b>Net Financing &amp; Distributions Cashflow</b>	<b>(141,034)</b>	<b>(155,257)</b>	<b>(62,632)</b>	<b>(59,440)</b>	<b>(26,971)</b>	<b>(30,114)</b>	<b>(39,082)</b>	<b>(42,182)</b>	<b>(36,262)</b>	<b>(38,486)</b>	<b>(38,936)</b>	<b>(529,363)</b>
<b>Net Cash Inflow / (Outflow)</b>	<b>(8,753)</b>	<b>(117,518)</b>	<b>(25,685)</b>	<b>(12,571)</b>	<b>7,878</b>	<b>8,040</b>	<b>8,216</b>	<b>9,914</b>	<b>7,956</b>	<b>36,895</b>	<b>49,178</b>	<b>(27,696)</b>

## Appendix B: Glossary

<b>ACVL</b>	Americas Cup Village Limited
<b>ARC</b>	Auckland Regional Council
<b>ARH</b>	Auckland Regional Holdings
<b>ARLTS</b>	Auckland Regional Land Transport Strategy
<b>ARTA</b>	Auckland Regional Transport Authority
<b>Auckland City</b>	Auckland City Council
<b>DFA</b>	Diversified Financial Assets
<b>IA</b>	Infrastructure Auckland
<b>IRD</b>	Inland Revenue Department
<b>LTCCP</b>	Long Term Council Community Plan 2006-2016
<b>LTFP</b>	Long-Term Funding Plan
<b>NDSL</b>	Northern Disposal Systems Limited
<b>POAL</b>	Ports of Auckland Limited
<b>PRCU</b>	Port Related Commercial Undertaking
<b>RCD</b>	Registered Certificates of Deposit
<b>RFT</b>	Regional Fuel Tax
<b>SCPL</b>	Sea+City Projects Limited
<b>The Act</b>	Government (Auckland) Amendment Act 2004