



Joint Report: Equity Ownership Options through the Provincial Growth Fund

Date:	27 April 2018	Report No:	T2018/464 3107 17/18
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Action Sought

	Action Sought	Deadline
Minister of Finance (Hon Grant Robertson)	Discuss this report with the Minister for Regional Economic Development. Agree to the recommendations.	02 May 2018
Minister for Regional Economic Development (Hon Shane Jones)	Discuss this report with the Minister of Finance. Agree to the recommendations.	02 May 2018

Contact for Telephone Discussion (if required)

Name	Position	Telephone	1st Contact
Sam Grayling	Senior Analyst – Business Growth & Innovation, the Treasury	Privacy of natural persons	✓
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John Doorbar	Director – Regional Economic Development Policy, Provincial Development Unit, Ministry of Business, Innovation and Employment		

Actions for the Minister's Office Staff (if required)

Return the signed report to agencies.

Enclosure: No

Joint Report: Equity Ownership Options through the Provincial Growth Fund

Purpose of Report

1. On 19 February 2018, Cabinet directed officials to “report back to Cabinet by 30 June 2018 on options for managing any equity shares the government takes in projects through the [Provincial Growth] Fund.”
2. This joint MBIE and Treasury report builds on the Treasury’s earlier advice on managing equity shares taken through the Provincial Growth Fund (PGF) – (T2018/188 refers), sets out two broad options for doing so, and highlights the key considerations for Ministers in choosing between them.
3. The information presented in this report informs Ministers on options for managing equity shares taken through the PGF. Ministers’ preferred approach to managing these equity shares will be incorporated into a paper for the Minister of Regional Economic Development to take to Cabinet in June.

Background

4. In funding projects through the PGF, Ministers will need to consider which arrangements best meet their objectives. This will involve choosing between types of funding, including grants, loans, and equity (T2018/23 / MBIE 1744 17-18 refers).
5. Officials will provide further advice on principles for Ministers to choose between various funding mechanisms as part of advice on the PGF Investment Strategy. Officials consider that funding via equity should only be considered for investments that are expected to generate a commercial rate of return.
6. This report provides advice only on how the government can manage any equity shares, once it has been agreed that a project will be funded through equity shares.
7. Management of equity shares will be discussed at the PGF Ministers meeting on the 02 May 2018.

Ownership options

8. When possible, we recommend using appropriate existing vehicles to manage shares taken in PGF projects (e.g. the New Zealand Transport Authority for roading projects). We expect these to be most common for Transport and Infrastructure investments in Tier 3.
9. For remaining projects we consider there are two broad options the government could use to take equity shares in any project companies funded through the PGF:

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- a. Departmental management – Ministers directly own shares which are administered through a department – eg, MBIE’s New Zealand Provincial Development Unit (PDU), and
 - b. Special purpose holding entity – using a holding company that could take shares in companies and manage those shareholdings.
10. To decide between these options, Ministers may wish to consider their impact on the following dimensions:
- a. Ministerial influence – the extent to which Ministers can influence investment decisions and ongoing investment management.
 - b. Incentives on private investment – equity ownership structures may have a signalling impact (positive and negative) on how private investors perceive the fund.
 - c. Timeframes and costs – how long it takes to establish and the costs incurred in doing so.
 - d. Duration – both management options will hold shares following the expiry of the fund and are likely to require ongoing operational funding.
11. A more detailed description of each equity management option and an assessment against these dimensions is provided in Annex 1 and 2. There are two main considerations which are set out below.

Departmental management of equity holdings provides Ministers greater influence

12. Departmental management of equity shares allows Ministers to directly influence which investments are made, when the government should exit projects, and make board appointment decisions where relevant.
13. When a holding company is used, Ministers have less direct influence over how and which equity investments are made by the holding company. Ministerial influence can, however, be strengthened by funding agreements, the entity’s constitution, and its statement of intent. This could allow Ministers to specify which equity investments are to be made by the holding company, but limits influence on the ongoing day-to-day management of those shareholdings.
14. Where equity shares are managed through a holding entity, Ministers will be able to make board appointments for the holding company, but not the project companies invested in through the PGF as these shares would be owned and managed by the holding company.

A holding company has greater start-up costs, but can provide efficiencies with scale

15. Setting up a functional holding entity is expected to take at least three months and will incur establishment costs, while departmental management can be done within an agency’s existing structure.
16. There may be administrative efficiencies from owning and managing equity shares through a holding company. However, there is a risk that a holding company is established and its Board of Directors initially have few or no

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investments to manage. Salaries, administrative costs, and directors' fees will still need to be paid.

17. Currently uncertainties exist regarding:
 - a. The number of equity investments being taken through the PGF
 - b. The size and complexity of these investments, and
 - c. The performance of departments in managing the equity shares.
18. Therefore officials recommend using departmental management for any initial equity shares taken through the PGF, with a view to transitioning these to a holding entity when sufficient investment has been made to justify the operating costs of the holding entity.
19. If Ministers agree to initially administer equity shares through departmental management, MBIE will provide advice in 12 months, or sooner if appropriate, on upcoming investments decisions. This advice will include the size, number, and complexity of equity shares which have been, or are expected to be, taken through the PGF, and whether this is an appropriate time to establish a holding company.

Temasek Holdings Investment Model

20. Temasek Holdings is a Singapore company which was incorporated to own and commercially manage investments previously held by the Singaporean government. It has its own board of directors and makes its own investment, divestment and operational decisions.
21. Aspects of the Temasek model could be applied to assist officials to provide advice on when it may be appropriate for the PGF to invest in equity, and, if required, how any such equity may be held through a holding company structure.

Next Steps

22. Following feedback from Ministers on their preferences for equity management, officials will incorporate information from this report into the Minister for Regional Economic Development's June 2018 Cabinet paper.
23. Officials are currently developing advice on the broader PGF Investment Strategy, which will inform the majority of the June 2018 Cabinet paper. This advice is expected to be provided to Ministers in early May. An overview of the PGF Investment Strategy will be discussed with the RED Ministers group on the 02 May 2018.
24. Officials can provide further advice on equity management options, after receiving feedback from Ministers on a preferred ownership direction.

Recommended Action

We recommend that you:

- a **Note** officials are developing advice on principles for funding instruments for the Provincial Growth Fund (PGF). These principles can support Ministerial decisions on the appropriate type of investment (grants, loans or equity) for projects funded through the PGF. These principles will be integrated into advice on the PGF's Investment Statement.
- b **Note** options for holding and managing the Crown's equity shares acquired through the PGF focus on:
 - a. direct shareholdings by Ministers which are managed by a department, and
 - b. creating a Crown entity holding company to hold and manage the shares.
- c **Note** deferring the establishment of a Crown entity holding company until a number of equity investments have been made, will provide clarity on the scale of investments the company holds and manages, and appropriate directorship.
- d **Agree** that Ministers initially hold any shares taken through the PGF and those shares are managed by a department.

Agree/disagree.
Minister of Finance

Agree/disagree.
Minister of Regional Economic Development

- e **Direct** MBIE to incorporate this shareholding proposal in a Cabinet paper for Minister Jones to lodge in June.

Agree/disagree.
Minister of Finance

Agree/disagree.
Minister of Regional Economic Development

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- f **Agree** officials will report back in twelve months, or sooner if appropriate, on whether the creation of a Crown entity company to hold and manage shares is justified. This report will be based on the size, number, and complexity of equity shares which have been, or expect to be, taken through the PGF.

Agree/disagree.
Minister of Finance

Agree/disagree.
Minister of Regional Economic Development

Privacy of natural persons

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Privacy of natural persons

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Hon Grant Robertson
Minister of Finance

Hon Shane Jones
Minister for Regional Economic Development

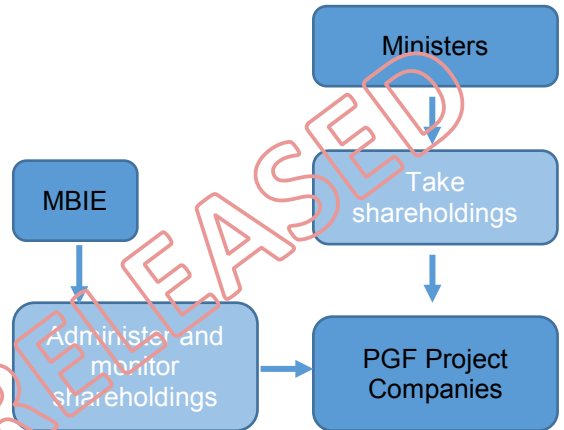
Annex 1 – equity share management structures

Annex 1 describes the structure and reporting arrangements of the two options for managing equity shares.

Departmental Management

Under this option, the Minister of Finance and the Minister of Regional Economic Development would directly hold shares in any project companies which receive equity funding through the PGF. The PDU or appropriate department would administer and operate these shareholdings on behalf of Ministers.

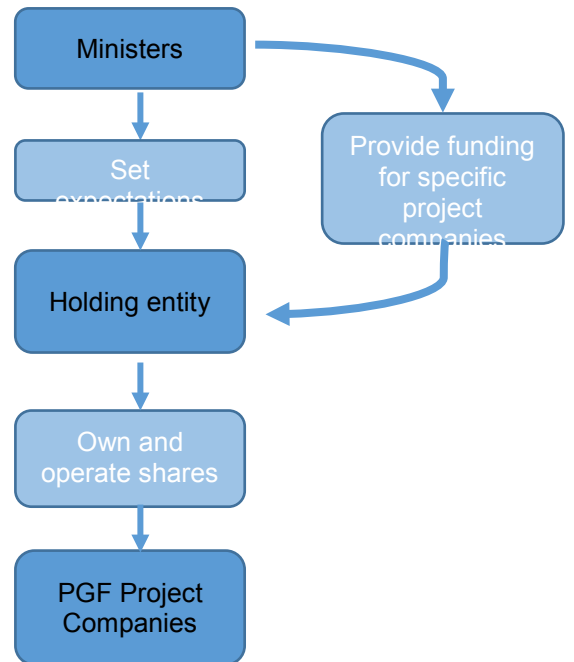
To ensure appropriate reporting and accountability frameworks are in place, we would recommend any majority shareholdings in project companies are established as schedule 4A companies under the Public Finance Act.



Holding Entity

A holding entity would be set up as a Crown owned company to hold and manage shares in any projects companies. We have assumed that the appropriate form of a holding entity would be a company, rather than a statutory entity, as it would have a commercial objective and this would avoid the need to pass legislation to establish the entity, which is a time consuming process

On the basis that the Crown would always intend to hold 100% of the shares in any holding company we would recommend that the entity be established as a Crown entity company under the Crown Entities Act and subject to the reporting and accountability frameworks in that Act. Unlike PFA Schedule 4A companies, Crown entity companies must always be wholly owned by the Crown.



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Annex 2 – Comparison of managerial structure by dimension

Annex 2 assesses how each of the two options compare against the four criteria of Ministerial influence, incentives on private investment, timeframes and costs, and duration. Assessments show relative strength between the ownership structures, with neutral indicating neither structure clearly performs better.

	Departmental Management	Holding Entity
Ministerial influence	<p>High</p> <p>Ministers would make final decisions on investing in shares and would retain a high degree of control over how those investments are made. Ministers would also have a high degree of control over how and when to divest those shares in cases where Ministers believe the government no longer needs to provide the same level of support to the company and the project.</p> <p>If Ministers take a majority shareholding in a project company we would recommend that the company be added to Schedule 4A of the PFA, meaning that the company will have certain reporting and accountability obligations under the PFA and Crown Entities Act, such as producing a statement of intent. While MBIE will administer the shareholdings and monitor the companies' compliance with the relevant obligations, the demand on Ministerial time to engage in these investments will increase as the number of majority owned shareholdings increases.</p> <p>As direct shareholders in project companies, Ministers will have the right to vote on director appointments for the project companies. However, as shareholders, Ministers will not have power to direct the company in relation to day to day operational matters, which will remain the responsibility of the board of the company.</p>	<p>Low</p> <p>Under this scenario final decisions on investing in shares in a project company would be transferred to the holding company. However, Ministers can potentially exercise some influence over the holding company's decisions to invest in shares in project companies through funding agreements, the holding company's constitution, statement of intent (including consultation requirements), letters of expectation and director appointments. This may include:</p> <ul style="list-style-type: none"> • providing in the constitution of the holding company that its purpose and objectives are to invest in project companies that have been approved by Ministers and where funding is provided from the PGF for that purpose; and • the use of funding agreements between Ministers and the holding company to ensure funds provided to the company for investment in project companies are only used for specified purposes. <p>As the holding company, rather than Ministers, would hold shares in the project companies, Ministers would have less influence over how that shareholding is administered including any decisions on how and when to divest those shares. For example, decisions on appointing directors to the project companies would be made by the holding company (as the shareholder) rather than Ministers. There is a risk that from time to time the views of the directors of the holding company and Ministers on the administration of the shares in the project companies will not be fully aligned.</p>
Incentives on private investment	<p>Neutral</p> <p>The capability of those tasked with administering and monitoring the equity investments is likely to have a greater impact on investment performance than the structure of how those investments are held (i.e. directly by Ministers or through a holding entity).</p> <p>Signalling impacts may influence private investors, however it is unclear how, and by how much. While companies may be perceived as being more influenced political considerations, private investors may also consider shares directly held by Ministers to have more commitment from the government.</p>	<p>Neutral</p> <p>The capability of those tasked with administering and monitoring the equity investments is likely to have a greater impact on investment performance than the structure of how those investments are held (i.e. directly by Ministers or through a holding entity).</p> <p>Similar to direct shareholdings, it is unclear how and how much private investors will be influenced by the holding structure.</p>
Timeframes and costs	<p>High – Immediate, costs variable based on project needs</p> <p>Direct Ministerial shareholdings administered by a Department can be implemented immediately, with MBIE's Provincial Development Unit able to take on administrative and monitoring tasks as soon as any equity shares are taken. New costs are likely to be limited to contracting new staff to provide additional capability to administer and monitor the shareholdings.</p>	<p>Low – At least 3 months. Costs higher and variable based on project needs.</p> <p>Setting up a functional holding entity is expected to take at least three months and will incur establishment costs including:</p> <ul style="list-style-type: none"> • Designing the company's constitution and statement of intent, • Incorporating the company under the Companies Act • identifying and appointing a board of directors, • Providing sufficient operating capital to the company to cover director fees, contract staff, procure premises, and provide back office support systems, and • Company monitoring costs. <p>While the holding company will incur additional costs, it is possible that there will be administrative efficiencies which outweigh these costs once a sufficient amount of equity investments have been made over time.</p> <p>A holding company could be set up immediately, or it could be set up after a sufficient number of equity shares have been acquired by Ministers through the PGF to generate economies of scale that justify the establishment of a holding vehicle.</p>
Duration	<p>Neutral – Ongoing past 3 years of PGF commitment</p> <p>Investments made through the PGF will continue to be held following the expiry of the three year term of the fund, with ongoing funding likely to be required.</p>	<p>Ongoing past 3 years of PGF commitment</p> <p>Investments made through the PGF will continue to be held following the expiry of the three year term of the fund, with ongoing funding likely to be required.</p>