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Innovative thinking in the infrastructure funding debate for housing and how it could be applied to local government

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Macquarie Capital NZ

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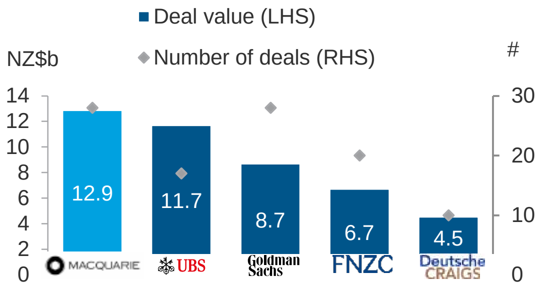


Equity Capital Markets

Largest capital raisings in NZ

Client	Size ($m)	Comments
Contact	1,810	✓ Largest ever selldown
meridian	1,886	✓ Largest ever IPO
Mighty River Power	1,715	✓ 2nd largest IPO
Fletcher Building	750	✓ Largest ever capital raise

Infrastructure

Major pathfinder infrastructure projects

Project	Comments
SECUREFuture	Wiri Prison - first pathfinder PPP in NZ
NextStep Partners	Auckland Prison – evolution of PPP model
NX2	Pūhoi to Warkworth highway – largest PPP by capital raised in NZ
Crown Infrastructure Partners	New commercial model to attract private investment in housing related infrastructure

Macquarie awards

Key Local Government Funding Issues

There are a multitude of issues for local government to address when considering funding and financing options

Debt constraints

- Local councils ability to fund infrastructure constrained by the implications of high debt levels on credit ratings

Limitation of rating model

- Council rates income is subject to annual variability
- Does not capture benefit of growth

Affordability

- Ratepayers do not have unlimited capacity to afford sustained rates increases
- Willingness to pay impacted by perception of efficiency

Institutional framework

- Local councils may be morally obliged to step in if development becomes distressed
- Limited access to centrally provided capability and capacity

Observations from the INZ Visit to the USA

Incentives are in place to allow local governments to share in the benefits of growth

Observation 1: Incentivising growth is key

- **Problem**: councils are not incentivised to pursue growth objectives
  - Current cost recovery model does not provide local council with an ability to share in growth upside
- **Solution**: provide incentives which allow local councils to share in growth upside
  - Ensures councils are aligned to encourage local growth
  - Results in higher sales taxes, income taxes, property taxes
  - Enhanced responsibility on local governments results in cities that develop better than their competitors attracting more skills and investment
  - Greater competition and accountability leads to a duel mandate to keep costs down and add value

Example: Stapleton airport redevelopment

Location	Stapleton, Denver
Size	US$4.8 billion in value
Description	1600ha redevelopment of airport into residential housing for 26,000 residents

Before and after…

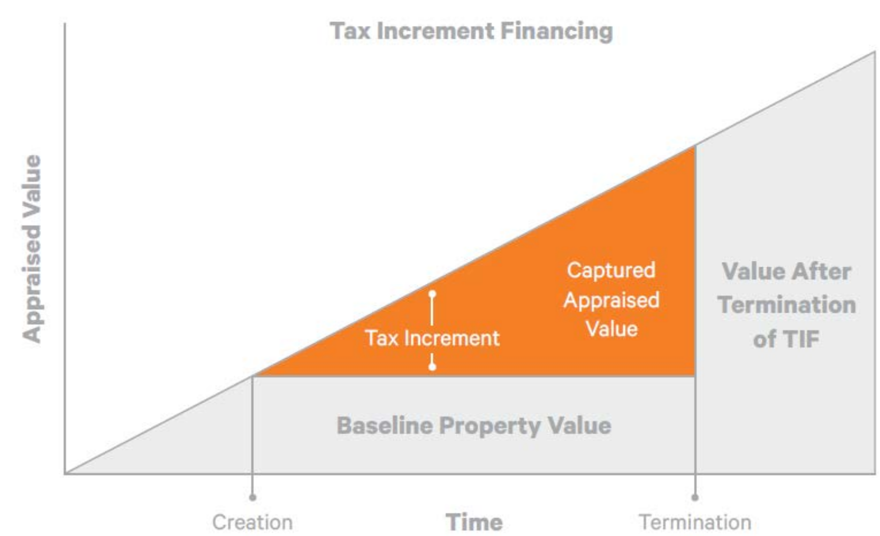
Observations from the INZ Visit to the USA

Local governments have access to a wider array of funding and financing tools to allow for greater flexibility and collaboration between public and private entities

Observation 2: Improve flexibility

- **Problem**: local councils have limited options in funding municipal infrastructure and new tools are needed to provide flexibility
- **Solution**: provide local councils with funding tools that enable flexible governance, including:
  - — Municipal utility districts (MUD)
  - — Tax increment financing (TIF)
- Encourages collaboration between both public and private entities
- Improved price and tax signals
- A more comprehensive funding toolkit allows Councils to tailor their funding strategy more appropriately to the specific demands of the infrastructure project at hand

Example: Tax Increment Financing



Infrastructure Investor Requirements

There is an estimated US$150 billion of unallocated infrastructure funds, with 95% of global unlisted infrastructure funds planning to increase or maintain the allocation over the next year

Infrastructure Investor requirements

Reliable revenue stream

- Typically long term investors with a preference for stable, predictable cash flows
- Expected returns for infrastructure investors depend on the underlying asset and quality of cash flows

Managed risk profile

- Must have the ability to manage risks and appropriately price these into the solution
- Bring discipline around the assessment of risk and which parties are most appropriate to bear the risk

Strong partners

- Given the number of players in an infrastructure project, there is material counterparty risk
- To manage this risk, investors have a preference for strong partners with established experience in the industry

Robust framework

- A robust framework allows financiers to have greater legal and regulator certainty
- This allows for a more stable macroeconomic setting, giving investors greater visibility on future economic outlook

1. As at April 2017.

NZ Options - Funding

New funding mechanisms are being considered, including targeted rates (or similar) and value capture, which aim to resolve the current issues faced by local councils

User pays 1

- Funding sourced from those who use the infrastructure asset
- Provides a clear nexus between benefit received by user and the costs borne by those who use it
- Examples include toll roads

Targeted Rates (or similar) 2

- Targeted rates allow Councils to charge beneficiaries for specific assets
- Current framework requires Councils to retain the revenue and restricts the ability to set targeted rates over an extended period, acting as a barrier to attracting private finance

Value capture 3

- Funding sourced from those who benefit from proposed infrastructure
- Value that is captured is linked to the additional advantages received by those who benefit from proposed infrastructure

Asset Recycling 4

- Government well placed to provide seed/development capital
- Political sensitivity but does Government need to own?
- Government objectives achieved through regulation
- Not recurring

NZ Options - Financing

The current Government has signalled a reduced mandate for PPP but a strong desire to explore other mechanisms to harness private capital to finance infrastructure

Financing options

1 Capital markets rated instruments

- NZ has a relatively illiquid capital market with regards to infrastructure finance
- Obtaining investment grade rating is difficult when financiers are exposed to construction risk
- Expected to be demand for appropriately structured and rated capital market instruments (e.g. Kiwisaver funds who allocate to infrastructure investments)

2 Institutional equity

- Excess capacity for institutional equity investors to fund infrastructure
- Benefit of institutional equity is the rigour and international best practice of asset management which has the potential to add value in the housing New Zealand context
- Jury still out on the optimal ownership structure for housing infrastructure with regards to the appropriate level of institutional equity ownership

3 Central Government support

- Consider mechanisms whereby central Government assumes certain risks to facilitate financing outcomes

Self Supporting Structures

The key difference between the traditional and SPV model is that councils specify infrastructure requirements but are not the central vehicle for its funding and financing