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11 March 2019

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# Asset review

**Introduction**

This purpose of this report to the Kaikōura District Council (the Council) is to undertake a high level stocktake of the Councils' asset base to identify assets that could be divested or could have revenue opportunities.

**Assumptions used in assessment**.

I have based my review on current valuations prepared for the Council by experts in the appropriate fields, however while prepared on a market basis, the primary purpose of these valuations are for financial reporting purposes. Therefore, the actual values the Council could realise could be more or less than the values used in this report.

As part of this review, there are a number of assumptions that need to be considered. The most important is, if that assets were realised, could those funds be better used by Council. Council debt is currently well within acceptable limits; therefore, I have used Council's current weighted costs of borrowing of 4.83% as it is assumed that any funds received would be used to reduce debt.

Key assets that have to be considered in this report are:

- Forestry assets
- Commercial property
  - 25 Beach Road, Kaikoura
  - 34 Esplanade, Kaikoura Former Council Office Building
  - Wakatu Quay, Kaikoura North Wharf

The assets listed below have not been considered as part of this review but were considered as part of the Revenue Streams Health Check where the recommendation was to increase the revenue to recover the costs. It is generally accepted that the assets considered in this section will not provide a commercial return and therefore are unlikely to provide Council with significant sale proceeds.

- Council's pensioner housing

- South Bay Harbour
- Airport

I have not considered the following assets:

- Council's administration building, this also provides for the library, and museum. Council would need to enter a sale and leaseback agreement. With current interest rates, this would result in a negative cash flow.
- Reserves held under the Reserves Act 1977. If sold, the Act requires the funds to be allocated to other reserves.
- Paper or surplus roads. While these have value, the costs in closing a road often exceeds the value realised.

## Forestry assets

The Council has two forestry assets, one minor planting (approximately 8 ha at the South Bay) which is unlikely to produce a commercial return because it has not been managed a forestry block but primarily used for erosion mitigation. The major forestry asset is Council's 11.5% share in the Marlborough Regional Forestry (MRF) joint venture. Of that share, Council holds 13.37% share on behalf of Environment Canterbury, therefore the effective share in MRF is 9.96%

The gross current valuation as at 30 June 2018 of the MRF assets[1] is as follows:

| | |
|---|---|
| Tree crop value | 18,495,513 |
| Freehold land | 6,250,000 |
| Improvements | 3,725,000 |
| Carbon credits | 22,183 |
| Total | $28,492,696 |

Therefore, the Councils net share based on the above valuation is $2,838,571. The unaudited and unadopted financial statements as at 30 June 2018 reflect a share of net assets employed of $2,646k. This is set out in appendix 1 Note 30

### Cash flow impacts for Council

The valuation as at 30 June 2018 forecasts a number of years where there is a net cash flow deficit. This will require the Council to make payments to the joint venture to fund the direct operating and supporting costs. While the Council has allocated reserves of approximately $400k, the estimated share required over the 6-year period is $650k leaving a balance of $250K to be funded from rates or funded from future cash surpluses.

The table below uses the valuation estimates to estimate returns that will be available to Council over the next 20 years. The table does not provide for the use of the forestry reserve. The interest rate used is assumed to be 5.5%.

[1] Based on the Buck Forestry Services Ltd valuation for the purpose of the valuation is to estimate a pre-tax value for the forest estate as at 30 June 2018 for inclusion in MRF annual financial statements.

| Year | KDC share Gross | Net of Ecan | Accumulated deficit no interest | Accumulated deficit with interest |
|---|---|---|---|---|
| 2019 | 365,285 | 316,446 | | |
| 2020 | 157,950 | 136,832 | | |
| 2021 | - 112,748 | - 97,674 | - 97,674 | |
| 2022 | - 127,834 | - 110,743 | - 208,417 | - 213,789 |
| 2023 | - 134,429 | - 116,456 | - 324,873 | - 336,631 |
| 2024 | - 138,960 | - 120,381 | - 445,254 | - 463,768 |
| 2025 | - 106,609 | - 92,355 | - 537,609 | - 563,116 |
| 2026 | - 71,795 | - 62,196 | - 599,805 | - 630,776 |
| 2027 | 91,349 | 79,136 | - 520,669 | - 555,361 |
| 2028 | 80,444 | 69,689 | - 450,980 | - 481,525 |
| 2029 | 311,074 | 269,483 | - 181,497 | - 207,981 |
| 2030 | 265,852 | 230,308 | 48,811 | 37,372 |
| 2031 | 265,740 | 230,211 | 279,022 | 281,077 |
| 2032 | 290,402 | 251,575 | 530,597 | 546,056 |
| 2033 | 257,358 | 222,949 | 753,546 | 783,579 |
| 2034 | 333,779 | 289,153 | 1,042,699 | 1,085,796 |
| 2035 | 243,628 | 211,055 | 1,253,754 | 1,313,473 |
| 2036 | 563,344 | 488,025 | 1,741,779 | 1,814,020 |
| 2037 | 606,068 | 525,037 | 2,266,816 | 2,366,587 |
| 2038 | 537,890 | 465,974 | 2,732,790 | 2,862,952 |

**Issues for Council to consider**

Normally any joint venture entered into by a local authority would be subject to New Zealand Income Tax, however it should be noted that the MRF has tax free status because of specific legalisation and the MRF is governed by way of Joint Committee under the Local Government Act 2002. This may limit the buyer to be only the Marlborough District Council

Most of the forest harvested after 2026 will be a second harvest and therefore the supporting roading and haul ways are already in place, thus reducing the harvest costs and increasing the returns to both Councils.

While a cash injection of approximately $2.8m might be positive in the short term, the loss of future income will be significant in the longer term. With current low interest rates and the majority of the expected deficit to be funded from a funded reserve of Council, there appears to be little short-term advantage in selling the share in the MRF and there is no long-term advantage.

## Commercial property

All commercial property listed below was valued as at 30 June 2018 by Maxwell Valuation Ltd for financial reporting purposes but provides indicative market values.

**25 Beach Road, Kaikoura**

The current valuation

| | |
|---|---|
| Land value | 255,000 |
| Less demolition estimate | 80,000 |
| Less Profit | 10,000 |

Current estimated market value $165,00

The valuer's report states this is an older industrial style building which has been converted to provide for a variety of uses occupying a 1,017m2 'Business B' zoned front site along Beach Road in Kaikoura. The property is currently held under three short term lease agreements at a combined gross rental of $9,600 per annum plus GST. The structure is classified as an earthquake prone building and has a seismic capacity of less than 33% NBS. This may become a liability to the Council in the future, if Council wishes to retain the property.

This is currently used as a community second hand goods shop where the profits from the shop are returned to the community.

The issue that the Council needs to consider is the current value to the community i.e. is the contribution from the shop greater than the benefits of reduced debt?

**34 Esplanade, Kaikoura Former Council Office Building**

Current estimated market value $150,000

In considering an appropriate value in this instance the valuer noted the following:

- The premises comprises an older commercial building which has a reasonably specialised internal layout.
- The property benefits from its situation along the Esplanade within close proximity of the waterfront albeit in a slightly more fringe commercial location some distance to the south of the main West End precinct.
- There are very few businesses within the wider Kaikoura market which would require larger office premises such as the subject building. From an investment perspective it may be necessary to lease the building to a multiple number of tenants in order to sufficiently utilise the total building area and maximise the return. There is obviously an inherent risk in obtaining a sufficient number of tenants and also additional management issues.
- The building has earthquake strengthening requirements. We consider most buyers would factor in a suitable margin for the cost involved in completing the necessary upgrades together with an additional margin for profit and risk. This would include demolition of the southern extension which has a low NBS rating and redeveloping a new structure over the existing footprint.
- It is estimated the cost to bring the building up to the required standard is $400,000.
- The building in a repaired and strengthened state would have a market rental around the $44,000 per annum level as a single tenancy.

**The building will ultimately need either to be demolished or earthquake strengthened and upgraded. There are number of risks for the Council as the costs are uncertain and the future market rental is also uncertain. It may not be prudent for the Council to retain this site.**

**Wakatu Quay, Kaikoura North Wharf**

Current estimated market value $1,300,000

Wakatu Quay buildings have recently been returned to the Council's ownership. Two of the buildings are very dilapidated. One (which housed the previous aquarium) has significant amounts of asbestos in and on it. The largest building, which previously housed a paua processing operation, is in better condition but is below current codes and has earthquake and corrosion damage. Any change from the previous use of this building would require substantial and costly improvements.

The buildings detract from the land value. The recommendation is that they be demolished to leave a bare site, provided sufficient demolition funding (in the order of $300,000) can be made available.

In my opinion this is a strategic site for the District and needs to be carefully managed to ensure the best long-term value for the community and Council.

While the site could be offered for sale, but given the prime location, the low interest rates, and debt forecast debt within prudent levels, the recommendation is that it be offered for long term lease. This recommendation is consistent with advice received from the valuer.

## Other current financial impacts

The Council needs to consider the impact of its commercial properties on its current rate requirement as the current Three-year plan provides a contribution from rates for the following amounts:

| | |
|---|---|
| 2018/19 | 137,184 |
| 2019/20 | 108,808 |
| 2020/21 | 119,275 |

Council needs to consider increasing its revenue to ensure that there is not ratepayer subsidy without valid reasons.

In addition, Council needs to consider that within the Facilities activity of the Three-year plan from 2020/21 then is projected Revenue for Coastal Walkways Licenses to Occupy $350,000 p.a. I have not been able to identify any potential income sources that would generate this level of income.

Appendix 1 Extract from Unaudited 2018 Annual Report

## 11 Environment Canterbury's share of the Marlborough Regional Forestry joint venture surplus/(deficit)

Council holds an 11.5% share in the Marlborough Regional Forestry (MRF) joint venture (see note 30). Of that share, Council holds 13.37% share on behalf of Environment Canterbury, and share of any surplus or deficit. Any gains or losses on asset revaluation (note 12), are shown in the statement of comprehensive revenue and expense, and the total share is disclosed as a non-current liability (note 25).

| | Council & Group | |
|---|---|---|
| | **2018 $000** | **2017 $000** |
| Marlborough Regional Forestry joint venture surplus/(deficit) | 744 | 360 |
| **Environment Canterbury share @ 13.37%** | **(99)** | **(48)** |

## 12 Gains/(losses) on asset revaluation

| | Council & Group | |
|---|---|---|
| | **2018 $000** | **2017 $000** |
| Marlborough Regional Forestry joint venture revaluation | (25) | 38 |
| Environment Canterbury share of MRF revaluation (13.37%) | 3 | (5) |
| Gains on revaluation of assets | 27 | - |
| **Total gains/(losses) on asset revaluation** | **5** | **33** |

## 17 Forestry assets

The council has an 11.50% interest in a joint venture agreement on the Marlborough Regional Forestry (MRF). Of the council's share of MRF, 13.37% is held on behalf of Environment Canterbury. The forestry assets are at varying stages of maturity. The joint venture continued its normal logging activity during the year, the council's share of the sales revenue was $741,997 (2017: $663,088).

The council has reduced its forestry holdings over the last few years and now owns only eight hectares of pine forest at South Bay. The council didn't harvest any logs from the forest in 2018, and so net logging sales returned $nil during the year (2017: $nil).

## 18 Investment property

The council's investment properties are 25 Beach Road (currently occupied by the Opshop plus a joinery business), an area of land between Beach Road and the railway line, and the land at Wakatu Quay. Investment property was not revalued in 2017 due to extreme uncertainties in property values following the November 2016 earthquake, but the building at 25 Beach Road was assumed to have suffered 50% impairment in quake damage, as estimated from visual inspection by structural engineers.  No impairment has been recognised for any of the other investment properties.

| | Council & Group | |
|---|---|---|
| | **2018 $000** | **2017 $000** |
| Opening balance 1 July | 1,860 | 1,870 |
| Additions from subsequent expenditure | - | - |
| Disposals | - | - |
| Fair value gains/(losses) on valuation | (395) | - |
| Loss on impairment | - | (10) |
| **Closing balance 30 June** | **1,465** | **1,860** |

## 20 Intangible assets

### *Carbon credits*

At the start of the year, the council had no carbon credits, and outstanding surrender obligations under the Emissions Trading Scheme for carbon emissions from its landfill operations, of 293 units.  The council purchased 1,345 units in May 2018, and met it's surrender obligations of 293 units for 2016 and 1,052 for 2017.  At balance date, the council holds no carbon credits.

## 25 Other term liabilities

| | Council & Group | |
|---|---|---|
| | **2018 $000** | **2017 $000** |
| *Non-current* | | |
| Share of interest in MRF held on behalf of Environment Canterbury | 354 | 334 |
| **Total other term liabilities** | **354** | **334** |

## 30 Joint venture

### *Marlborough Regional Forestry*

The council has an 11.5% participating interest in the Marlborough Regional Forestry joint venture.  Of the council's share, 13.37% is held on behalf of Environment Canterbury.  The council's interest in the joint venture is accounted for as a jointly controlled operation, and are as follows:

| | Council & Group | |
|---|---|---|
| | **2018 $000** | **2017 $000** |
| Current assets | 123 | 308 |
| Non-current assets | 3,276 | 3,049 |
| Total assets | **3,399** | **3,357** |
| Current liabilities | 58 | 160 |

| | | |
|---|---|---|
| Non-current liabilities | 695 | 695 |
| Total liabilities | **754** | **855** |
| **Share of net assets employed** | **2,646** | **2,502** |
| **Share of net surplus/(deficit)** | **744** | **360** |

The council has no capital commitments, contingent liabilities, or contingent assets in relation to the joint venture.