Investment Fund

The prime reason for part (a) of the recommendation is to preserve a substantial portion of the capital for future generations. It is envisaged that a separate professionally managed fund, with its own governance procedures, be established, to invest in a balanced portfolio of securities. A portion of the annual returns would be added to the capital each year and reinvested to protect the fund against inflation. The balance of the returns would be available for the purposes of the fund as outlined in this report.

While the fund would be separate from the Council's normal operations, the Council would have legal ownership and control of the fund and the annual allocation of the net income would be part of the ordinary annual plan consultation process each year. As the current Council cannot legally bind future councils, the following measures are proposed to deter a future council from spending the capital of the fund without proper consideration of the undertaking being made to the public as part of this consultation:

(a) The Council has resolved that the capital of the fund will not be used unless 80% of the Councillors vote in favour. (This is intended to deter a change in the operation of the fund, unless there is a case of real need; eg. a major civil emergency or a large investment over which there is general agreement).

(b) A statement in the Council's funding policy and long term financial strategy will outline the structure and purpose of the fund. The intention is to protect the capital and the process of applying the income to projects for the benefit of the community. These documents are published every three years by the Council and will remind the Council and public of the commitments being made. This will legally require any significant variation to be reported in the Annual Report.

(c) The Council will establish a practice of reporting on the fund in its Financial Plan and Annual Report as a separate activity each year.

Use of Income from the Capital Endowment Fund

In order to protect the value of the fund over the long term, it is proposed that an amount equivalent to the annual rate of inflation is reinvested into the fund on an annual basis.

The allocation of the remaining income from the fund would be subject to the full public accountability requirements of the Financial Plan process.

The Council proposes to apply the following rules to the way it will allocate the income each year:

- No more than 75% of projected income from the fund will be allocated more than 12 months in advance.
- The income from the fund will generally be allocated each year in the following proportions:

Economic development including business initiatives	35%
Central City economic development	20%
Civic Projects	25%
Any of the above categories	20%

- That the allocation proportions be reviewed on five yearly cycles.
- That, if desired, funding for a particular category may be carried forward to another year or up to 10% reallocated to another category if there is no demand in that year for use in the primary category.
- Projects which have a cost of less than $100,000 in any one year should not be funded from this source.
- No single project should be funded for more than five years except in exceptional circumstances.

The Council intends to request the Chairpersons of the Canterbury Development Corporation, Canterbury Employers Chamber of Commerce and Canterbury Manufacturers Association and other relevant persons to assist in developing criteria for prioritising the general economic development projects.

It is estimated that the Capital Endowment Fund would have available for allocation in 2001/02 a sum of $2.3M and this will increase over the next four years from $3.81M to $4.04M after providing for inflation proofing of the fund.

In future years the Council will detail its proposals for the use of the income as part of its normal annual plan consultation process. In this first year the Council is considering the following projects which fall within the proposed purpose of the fund. These are subject to the outcome of public consultation. Other specific projects will be considered after public consultation on the concept.

The proposals currently being considered are:

- Various projects to enhance economic development of the Central City - $500,000 in 2001/02, $300,000 in 2002/03, $200,000 in each of 2003/05 to 2005/06.
- CDC proposal for Central Plains Water Enhancement Feasibility study - $200,000 in 2001/02
- Grant to Canterbury Museum to assist with major revitalisation Project - $5.5M spread over five years commencing in 2002/03.

None of these projects will be committed until the consultation and subsequent decision making process are complete.

Debt Repayment Reserve

The second part of the recommendation is that the balance of the capital repatriation ($100 million) is invested in the Council's Debt Repayment Reserve. This will significantly reduce the Council's servicing costs in future years and reduce the level of rates.

Other Options Considered

Establishing an independent "Community Trust-type" fund:

Detailed consideration was given to vesting an independent charitable trust with a substantial portion of the proceeds. The primary rationale for considering this option to protect the capital for future generations, and to provide an ongoing income stream for community projects.

On further examination, however, a number of complex legal and taxation issues arose which made this option less viable. In order to achieve charitable status for tax purposes, the trust would need to be largely independent of the Council. It could potentially weaken the governance of the City if the independent trust's activities were not co-ordinated with, or indeed opposed to, the Council's policies. It would also weaken the financial position of the Council, since it would involve the transfer of a large sum of capital outside the Council's financial reporting group. There would also be additional complexity and cost to address the legal and taxation issues.

For these reasons, the Council decided that this option was inferior to the one proposed.

Making a capital repayment to ratepayers

There has been recent publicity regarding capital repayments to consumers made by some electricity trusts, and hence this is a topical issue.

On a political or philosophical basis, there will always be a divide between those who believe that individual ratepayers should be able to decide how best to spend the money, and those who believe that greater public benefit can be obtained by combining the resources of individuals to enhance the City as a whole.

On balance, and having taking independent economic advice, the Council has concluded that there would be greater public good from retaining the capital in a separate investment fund to provide a continuing benefit to the City. The Council views the availability of this capital as a unique opportunity to further enhance the long-term wealth of the City for the benefit of current and future generations.

Quite distinct from the philosophical or economic viewpoint discussed above, there would be some very significant legal, equitable and practical issues to be addressed (discussed below) before a return of capital to ratepayers could be contemplated.

No Legal Power to Return Capital

From a legal perspective, local government legislation is restrictive as to what councils can do. The legislation is expressed in terms of what councils are legally permitted to do, with the corollary that any action outside the specified activities is illegal. There is no power in the legislation to return funds directly to ratepayers.

Distinction between councils and electricity trusts

The Council's situation must be distinguished from that of local electricity trusts. The Energy Companies Act 1992 established energy companies out of two previous structures, with the resulting ownership of the newly-corporatised bodies depending on that structure.

The first of these structures – Municipal Electricity Departments ('MEDs') – evolved from departments of urban councils. Generally when the MEDs were corporatised under the 1992 Act, the shares were vested in the local authorities that had owned them.

The other types of structure – power boards – had no obvious owners, as they were established by Act of Parliament in the 1930s to reticulate rural areas. When the 1992 Act required the power boards to be corporatised, statutory provision was made for ownership of the shares to be vested in a local trust to represent the local consumers as there were no other obvious owners. These trusts do not operate under the same statutory restrictions as Councils.

Any capital repayment by an energy company will be made to its owner – the local council in the case of most urban electricity companies and the trust in the case of the rural companies. Often the trust will in turn return the capital to the consumers, since it has no alternative use for the money. Councils, on the other hand, have a multitude of community uses for the capital, and it is quite proper that they use the funds for community purposes, given that the MEDs and the earlier electricity departments were originally established and developed using Council funds.

Allocation of repayments – inter-generational and other equity issues

If, for the sake of argument, it was legally possible for the Council to return capital to the ratepayers, there would be significant issues regarding the allocation of the payments. For example, ratepayers are not the same body of people as Orion's electricity consumers. In particular, non-ratepaying consumers such as tenants would not benefit from such a repayment, even though they may have been long term Southpower/Orion customers. There are also some significant inter-generational and equity issues.

- Should people who have only just moved to Christchurch benefit equally to long-standing residents?
- Should the present generation of ratepayers receive a windfall payment at the expense of future generations?

A one-off Increase in Capital Expenditure

There is no proposal to use the capital returned for additional capital projects. All of the capital is proposed to be invested in either the long-term investment fund or the debt repayment reserve.

Applying Funds to Reduce Rates

If the capital sum is applied directly to reduce the rates requirement of the Council it will have an impact on the year it happens and a significantly adverse impact on the rate increase in the following year. The following table illustrates this point by showing how a reduction of $5 million in year 2 will create a rate decrease of 3.1% in year 2 and a rate increase of 7.4% in year 3 (this would have normally been 2%).

	Year 1	Year 2	Year 3
Normal Rates Required million (assumes 2% increase on previous year)	$98 million	$100 million	$102
Temporary Rate reduction	Nil	$5 million	Nil
Reduced rates required million	$98 million	$95 million	$102
Rates increase	N/A	-3.1%	7.4%

Application of the interest reduction from debt repayment or the interest income from the proposed Capital Endowment Fund can have an ongoing impact in terms of the level of total rates provided it is applied consistently in successive years. It would mean however, that the income once applied in this way could not be used in later years for other things without causing a spike in the level of rate increases. Use of the funds on a single year basis to reduce a rates increase will have an adverse affect on the following year in terms of the percentage rate increase. By way of example, the Council is concerned about the spike in forecast rates in year 2004/05 when there is a forecast rates increase of 8.60%. If the Council was to apply the income from the Capital Endowment Reserve to reduce this spike it would merely defer the impact for one year. The following table illustrates this issue.