

6. PHYSICAL WORKS LATE - SALE AND PURCHASE AGREEMENT

Officer responsible Director of Business Projects	Author Ian Hay
Corporate Plan Output: Trading Activities Liaison	

The purpose of this report is to update Councillors on the transfer of the Works Operations Unit and mechanical services functions of the Plant and Building Services Unit to Canroad Construction Limited.

At its meeting on 26 August 1999 the Council adopted the Establishment Plan pursuant to Section 247D of the Local Government Act to set up a new physical works LATE incorporating Works Operations and parts of Plant and Building Services and the wholly owned Council subsidiary company Canroad Construction Limited.

The resolution of the Council also delegated authority to the Chairman of the Strategy and Resources Committee and the Director of Business Projects to approve legal documentation relating to the sale and for Council members of the Establishment Unit to agree on the final sale and purchase price with directors of the company, after consideration of professional valuation advice.

The transfer of operations and staff to the company occurred on 1 December 1999 with the Sale and Purchase agreement executed on the same date.

Council members of the Establishment Unit, excluding Councillor Wright, met on 20 December 1999 to review the implementation and set-up processes since the adoption of the Establishment Plan and to review and agree the sale price after considering the valuation information and methodology provided by the professional advisers appointed to work with the company and the Council.

The valuation involved a combination of valuing the physical assets used in the business and also future projected cash flows. In valuing the future cash flows assumptions needed to be made on a variety of issues, namely:

- Continuing work volumes including rate and term
- Council desire to transfer staff to sustainable jobs in the new organisation
- The view developed during the establishment process and confirmed by the Council that the maintenance of intellectual capital of value to the city infrastructure was an associated element of the process.

Ongoing work arrangements where applicable have been negotiated between the company and policy units that reflect these views and were also incorporated into the valuation model. The work arrangements have terms ranging from 2.5-8 years for park maintenance, 6 years for strategic assets such as water and sewer reticulation maintenance to defined periods for operations such as refuse cartage where a finite time line exists. Council units will also use this opportunity to tidy up contract documentation and group arrangements by area or other logical groupings.

The current practice of sourcing construction and maintenance work by competitive tender in the roading and piping areas whether required by legislation or as usual business practice will continue in the future. Other work transferred to the company will be market tested as appropriate as initial negotiated contract terms expire.

Ongoing savings to the Council achieved during discussions range from \$300,000 per annum in year 1 up to \$650,000 in year 5. This review will lead to minimum savings of \$2.50M over the 5 year period.

PRICE TO BE PAID FOR THE BUSINESS TRANSFERRING

The purchase price agreed by the Company and the Establishment Unit is the net book value of assets. This sum of approximately \$10.336M is slightly more than valuations arrived at by other methods such as discounted cashflow and optimised depreciated replacement cost of assets. From this sum an amount of \$1.500M representing the current estimate of staff liabilities transferred is deducted to give a net settlement figure of \$8.836M made up as follows:

Estimated net value of assets at settlement date	10.047M
Stock	0.135M
Road user charges	<u>0.154M</u>
	10.336M
<i>Less liabilities assumed</i>	<u>1.500M</u>
Price to be paid	8.836M
Less deposit received	0.025M
	<u>\$8.811M</u>

It should be noted the figures are not finalised at the time of writing due to final asset identification but the final price is expected to be within \$300,000 of the amount above.

PURCHASE OF SHARES IN THE COMPANY

To enable the enlarged company to purchase the assets from the Council an equity injection by way of share purchase is required. The company will borrow externally to meet the majority of its working capital requirements but it is proposed to purchase shares for \$8.8M made up as follows:

Ordinary Shares	5.900M
Redeemable Preference Shares	2.900M
	<u>\$8.800M</u>

The figure may need to be adjusted dependent on the final purchase price discussed above.

The amount of approximately \$9.00M is well within the authorised borrowing limit of \$15M agreed at the December 1999 meeting of the Council to purchase shares in the company.

One remaining issue is the requirement in Section 247E of the Local Government Act that where the Council is contemplating entering into any contract for the supply of goods or services that is likely to involve the Council in expenditure it considers significant then the Council shall consider whether or not to put the matter to tender. If the Council decides not to put the matter out to tender then it must ensure the reasons for that decision are recorded in writing.

In this case as a consequence of the establishment process and as discussed in previous reports, the Council is preparing to enter into a number of contracts with Canroad Construction Ltd to deliver physical works currently provided by the Works Operations Unit. It is recommended that these proposed contracts not be tendered at this time for the following reasons:

1. Certainty of base workload required to ensure Council objective of transferring staff to sustainable jobs met.
2. Time required for policy units to fully document work schedules.
3. The view developed during the establishment process and confirmed by the Council that the maintenance of intellectual capital of value to the city infrastructure was an associated element of the process.
4. Savings made as part of the negotiation and transfer process.
5. The Council's obligation and ability to provide Civil Defence emergency and trained Rural Fire Fighting early response teams.

Recommendation: 1. That the Council purchase additional share equity in Canroad Construction Ltd of approximately \$8.800M + or - \$300,000 to enable the company to finance the business purchase with the shares being split as follows:

Ordinary Shares	$\frac{2}{3}$	5.900M
Redeemable Preference Shares	$\frac{1}{3}$	2.900M
		<u>\$8.800M</u>

2. That following clarification of the exact price, the Director of Business Projects be authorised to finalise the resultant equity purchase in accordance with the above prices.
3. That, as required under Section 247E of the Local Government Act, and in accordance with the Establishment Plan approved by the Council, the Council resolve not to tender but to negotiate contracts with Canroad in the relevant areas of sewerage, water supply, parks maintenance etc for the reasons set out above.

(Councillor Wright abstained from the discussion and voting on the above clause.)