DUNEDIN CITY COUNCIL | kaunihera a-rohe o Ōtepoti

Date:	**Wednesday 20 March 2024**
Time:	**1:00 p.m.**
Venue:	**Council Chamber, Dunedin Public Art Gallery, The Octagon, Dunedin**

Council

OPEN ATTACHMENTS – POTENTIAL SALE – AURORA ENERGY LIMITED

UNDER SEPARATE COVER

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Page Sequencing

To be confirmed once content finalised.

FRONT COVER

Aurora Energy Proposal

Have Your Say on the proposal to sell Aurora Energy Limited, pay off Aurora Energy's debt and invest the proceeds into an investment Fund.

INSIDE FRONT COVER

How to have your say

Over the following pages you will find information designed to help you provide feedback on what you think would be the best option for our city.

Your opinion matters and we look forward to receiving your feedback

- Submissions open from 28 March 2024
- Make a written submission before 12 noon on 2 May 2024
- You can ask to speak to your submission at the Hearings in mid-May.
- Council will consider submissions and will deliberate to reach a decision.

Go to dunedin.govt.nz/aurora and make an online submission or email auroraproposal@dcc.govt.nz

Timeline

Info graphic here taken from key dates

28 March Submissions Open

12 noon 2 May Submissions Close

Mid-May Hearings

Late May/early June Deliberations and decision

Where to find more information

This booklet highlights key points to help you provide feedback.

Go to dunedin.govt.nz/aurora for more information and supporting documents.

Attend a drop-in session and ask questions. These will be advertised on the Council website and Facebook.

This document is a Statement of Proposal in accordance with Section 83 of the Local Government Act 2002.

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Background

Aurora Energy Limited (Aurora Energy) is an electricity distribution business that owns and operates regulated electricity distribution networks in Dunedin, Central Otago (including Wānaka) and Queenstown Lakes.

Aurora Energy is 100% owned by Dunedin City Holdings Limited (DCHL), and DCHL is 100% owned by Council. The "Council Group" is Council and its subsidiary and associated companies, Dunedin City Holdings Limited and its subsidiary and associated companies.

The Proposal

Council is considering the possibility of approving the sale of Aurora Energy and using the proceeds:

a) To repay Aurora Energy's debt (forecast to be $576 million by mid-2025); and

b) To establish a diversified investment fund to generate income for Council.

The diversified investment fund would be worth many hundreds of millions of dollars. The capital in the fund would be protected and inflation adjusted to protect its value over time, making it an intergenerational asset. Council would receive income from the fund. Council would decide how to use the income through the usual annual plan and long-term plan processes. The income could, for example, be used to offset rates or repay Council debt.

Key reasons for the proposal are:

a) To increase income to Council by having a more consistent and sustainable income stream. Aurora Energy has not paid a dividend since 2017.

b) To reduce Council Group debt by repaying Aurora Energy's debt.

c) To avoid the Council Group debt increasing to fund Aurora Energy's future capital requirements.

d) To reduce risk by having a diversified investment fund.

Aurora Energy is a regulated company. Consumers would continue to be protected by the Commerce Commission and Electricity Authority if Aurora Energy was sold to a new owner.

Aurora Energy's most recent Annual Report records that Aurora Energy has total assets of $805 million. Given recent sales evidence for infrastructure companies, interest in purchasing Aurora Energy is expected to be high and is likely to generate a price premium. If Council decided to approve a sale of Aurora Energy, it would set a confidential minimum price that reflects what Council considers to be the current market value.

Council's preferred option for consultation is to sell Aurora Energy and to use the proceeds of any sale to repay Aurora Energy's debt and use the remainder to generate income through a diversified investment Fund.

The alternative is to keep Aurora Energy, which is likely to increase in capital value over time. However:

- Aurora Energy is unlikely to provide a dividend to Council in the short term. If it does provide a dividend, it is likely to be debt funded (i.e. Aurora Energy would probably need to borrow funds to provide a dividend to Council).
- Aurora Energy is likely to take on more debt over the next decade which, together with borrowing by Council, is likely to increase the Council Group debt.

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Council would like to hear from you

The decision whether to sell Aurora Energy is a very important decision. Council wants to hear your views before it makes the decision on whether to sell Aurora Energy and how to use the proceeds.

The question for you and what we are consulting on is:

Option One-Council's preferred option - Sale of Aurora Energy

Council to approve a sale of Aurora Energy, on the basis that the proceeds are used:

a) To repay Aurora Energy's debt (forecast to be $576 million by mid-2025); and

b) To establish a diversified investment fund worth many hundreds of millions of dollars to generate income for Council.

OR

Option Two- the alternative option - Keep Aurora Energy

Council to keep Aurora Energy. If Council keeps Aurora Energy, then it will likely increase in value over time, but a regular income to Council is uncertain. If Aurora Energy was to pay dividends (income) to Council, this would probably be funded by more debt.

Who are we consulting?

We want to consult widely, so we are asking Dunedin ratepayers, residents and members of the public what they think. We are also asking Central Otago residents and Queenstown Lakes residents what they think as Aurora Energy operates in those areas as well as Dunedin.

What happens next?

Submissions open from 28 March 2024 and close at 12 noon on 2 May 2024.

Council will have Hearings in mid-May for anyone that wants to speak to their submission. Council will consider submissions and then make a decision in late May/early June 2024.

If Council approves a sale of Aurora Energy, then Aurora Energy will be marketed for sale in the second half of 2024.

A potential sale of Aurora Energy was not included in the current 2021-31 long term plan. This is because work on possible divestments commenced after the long-term plan was adopted. In 2023, DCHL signalled that they were likely to recommend the divestment of Aurora in early 2024.

If a sale proceeds, then this would be incorporated into the Council's next long-term plan which will be developed in the second half of this year and the first half of next year. The Council's next long-term plan is called the 9 Year Plan, which will relate to the period from 2025 to 2034.

As part of the 9 Year Plan process, Council will develop an investment plan for all its investments. The investment plan would include the new diversified investment fund (if Aurora Energy is sold).

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Options overview

Option	Advantages	Disadvantages
Preferred Option (subject to consultation and council approval) **<u>Sale of Aurora Energy</u>** The Council's preferred option is to sell Aurora Energy, repay Aurora Energy's debt and establish a diversified investment fund worth many hundreds of millions of dollars to create income for Council. The capital in the diversified investment fund would be protected (including against inflation) to create an intergenerational asset. Council would decide how to use income from the fund through the usual annual plan and long-terms plan processes. Council could use the income for such things as the reduction in Council debt or to offset rate increases.	• **Increase income to Council**: The income to Council from a diversified investment fund is expected to be more consistent and higher compared to Aurora Energy's dividend forecasts. The income from the diversified investment fund would be available for the benefit of ratepayers such as repaying Council debt or offsetting rates increases. • **Reduce debt**: A sale of Aurora Energy would reduce the Council Group debt, strengthen financial ratios and help protect Council's credit rating. • **Premium value available in market now:** Recent sales evidence indicates that major infrastructure investors are currently willing to pay premiums to buy regulated infrastructure businesses. • **Reduce risk**: A diversified investment fund would reduce risk because risks would be spread across many assets. It would also improve liquidity.	• **Potential future increase in value**: Council would not get the benefit of any potential capital growth in the value of Aurora Energy. In other words, Council may be able to sell Aurora Energy at a higher price in the future. • **Regulated asset**: Council would no longer own a regulated asset that is a natural monopoly. • **Potential for future dividends**: If Council kept Aurora Energy for the long term, Council may receive dividends in the future. With continued investment there is the potential for future dividends, but this is uncertain. • **Returns may vary:** An investment fund may be subject to market fluctuations, although this would be managed through having a fund that is diversified across many different assets.
Alternative Option: **<u>Keep Aurora Energy</u>** The alternative to keep Aurora Energy and not sell. This option would mean that Council, through DCHL, retains 100% ownership of Aurora Energy.	• **Potential increase in value:** Aurora Energy is likely to continue to increase in value with continued investment. Council may be able to sell Aurora Energy at a higher price later. Premium value available in the market now. • **Regulated asset**: Council continues to own a regulated asset that is a natural monopoly. • **Potential for dividends (income) in long term**: If Council kept Aurora Energy for the long term, Council may receive dividends. However, it is uncertain when Council would receive dividends and what the amount of any dividends would be.	• **Low dividends (income) to Council in short to medium term:** It is uncertain when Council will receive dividends (income) from Aurora Energy and what the amount of any dividends would be. Any dividends in the short to medium term would likely be debt funded. • **Increase debt**: Interest would continue to be payable on Aurora Energy's debt which is likely to increase to fund capital expenditure on Aurora Energy's network. • **Risk remains**: Aurora Energy is a single asset in one industry and in one region, as opposed to a diversified investment fund that would have risk spread across many assets. • **Premium value may not be available later**: Recent sales evidence indicates that major infrastructure investors are currently willing to pay premiums to buy regulated infrastructure businesses. However, there is no guarantee that a premium would be available in the market in later years.

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Who is DCHL?

DCHL is a company that is 100% owned by Council. DCHL owns seven companies and 50% of Dunedin International Airport Limited.

The principal activity of DCHL is to provide leadership and oversight of these companies on behalf of the ultimate shareholder, the Dunedin City Council. This is achieved via a Board of Directors with professional backgrounds including commercial operations, corporate finance and investments. Their role includes ongoing governance of the subsidiaries' financial and non-financial performance with a view to maximising value for ratepayers. Aurora Energy is estimated to have the highest financial value in the DCHL portfolio.

Each year the Council writes a letter to DCHL setting out its requirements of the companies. This is called a Letter of Expectation.

For this current rating year, in the context of Council working on a draft investment plan, Council's Letter of Expectation to DCHL included an expectation **"***to provide the Dunedin City Council with strategic options for consideration (including consideration as to the future composition and direction of the portfolio) that allows the Council to consider the implications for the Council as shareholder with a particular focus on dividends/return on investment from DCHL."*

DCHL thoroughly considered the Letter of Expectation with input from various expert advisors. After reviewing Council's company portfolio, they identified Aurora Energy as the primary candidate for divestment (sale). Aurora Energy's substantial scale and projected high capital expenditure, leading to escalating debt profiles, underpinned this decision. Their review included evaluating Aurora Energy's forecast capital structure and exploring strategic options.

DCHL concluded that the case for selling Aurora Energy is compelling and there is likely to be strong market interest based on comparable transactions in New Zealand and Australia.

Why does DCHL need Council's approval of a proposed sale?

Under the Companies Act 1993 and DCHL's Statement of Intent, DCHL can only sell Aurora Energy if it obtains Council's prior approval.

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About Aurora Energy

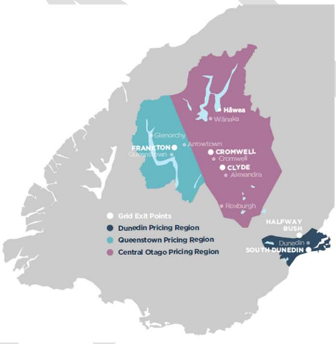
In a nutshell:

- Financial Summary information from Aurora Energy's Annual Report for the year ended 30 June 2023:
    - Total assets $805 million
    - Capital expenditure $99 million
    - Net profit $11 million
- Projected debt $576 million by mid-2025
- Planned investment in the network in the order of $800 million over the next decade (based on Aurora Energy's Statement of Intent for the year ending 30 June

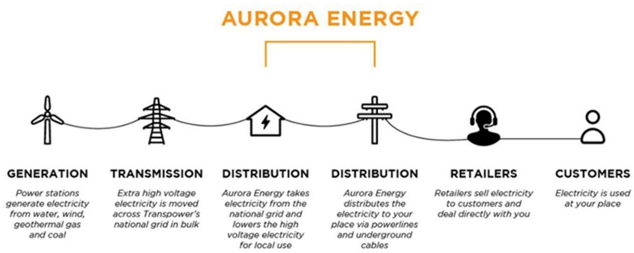
In more detail:

Aurora Energy owns and operates the regulated electricity distribution networks for Ōtepoti Dunedin, Central Otago (including Wānaka) and Tāhuna Queenstown. It had 94,723 customer connections in 2023.

The company owns and manages the local network of poles, power lines, underground cables, substations, and other equipment that distributes electricity from Transpower's national grid to power communities, in Ōtepoti Dunedin, Central Otago, Wānaka and Tāhuna Queenstown.



Aurora Energy's network was largely built in the 1950s and 1960s and requires ongoing renewal and development to meet growing electricity demand. Over the intervening decades and prior to 2017, investment was kept lower than was required which led to deterioration of asset condition and a backlog of renewal work which is being addressed through the current Customised Price-Quality Path (CPP). This investment has impacted recent profitability.



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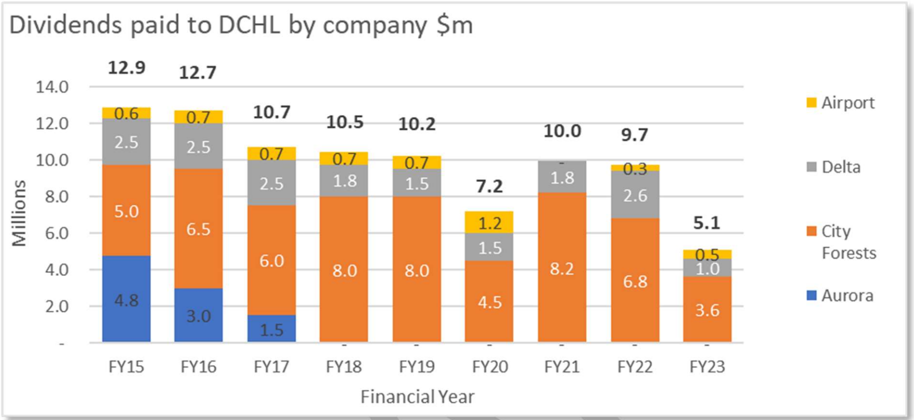
The Dunedin population is growing, and alongside current and forecast population growth in Central Otago and Queenstown Lakes enhanced infrastructure and new connections will be required. More generally, the electricity distribution sector is facing a significant sector-wide step up in network investment due to decarbonisation (electric vehicle requirements, process heat conversion etc) and increased resilience requirements meaning that cashflow pressures will continue and will impact the ability of Aurora Energy to pay a regular dividend.

As shown in the table below, Aurora Energy has not paid a dividend since 2017. In 2017, Aurora Energy paid a dividend to DCHL of $1.5 million.



The proposed new fund

DCHL believes the most appropriate approach to any fund established following a sale of Aurora Energy is to create a diversified investment fund, similar to the existing Waipori Fund, under professional fund management, applying the principles of evidence-based investing.

Council would have mechanisms to ensure that the capital of the new fund is protected (including against inflation). This is to ensure that the new fund is an intergenerational asset. Potential mechanisms include:

- Having a statement of investment policy and objectives (a SIPO);
- Council adding the proposed new fund as a "significant asset" under Council's Significance and Engagement Policy so that it can only be changed through a consultation process; and/or
- Amending Council's Standing Orders to include a provision similar to that of the Waipori Fund which requires a 75% majority of votes for the divestment of all or any part of the capital in the Waipori Fund.

Impact of a proposed sale of Aurora Energy on Council's finances

Council has clearly signalled to DCHL its desire for higher and more consistent, sustainable cash returns from its investments. Council is looking for alternative sources of funding (i.e. sources other than rates or debt) to manage its budgets.

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While a sale of Aurora Energy would not make a difference on this year's draft budget, it would have a significant effect on future Council budgets as it could help Council to do any one or a mixture of the following:

- Minimise rates increases.
- Repay debt sooner.
- Borrow less.
- Council's income will match its expenditure sooner.

If Aurora Energy is not sold, it may generate dividends in the future but:

- The amount and timing of any dividends is uncertain.
- Any dividends from Aurora Energy in the medium term would probably be funded by debt, which would increase the Council Group debt.
- Given Aurora Energy's capital requirements for its network, Council expects that for the next decade at least, any dividends from Aurora Energy would be significantly less than the amount that it would receive from a diversified investment fund.

Impact of a proposed sale of Aurora Energy on the Council Group finances

Aurora Energy is delivering reasonable capital growth, but, as an infrastructure business with growing demand, it is likely to require more debt to fund renewals and improvements in its network.

This is an issue because Council also has significant expenditure requirements. For example, Council needs funds for roading and three waters improvements, meaning that both Council and Aurora Energy are capital intensive and facing increasing borrowing.

If Aurora Energy is sold and its debt of approximately $576 million is repaid, and there would be no need to borrow further to fund capital expenditure on Aurora Energy's network.

A sale of Aurora Energy would reduce the Council Group debt and would reduce risk to Council's future credit ratings, debt covenants and borrowing costs.

DCHL's Recommendation

DCHL has advised that major infrastructure investors, with different objectives to Council's objectives, are willing to pay attractive premiums to buy regulated infrastructure businesses. Aurora Energy is one of these businesses. This creates an opportunity to realise value that might not be there in the future. DCHL's advice to Council is that now is a good time to sell to realise a price premium.

DCHL has advised that, although Council may be able to sell Aurora Energy for a higher price in later years, the advantages of selling Aurora Energy far outweigh the advantages of keeping Aurora Energy. DCHL expects that a sale of Aurora Energy would increase income to Council, reduce risk and reduce Council Group debt.

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The diagram below summarises the difference between keeping Aurora Energy and selling Aurora Energy to repay Aurora Energy's debt and to establish a diversified investment fund worth many hundreds of millions of dollars.

	Aurora Energy Limited	Diversified Investment Fund
NATURE OF INVESTMENT	One company, one industry	Many companies, many industries (and other assets)
RISK PROFILE Uncertainty of returns	Regulated but specific single company and industry risks	Risk reduced by diversification
DISTRIBUTIONS Cash income to the shareholder	Low Especially short-term Funded by debt	Higher More sustainable Less volatile
CAPITAL GROWTH Growth in value of investments	Strong	Strong
CAPITAL REQUIREMENTS Need for reinvestment of cash and higher debt	High	Nil
MARKET PREMIUM Additional value priced in by investors	Uncertain in the future	Available now

Is it an option to sell only part of Aurora Energy?

DCHL considered the possibility of selling only part of Aurora Energy (e.g. 50% of its shares or a specific part of the network), but DCHL does not recommend this approach. Their advice is that a partial sale is unlikely to attract large infrastructure investors and therefore would not attract a premium price. DCHL expects a higher premium and a higher probability of a successful outcome if 100% of Aurora Energy is sold.

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What does the proposed sale of Aurora Energy mean for me as a ratepayer?

The Council already owns a diversified investment fund, called the Waipori Fund. That fund was established from the sale proceeds of the Waipori electricity generation scheme. The Waipori Fund has increased in value over time and was valued at approximately $100 million as of 31 December 2023. One of the objectives of the Waipori Fund is to protect its value over time against inflation. Income earned on the fund is available to Council.

The new fund from the proposed sale of Aurora Energy would not make a difference to the rates increase proposed for 2024/25, but Council expects that a new fund worth many hundreds of millions of dollars would generate a future income stream for Council.

Council would need to plan how to apply revenue received through the new fund, but potential uses include reducing Council debt and the offset of rates increases. Council would decide how to use the income through the usual annual plan and long-term plan processes.

What does the proposed sale of Aurora Energy mean for me as an energy customer?

The Commerce Commission sets price and quality controls across the sector, ensuring that excessive profits are not earned and the quality of service to customers is maintained, regardless of Aurora Energy's ownership.

If Aurora Energy is sold, a new owner would be subject to the same regulation as currently applies under Council's ownership. Customers would notice very little difference as the Commerce Commission would continue to ensure that Aurora Energy sets prices reflecting its operating and maintenance costs. The Commerce Commission would also continue to ensure that customers who rely on the network for electricity would continue to experience reliable and safe electricity distribution.

If sold, customers may benefit from a new owner with the scale and ability to make necessary long-term investments, ensuring the network can meet growth and electrification demands.

Who might buy Aurora Energy

New Zealand based investors, such as major superannuation funds, may be interested in buying Aurora Energy. Interest in buying the company may also come from overseas investors.

Aurora Energy doesn't need to be publicly owned to protect the community and consumers because regulatory rules in place already look after consumers. There are electricity distribution companies in New Zealand that are currently owned by overseas investors.

Under the Overseas Investment Act 2005, no overseas person or entity will be able to purchase Aurora Energy unless it first obtains Overseas Investment Office (OIO) consent. The OIO will only grant consent if it is satisfied the overseas investment will, or is likely to, benefit New Zealand and that the proposed purchaser is not unsuitable to own or control Aurora Energy.

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HAVE YOUR SAY

Submission form

Your name and submission will be made public as part of the Council's decision-making process. This information will be included in papers available to the public and the media but will only be used for the Aurora Energy Proposal consultation.

Submissions close at 12 noon on 2 May 2024. Late submissions may not be accepted.

Thank you for your feedback.

Your details

First name ______________________________

Last name ______________________________

Organisation (*if applicable)* ______________________________

Post Code ______________________ **Telephone** ____________

Email ______________________________

The provision of your personal information is optional. Council will collect and store your information in accordance with the Privacy Policy. This can be found on the Council website: dunedin.govt.nz/privacy-policy

Which option do you prefer? Tick one box.

☐ **Option One – the preferred option – Sale of Aurora Energy**

Council to approve a sale of Aurora Energy Limited, on the basis that the proceeds are used:

a) To repay Aurora Energy's debt (forecast to be $576 million by mid next year); and

b) To establish a diversified investment fund worth many hundreds of millions of dollars to create income for Council.

☐ **Option Two – the alternate option – Keep Aurora Energy**

Council to keep Aurora Energy. If Council keeps Aurora Energy, then it will likely increase in value over time, but a regular income to Council is uncertain. If Aurora Energy was to pay dividends (income) to Council, this would probably be funded by more debt.

Further comment

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HEARINGS

Do you want to speak to the Council at the Hearings? Please tick your preferred time.

Tuesday 14 May	Morning	Afternoon	Evening
Wednesday 15 May	Morning	Afternoon	Evening
Thursday 16 May	Morning	Afternoon	

If you wish to speak at the Hearings, please ensure you provide your contact details. Normally, speakers will be allocated five minutes but depending on how many people wish to speak, time limits may be adjusted.

Where to send your submission

Drop your submission to any Dunedin City Council library or service centre. Or mail to:

Dunedin City Council
Aurora Proposal
PO Box 5045
Dunedin 9054

How to join the conversation

- Go to dunedin.govt.nz/aurora and fill in the online submission form.
- Councillors will be attending a number of drop in sessions. Find a place near you and come down for a chat. Dates, times, and venues can be found on dunedin.govt.nz/aurora or call us on 03 477 4000 for details.
- You can speak to all Councillors at the Hearings on 14 and 15 May. To register for a speaking spot at the Hearings tick the box on the submission form or call us on 03 477 4000.

Want more information?

Go to dunedin.govt.nz/aurora for more information and supporting documents relating to Council's proposal.

These documents include further information about:

- Aurora Energy Limited – the company's performance to date and future asset management plans. Aurora Energy's Customised Price Quality Application in 2020 and reporting against this investment program to date. Aurora Energy's statement of intent.
- Dunedin City Holdings Limited (DCHL) - its structure, performance, and role, as well as its obligations to the Dunedin City Council.
- Dunedin City Council – Council's public record of decision making regarding this proposal, Council's long term and annual plans, as well as relevant council policy relating to the proposal.
- The Waipori fund – details of this existing investment fund, its protections and performance to date.
- Energy distribution business regulation – industry information relating to how Aurora Energy is regulated and the company's performance in year two of the Customised Price-Quality Path and more generally.

If there is a topic you would like more information on visit dunedin.govt.nz/aurora

BACK INSIDE COVER

Glossary (still to be finalised as editorial changes)

Aurora Energy Limited (Aurora Energy) – an electricity distribution business servicing Dunedin and parts of Central Otago and Queenstown Lakes.

Assets – a resource with economic value that an individual, corporation, or country owns or controls with the expectation that it will provide a future benefit.

Commerce Commission – New Zealand's competition, fair trading, consumer credit and economic regulatory agency. The Commerce Commission play a role in ensuring New Zealand's markets are competitive, consumers and businesses are informed and empowered, and their interests are protected, and sectors with little or no competition are appropriately regulated. This includes Electricity Network Businesses in private and public ownership.

Council – Dunedin City Council

Council Group – this is Council and its subsidiary and associated companies, Dunedin City Holdings Limited and its subsidiary and associated companies. These are Aurora Energy, City Forests, Delta and Dunedin Airport.

Diversified Investment Fund (the Fund) – means, if DCHL sells Aurora Energy, an investment portfolio that would be established with the net proceeds from the sale, consisting of a diverse portfolio of investments that would generate income for the Council. Council's 9 Year Plan 2025-34 would include options for consultation on ways to protect the capital of the investment fund for the future.

Dunedin City Holdings Limited (DCHL) – is the company that owns and manages various companies, including Aurora Energy. DCHL is 100% owned by the Council. DCHL has its own board of Directors. DCHL can only sell Aurora Energy if Council gives prior approval.

Divestment – in this document means to sell Aurora Energy.

Liquidity – is the ability to turn assets into cash.

Medium term: in this document the medium term is taken to be up to 2033.

Waipori Fund – a well-established investment portfolio, established in 1998, using the proceeds from the sale of the Waipori electricity generation assets. The primary objectives of the Waipori Fund are to maximise its income, subject to a proper consideration of investment risk; and grow the Fund's base value, while maintaining an agreed cash distribution to Council. The cash distributed to Council is used to offset rates.

BACK COVER

DCC logo contact details