Far North
Holdings Limited

Opua Marine Park
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PRIVATE AND CONFIDENTIAL

Far North Holdings Limited

Proposed Changes to Company Structure

Purpose

Following our initial verbal presentation to FNDC Councillors on 1 December, the purpose of this paper is to consult with FNDC regarding proposed changes to the structure of Far North Holdings Limited (FNHL) as required under our Statement of Intent, and to provide assurance that this change will not adversely affect the profitability and risk profile of the company.

Executive Summary

Given the business growth and diversification over recent years, the Board of FNHL wishes to establish two wholly owned subsidiaries in order to enable asset growth, improve business performance and delivery and appropriately manage business risks. It is appropriate to make these changes now due to:

- increasing risk with legislative and regulatory changes, coupled with the continuing diversification of the asset portfolio and business operations.
- the current commercial and social opportunity to respond to housing needs in our communities in the immediate term.
- the planned relocation of the FHNL office to the Ngawha Innovation Park once operational, and the need to manage any associated changes to the marina operations in Opuawhere the head office is currently based; and
- the existing development pipeline - while assets have grown from $40 million to $136 million over the last nine years, the current pipeline of development and strategic initiatives expect asset growth to be close to $200 million by 2024 based on current valuation evidence – this level of growth requires focus, execution and careful risk mitigation to deliver.

These two subsidiaries are intended to own and manage the Bay of Islands Marina, and to own, develop and manage community and social housing across Northland, which we see as a key strategic growth area for the company to achieve financial and social impacts. The entities are proposed to be called Bay of Islands Marina Limited, and Far North Housing Limited respectively.

Both entities would be 100 percent owned by FNHL, with the FHNL Board remaining fully accountable to FNDC for group performance. The Statement of Intent would continue to govern the overall performance of the FNHL Group (FNHL and all subsidiaries), as it does currently, howeverit is reasonable to expect some revisions to reflect the increasingly diverse asset portfolio managed by FNHL, the broader group strategy to encompass community housing, and the social, communityand environmental impacts achieved through this structural change and improved focus in key areas.

While ownership of some assets would be transferred from FNHL to these subsidiaries, FNHL confirms that no public assets (for example wharves, public marine infrastructure) will be transferred to the new subsidiaries. We can provide the draft list of assets to be transferred should that be of assistance.

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These changes do not require any changes to our funding by FNDC and should deliver more value. While additional costs are estimated at $300,000 per annum for additional director fees, accounting and audit fees, these costs will be offset by improved commercial performance within two years. While some existing staff may transfer employment from FNHL to the new entities, further staff recruitment will only occur as business performance allows while maintaining our dividend commitments to FNDC.

It is intended that each subsidiary will have four directors, two from the FNHL board and two independent directors to retain appropriate group control and oversight, and to recruit specific skills and expertise as identified to drive performance in the two new subsidiaries. We would like to recruit for the two independent directors in the new year, and plan to advertise broadly both regionally and nationally to find strong candidates.

Key Benefits

The key benefits derived from the proposed change in company structure are summarized below:

Bay of Islands Marina Limited

- **Improved business performance, profitability and risk management** – This will be achieved by a dedicated governance and management structure focused on the marina operations with specialist skills recruited over time to achieve this. The marina continues to represent our key operational asset and requires different skills and expertise from our core expertise of managing and developing commercial and infrastructure assets. While this change will deliver improved financial returns on marina assets, and increased profitability, we also expect improvements to a broad range of business, customer service and impact measures.

  This level of focus has become increasingly important in a post-Covid environment with tourism flows limited, shifting consumer perceptions and the upcoming shift of the head office toNgawha which risks alienating the marina operations.

- **Improved risk management –** The marina and surrounding businesses we operate such as the boatyard, paint shop, fuel and general marine environment are high-risk environments that need to be managed differently to that of a property and development entity. A separate legal entity, combined with additional governance and management oversight and expertise helps to provide more appropriate risk management and mitigation specifically in the key areas of biosecurity, health & safety and environmental.
- **Improved community & stakeholder engagement** – We acknowledge the importance of the marina in the broader Opua and Bay of Islands community. Focus and allocation of dedicated resources to work solely at the marina will enable us to improve relationships and engagement within the community, and to monitor our interactions and engagements more closely.
- **Improved environment outcomes –** Site specific focus is required to both meet, and exceed, our environmental obligations for compliance purposes and to deliver upon community expectations.
- **Improved customer service levels** – Structural and organisational changes will support improved customer service levels, by ensuring focus on day-to-day customer interactions with enhanced ability to measure and report on customer service, improving transparency.
- **Covid management and response –** The marina oversees and operates the entry port at Opua. This operation, together with the large number of berth-holders, local businesses, and residents in a potentially vulnerable region, means that we must deliver robust Covid responses that adapt over time, and manage various stakeholders, their safety and their businesses.

Far North Housing Limited

- **Strategic Opportunity –** There is a well-established need for social, affordable and community housing across the wider Northland region which we expect to continue for the medium term. We believe provision of affordable and social housing is the next strategic growth area for FNHL to meet social and commercial outcomes.

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FNHL is currently working on, and in negotiations for, further housing projects in the Far North and wider Northland region. We have successfully negotiated an agreement with the Ministryof Housing and Urban Development to secure 25-year government rents at an above market rate for provision of social housing. Government funding is currently available to support housing initiatives, FNHL has a strong balance sheet and delivery capability.

A separate entity with appropriate governance and management experience positions us to maximise this opportunity, while also managing the risk to the broader FNHL portfolio and business as we anticipate this will make a significant contribution to our asset growth over the next ten years.

- **Community Need –** FNHL has financial capability, and development expertise to respond and deliver housing improvements for our community, supporting community well-being and social outcomes across the wider Northland region. The scale and urgency of this need is such that we believe it requires clear focus to execute effectively for our communities.
- **Stakeholder Relationships –** This strategic focus in housing enables us to deliver social and community impact more deliberately and transparently than our existing development portfolio which often enable indirect benefits. It also provides opportunity to further develop and deepen current partnerships with community groups, hapu and iwi who have identified housingneeds for their communities. This will help to address community perceptions which purport a sole focus on FNHL's "for profit" purpose, and a separate entity helps to ensure focus, appropriate governance and management resource and delivery given the opportunity to reset perceptions of FNHL.
- **Commercial Opportunity –** We are currently one of three property developers in New Zealand to have secured a direct relationship with Ministry of Housing and Urban Development which enables us to deliver social housing with a 25-year government lease creating good commercial returns. This financial return, coupled with our strong balance sheet enables us to obtain cost effective lending to deliver housing, which we believe can deliver significant asset growth and profitability, improving our dividend stream for FNDC.
- **Risk Management –** While FNHL can secure external funding for housing based on its current balance sheet and financial performance, we expect a stand-alone entity focused on social housing will enable us to access lending and preferential interest rates from impact funders which will create significant cost savings. However, the new entity also provides some protection for the broader FNHL asset portfolio as we aim to secure social housing financing against these specific income streams for risk mitigation purposes.

Further Commentary

FNHL is first and foremost an asset management and development company, with assets acquired either originally from FNDC, developed or purchased. Our current skills and expertise reflect this core business of property development, ownership and management of property assets, rather than operational management of trading businesses.

While asset management is our core expertise, the diversity of our asset portfolio has helped to mitigate the effects of Covid over recent years and maintain financial performance at levels greater than budgeted. Accordingly, the directors consider this diversity a key strength of the business that needs to be maintained.

Over the last nine years, FNHL has achieved significant asset growth from $40 million to $136 million and has supported a number of key PGF projects across the region owned or managed by FNDC and / or other entities. With a strong pipeline of development activity forecast at Ngawha as we develop the Innovation Park, and community housing opportunities identified, we forecast an asset value of close to $200 million by 2024 based on current valuation evidence.

This growth will occur with a significant program of development activity and requires appropriate governance and management structures in place to maintain focus, monitor execution and manage risk frameworks and processes.

In addition to this planned growth, there is an increasingly complex regulatory environment, specifically relating to Health and Safety, biosecurity and environmental with increasing obligations for directors and senior management. These obligations and risks differ for our various business portfolios, and require different experience and oversight depending on the nature of the operations and risk. It is important that FNHL is structured and resourced appropriately to respond

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to, and proactively mitigate and manage potential risks, including climate change risks given the nature of our maritime assets.

While FNHL has previously been headquartered in Opua due to the marina being our largest asset, the intention is to shift to the Ngawha Park once operational to focus on the development of this Park over time, and to ensure co-location with other key tenants on the Park to help support economic and business initiatives at the Park. With a large number of operational staff based in Opua, we have carefully considered how best to manage this move while protecting the asset value and delivery at Opua and reflecting the significant development opportunity remaining at the marina over the next few years, and significant effort required to re-build international demand for marina services post Covid.

FNHL's greatest exposure to health and safety and environmental risk currently lies in the Marina and Boatyard operation. Currently staff well-being, health and safety is considered in context ofthe whole FNHL business, and we need to ensure specific focus on the operation and mitigations required for these higher-risk, and unique business operations compared to our wider operation.

The Marina is FNHL's largest revenue generating asset and yet, it receives the least of senior staff focus as a result of activities which compete for company resource – significant development projects, PGF project commitments – especially maritime projects, and stakeholder management requirements across the region. This restructure will create dedicated roles and governance focused solely on marina performance to maximise business outcomes, with a target to increase value by lifting the current return on marina investments from 3.46 percent to a more commercial return of 5.5 percent over a 3-year period.

As Councillors know, FNHL is currently completing our first social housing project in Kamo, which has demonstrated the potential for strong revenues and capital growth within this growth sector. Our financial projections expect a gross return in excess of eight percent upon our initial investment and asset value increases of approximately sixty five percent, and we believe these returns can be achieved across our social housing portfolio. Assuming our financial assumptions continue to reflect the economic and political environment, and based on our current development portfolio, we expect to grow the social housing asset base to circa $50 million in three years, with potential further upside possible.

Key Risks

The below table identifies potential risks due to the proposed structural change with responses and mitigations identified.

Strategic Risks	**Likelihood**	**Mitigation**
Inability to comply with legislative requirements within the Local Government Act.	Low	There is no limitation within the Local Government Act preventing the establishment of a wholly owned subsidiary.
Establishment of subsidiaries reduces FNDC's ability to oversee performance and outcomes of FHNL.	Low	As wholly owned subsidiaries, the entitieswill continue to be governed by the SOI between FNDC and FNHL and the FNHL Board remain fully accountable.
Potential legislative changes within the local government sector may impact on FNDC, and the relationshipbetween FNDC and FNHL.	Medium	While there is risk of future changes within the local government sector, FNHL is already a wholly owned subsidiary of FNDC, and the impact of any changes will need to be assessed over time if they eventuate. The creation of wholly owned subsidiaries does not alter this risk as all shares in the subsidiaries (and therefore ultimate asset ownership) remain with FNHL.

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Ratepayer perception that increased costs relating to subsidiaries are an inappropriate use of council funds.	Medium	FNDC is not required to provide any additional funding to FNHL as a result of these changes. We expect to fund the increased costs through improved business performance and return on assets within two years based on indicative modelling and expect further value creation as a result of these changes. FNHL remains committed to delivering dividends outlined in the SOI.
Profitability of subsidiary companies does not track to budget.	Low	Business performance will be monitored by the subsidiary management and board, with regular reporting to the FNHL Board. Any performance deficits will be proactively addressed with remedialaction and / or offset by performance improvements within the wider Group.
Ratepayer perception that increased governance costs are not necessary and / or excessive.	Medium	FNHL has commissioned an independent report on director fees to ensure fees reflect market to support recruitment of appropriate expertise to deliver business outcomes. Company directors carry statutory obligations and exposures, and fees must be appropriate to attract appropriate skills and experience given the organisational activities and related risk profile. In addition, the diversity of the current and planned FNHL portfolio means specific skills and experience are required in order to maximise business performance and manage risk appropriately within different divisions. This re-structure enables us to recruit specialist expertise accordingly. Company communications or media should reflect the above.
Transferring asset ownership to subsidiaries reduces Council influence and increases possibility of asset disposals in the future.	Low	The proposed change is to improve business performance and manage risk primarily, and the Directors do not haveany intention of selling strategic company assets. As previously indicated, we welcome the opportunity to review the entire company portfolio to identify any strategic assets that must be retained or subject to FNDC approval prior to disposal.

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Stakeholder perception this change is due to under-performance by the current management and Board.	Medium	FNHL has consistently delivered to most performance outcomes within the SOI, as a minimum guideline for performance. Significant asset growth and profitability has been achieved over recent financial years, despite Covid challenges. This change acknowledges the broad portfolio of FNHL's assets, and the need to acquire additional skills and expertise to manage risk and maximise business performance. Company communications or media should reflect the above.
Existing debt/equity ratios are impacted by the new company arrangements	1. Low	2. The new companies will form a consolidated group and the existing ratios will be measured for the group. There will be no change to the ratios or impact on borrowing capacity.

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