



AIDE MEMOIRE

Further information on establishing PGF Ltd

Date:	5 November 2018	Priority:	Medium
Security classification:	In Confidence	Tracking number:	1618 18-19

Information for Minister(s)
Hon Grant Robertson Minister of Finance
Hon Shane Jones Minister for Regional Economic Development

Contact for telephone discussion (if required)			
Name	Position	Telephone	1st contact
Isabel Poulson	Manager, Strategy and Policy	<small>Privacy of natural persons</small>	✓
Andrew Beaufort	Senior Policy Advisor		

The following departments/agencies have been consulted
The Treasury

Minister's office to complete:

- | | |
|---|--|
| <input type="checkbox"/> Approved | <input type="checkbox"/> Declined |
| <input type="checkbox"/> Noted | <input type="checkbox"/> Needs change |
| <input type="checkbox"/> Seen | <input type="checkbox"/> Overtaken by Events |
| <input type="checkbox"/> See Minister's Notes | <input type="checkbox"/> Withdrawn |

Comments

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Purpose

This aide memoire provides additional information regarding the establishment of Provincial Growth Fund Limited (PGF Ltd). Specifically, it answers the following questions asked by the Minister Jones' office:

- What are the skillsets required to be appointed to the PGF Ltd Board including what role Independent Advisory Panel (IAP) members could have?
- How long Option one would be expected to function before the transition to Option two is complete?
- What mechanism would be used to transition from Option one to Option two, including timeframes?

Isabel Poulson
Manager, Strategy and Policy
 Provincial Development Unit, MBIE

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Background

1. On 16 October 2018, Treasury and PDU officials provided advice on the establishment of Provincial Growth Fund Ltd (PGF Ltd), a company in which the Minister for Regional Economic Development and the Minister of Finance would be Shareholding Ministers (1379 18-19 refers).
2. We considered two options for the mandate and operating activities of the company:
 - a. Option one – a nominee company that holds investments but has no role in providing advice or management for those investments (these activities would be undertaken by the PDU under a management contract), or
 - b. Option two – an operational commercial entity that advises, monitors, and manages commercial investments which are ultimately approved by Ministers under the PGF. The Independent Advisory Panel (IAP) would continue its current role in providing independent advice to Regional Economic Development (RED) Ministers and Cabinet. The decision-making responsibilities of the Senior Regional Officials (SROs), RED Ministers and Cabinet would remain unchanged. However, Ministers would have less oversight over proposals coming into PGF Ltd – only seeing recommended commercial projects that PGF Ltd puts forward for funding.
3. In the advice to Ministers, officials outlined that the choice between the options needed to be made within the context of the potential nature, size, and complexity of the pipeline of commercial investments that might be held by the company.
4. The Treasury's estimate is that a portfolio of at least \$150 million is required for Option two. The Investment Team within the PDU has estimated that 15-25 quasi-commercial deals (i.e. not grants) of a magnitude greater than \$10 million may occur over the three year lifetime of the PGF but noted that the timing, size and complexity of deals is highly uncertain.
5. Given the significant uncertainty around this forecast, officials' recommended option one, a nominee holding company, with the ability to scale it into option two as needed, and officials will report back quarterly on the portfolio and pipeline of Commercial Investments.

PGF Ltd Board

6. You have asked what the skillsets required for the PGF Ltd Board are and what role Independent Advisory Panel (IAP) members could have under each option.

Different expertise is required for each option

7. Under either option, PGF Ltd's directors are required to act in the best interests of the company as per the Companies Act 1993. Similarly, under either option, directors will have responsibility for administering PGF Ltd in accordance with relevant legislation, including the Companies Act and Crown Entities Act. In addition, the approach to appointing directors and the time to appoint directors is the same under each option.

Option one

8. Under Option one, PGF Ltd would be responsible for administering a management contract between PGF Ltd and the PDU for PGF Ltd to act as nominee in respect of certain investments. Option one is likely to require a board of between one to three directors. Their skill set would need to be centred on good administrative skills, governance and public-sector experience.

Option two

9. Under Option two, PGF Ltd would make decisions about recommending investments to Ministers and then, if that recommendation is accepted, make those investments and actively manage them, applying commercial disciplines. Option two is likely to require a larger board of directors, with, for example, experience and skills relating to investment analysis and commercial disciplines.

IAP members becoming PGF Ltd directors

Option one

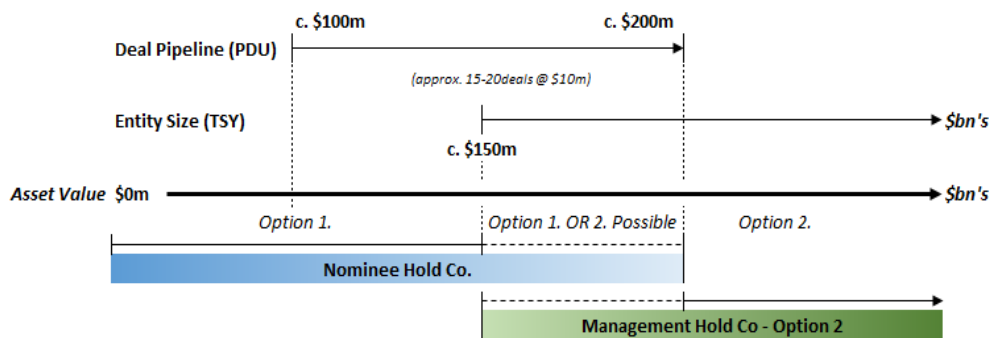
10. Under Option one, as a nominee company accepting any investment which meets the criteria under the management contract with the PDU, PGF Ltd will have no role in initiating investments. Thus, arguably the role of the IAP members is not in conflict with the role of a PGF Ltd director.
11. However, IAP members recommending an investment to Ministers which then had to be managed by PGF Ltd directors could create a tension between acting in the best interests of PGF Ltd (as required by the Companies Act) and in the best interests of the PDU (as required by the IAP's terms of reference). Community of directors could expose PGF Ltd and the PDU to risks of bias or challenge which are easily avoided by not having that community.

Option two

12. Under Option two, PGF Ltd would have a greater role in initiating and recommending investments. If members of the IAP were also directors of PGF Ltd, they would not be able to give advice on those recommendations to the PGF Ltd and Ministers, as there would be a direct conflict of interest between the two roles.

Transitioning from Option one to Option two

13. You have asked how long Option one would be expected to function before the transition to Option two is complete.
14. The pipeline for PGF Ltd is focused on Tier Two (Sector Investments) investments that have the expectation of interest/dividend and/or principal repayment and a fair value of greater than 50 per cent (Commercial Investments).
15. A Cabinet decision has been made that Tier Three (Enabling Infrastructure) investments be managed by the relevant department and Tier One (Regional Projects and Capability) investments are almost exclusively expected to be grants – and therefore, not relevant to the Company.
16. As illustrated below, the Treasury's estimate is that a portfolio of at least \$150 million in Commercial Investments is required for Option two based on similar Crown entities.



17. The PGF has been in operation for nine months. To date, only one loan has been completed by the Investment Team – a \$10 million concessionary loan to Ruapehu Alpine Lifts (RAL) that has a fair value of approximately \$5 million.

18. The pipeline for Commercial Investments is composed of two parts:

- a. **The immediate pipeline of Commercial Investments** – As illustrated by the table below, in addition to RAL, to date there are approximately 10 proposals that have been agreed, or are, under active consideration totalling \$61 million – although the fair value of these proposals is not known and is expected to be materially lower than \$61 million.

No.	Entity	Sector	Location	Debt (\$m)	Equity (\$m)	Total (\$m)	Fair Value (\$m)
1	Punakaiki Spa Complex	Tourism	West Coast	3.3	-	3.3	Not known
2	Garnet Westland	Mining	West Coast	10.0	-	10.0	Not known
3	LeaderBrand	Horticulture	East Coast	15.0	-	15.0	Not known
4	Opuke Thermal Pools	Tourism	Canterbury	5.5	-	5.5	Not known
5	Woodspan PLT Panels	Sawmilling	Taranaki	2.3	-	2.3	Not known
6	Westland Dairy	Agriculture	West Coast	9.9	-	9.9	Not known
7	Gisborne Airport	Aviation	East Coast	5.5	-	5.5	Not known
8	Manfield National Driver Training Centre	Transport	Manawatū-Whanganui	2.25	-	2.25	Not known
9	Oceania Marine 550T Travel Lift	Marine engineering	Northland	4.84	-	4.84	Not known
10	Whakarewarewa Forest Park	Tourism	Bay of Plenty	2.5	-	2.5	
	Total			61.09	-	61.09	Not known

- b. **The longer term pipeline of Commercial Investments** – Over 600 PGF proposals have been received by the PDU. Until commercial investment proposals have been reviewed by the IAP and decisions made by Ministers, the certainty that an investment will proceed is hard to assess.

19. The Investment Team's view of 15-25 quasi-commercial deals (i.e. not grants) of a magnitude greater than \$10 million (a portfolio of \$150 to \$250 million) is now supported by 11 deals (including RAL) and approximately \$71.9 million either completed, or under consideration. However the ultimate size of the portfolio of Commercial Investments is unknown.

20. Reaching \$150 million of Commercial Investments is not certain and the timeframe for achieving that threshold is not known. This position may change as we get clarity on upcoming deals over the coming months, therefore, PDU Officials will report back to Ministers quarterly on the portfolio and pipeline of Commercial Investments.

Mechanisms for transitioning from Option one to Option two

21. If Ministers' desired outcome is Option two, an operational commercial entity, there are two options. Either:
- a. Start with an Option one entity, and transition from Option one to Option two. That would be up to a 6 month process. A new, or increased, board of directors (four to six months) would need to be appointed, that board would need to "operationalise" the company including changing the constitution, taking premises, employing staff etc. (three to six months) and funding requirements to operationalise the entity would need to be worked through.
 - b. Start with an Option two entity, set up in a lean fashion (e.g. full Board, contracted staff). This would allow the capability and capacity of the entity to grow with the level of Commercial Investments– and lower the transition costs. This option would be a similar cost to set up as Option one, however the ongoing operational costs will be higher than Option one.

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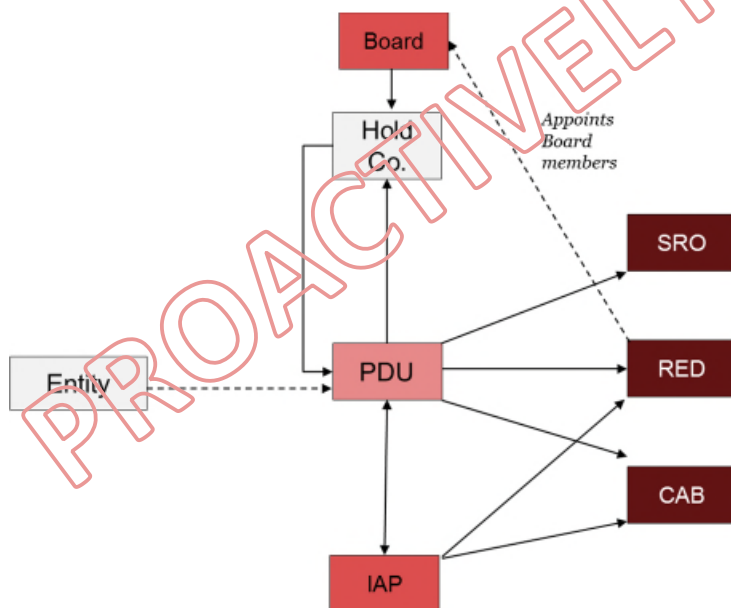
Appendix 1: Options recap

Option one

Option one – Nominee Company PGF Ltd

Under option one, PGF Ltd (Hold Co in the diagram below) is established as a nominee company – its role is to hold legal title to the loan or investment assets and to administer funding for the projects. PGF Ltd would have no operational role in analysing or providing advice on project applications, or for managing investments (after Ministerial decisions have been made). As the Crown would remain beneficial owner of the loan or investment assets all gains and any losses on the investments would continue to be for its account.

PGF Ltd would have a Board (likely comprising of 1 to 3 directors) who would perform a largely administrative role. A management contract between PGF Ltd and the PDU would transfer the operational responsibilities associated with analysing and providing advice on project applications, and managing and exiting investments, to the PDU. The PDU would maintain its status quo operational role applying PGF criteria and commercial disciplines to analyse and provide advice on applications. However, PGF Ltd is the vehicle funding goes through, and the vehicle that holds the investments.



The IAP would continue its current role in providing independent advice to RED Ministers and Cabinet. The decision-making responsibilities of the SRO, RED Ministers and Cabinet would remain unchanged. However, Ministers would have a responsibility to appoint members to PGF Ltd's Board.

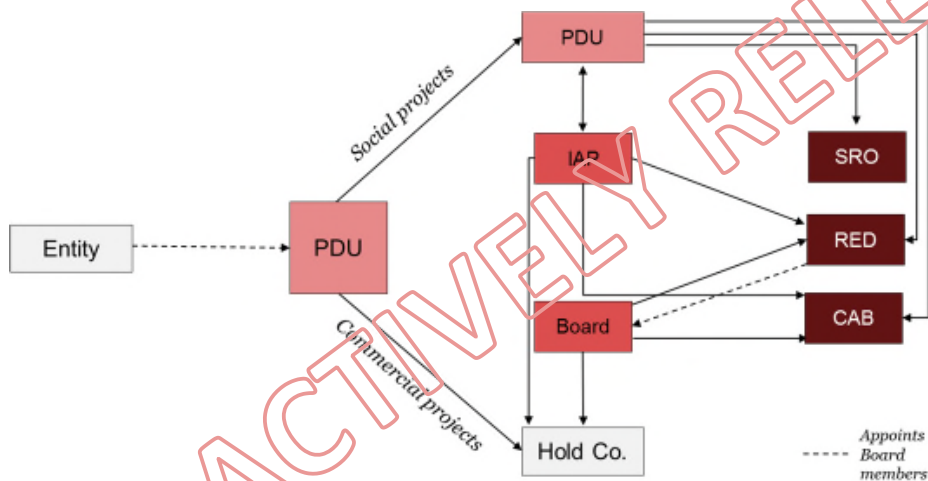
Option two

Under Option two, PGF Ltd (Hold Co in the diagram below) is established as an independent, commercially focused entity with an operational role. This structure requires the PDU to make an initial classification about whether a project application is likely to lead to a Commercial Investment.

PDU would retain its current role undertaking analysis and providing advice to SROs, RED Ministers and/or Cabinet (depending on the size of the application) for all non-Commercial Investments.

If a project is deemed to be a Commercial Investment it would be sent to PGF Ltd. Under this option PGF Ltd is an operational entity resourced with personnel who have commercial skill sets operating in an entity with a tightly focused mandate, policies and procedures. PGF Ltd would apply commercial disciplines to analyse, to provide advice on applications, and to recommend funding for projects. Once funding was approved by Ministers (subject to such conditions they may wish to impose) the loan or other investment asset would be held on the books of PGF Ltd, with all gains and any losses being for the account of PGF Ltd.

PGF Ltd would also be responsible for the on-going management of the investments (after decisions are made). Advice on proposals would be provided, through its Board, to RED Ministers and/or Cabinet (depending on the size of the project).



RED Ministers would still make funding decisions on projects between \$1m and less than \$20m, and Cabinet would still make funding decisions on projects over \$20m. However, under option two RED Ministers and Cabinet would only make decisions on the recommended commercial projects that PGF Ltd puts forward for final funding approval following a detailed business case. Currently RED Ministers see all applications that fit the evaluation criteria of the Fund (without rank or prioritisation). This change reflects that PGF Ltd is an independent entity, at arm's length from Ministers, and that it is best placed to undertake the analysis and provide recommendations to Ministers who ultimately agree to provide the necessary funding. While the directors of the company would be formally responsible for the loan and other investments the company takes on, Ministers would continue to exercise considerable influence by determining whether or not a loan or other investment proposal should be funded, and if so, on what conditions.

The decision-making responsibility for SROs would change; SROs would only have decision authority over social projects under \$1m (rather than all projects under \$1m). SROs' substantive role would not change. They would remain as the champions of their regions and the central government point of contact for their region. The IAP's role would remain unchanged as it would provide advice to Ministers independent of the recommendations of the company board. The IAP would receive information from the company on proposals but would not advise the Board or need to share its advice with the company.

As under option one, Ministers would also be responsible for appointing members to PGF Ltd's Board. However unlike option one, PGF Ltd is an operational commercial entity and therefore the

skill set and composition of the Board is important for ensuring PGF Ltd is effective in its role. As an operational entity it would be easier to attract highly-skilled potential board members.

Once an investment has been made, PGF Ltd would be responsible for monitoring and administering the investment, including decisions such as enforcing its commercial rights when investments perform poorly.

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