

Crown Irrigation Investments Limited

Investment Update – Central Plains Water

Date circulated	14 February 2014
Date to be considered	21 February 2014

Purpose of paper

To provide an update on engagement with Central Plains Water (CPW) since the last Board meeting.

An updated briefing will be presented at the 21 February Board meeting.

Recommendations

That the Board:

Note the conditions precedent and due diligence that apply to the proposed CPW terms sheet and commitment letter.

Approve the Chief Executive to negotiate a final terms sheet, on the basis of the key terms set out in this paper.

Approve the Chief Executive to provide a commitment letter and attached terms sheet to CPW on the 28 February.

Update on scheme development since the last Board meeting

Financing

CPW and its senior banking syndicate are close to agreeing a final terms sheet. Financial close for the senior banking syndicate is *s 9(2)(b)(ii), s 9(2)(ba)(i)*.

s 9(2)(b)(ii), s 9(2)(ba)(i), s 9(2)(j)

amount of capital CPW requires from CIIL to \$6.5 million. Management considers that this outcome is consistent with CIIL's investment objective of facilitating maximum investment from other sources of capital.

Since the last board meeting management have been negotiating with both CPW and its banking syndicate. At the time of writing this paper management had agreed the key terms of a \$6.5m mezzanine debt facility with CPW (subject to board approval).

Design and Construction

s 9(2)(b)(ii), s 9(2)(ba)(i)



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Economic benefits

s 9(2)(b)(ii), s 9(2)(ba)(i), s 9(2)(j)

CIL terms

Proposed terms for investment are outlined in the table below.

The status of these terms are as follows:

- Agreement in principle from the CPW board on 14 February.
- A common understanding of the objectives and constraints of CIL and the banks, and agreement in principle to the material aspects of the terms sheet. Management will be seeking final bank comments on the CIL terms sheet in the week commencing 17 February 2014 and do not anticipate any material issues.

The key terms are as follows:

Facility amount	\$6,500,000 s 9(2)(b)(ii), s 9(2)(j)
Target Financial close	At latest 30 June 2014 (earlier if possible)
Drawdown	s 9(2)(b)(ii), s 9(2)(j)
Interest rate mechanism	s 9(2)(b)(ii), s 9(2)(j)
Payment of interest	s 9(2)(b)(ii), s 9(2)(j)
Tenor	June 2019
Repayment	s 9(2)(b)(ii), s 9(2)(j)
Prepayment	s 9(2)(b)(ii), s 9(2)(j)
Covenants	s 9(2)(b)(ii), s 9(2)(j)
Costs	s 9(2)(b)(ii), s 9(2)(j)

¹ Assuming a discount rate of 4% as recommend by NZIER.

² CPW's economic benefits study was prepared in 2009.



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Conditions precedent	<i>s 9(2)(b)(ii), s 9(2)(j)</i>
Subordination & inter-creditor matters	Fully subordinated to senior debt providers

The purpose of the mezzanine debt facility is to cover excess capacity in the headrace to be built during Stage 1 construction that is needed for Stage 2. Management considers that this represents demand risk, as the irrigators for Stage 2 have not yet been contracted³.

s 9(2)(b)(ii), s 9(2)(j)

The conditions precedent allow up to four months for comprehensive CIIL due diligence and board approval, *s 9(2)(b)(ii), s 9(2)(ba)(i), s 9(2)(j)*.

Investment objective and CIIL economics

Consistent with CIIL investment mandate

Based on our assessment to date, management consider that the proposed mezzanine debt instrument is consistent with the CIIL investment objective and investment principles.

Refer to Appendix 1 for a summary assessment of the investment relative to CIIL's investment principles.

CIIL economics

s 9(2)(b)(ii), s 9(2)(ba)(i), s 9(2)(j)

³ Contracting irrigators for water is the same as issuing equity for CPW as it is a co-operative scheme.



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Allocation of capital to this facility

s 9(2)(b)(ii), s 9(2)(ba)(i), s 9(2)(j)

CILL, management considers that it is appropriate to allocate \$6.5m of CILL capital to this investment.

Risks

s 9(2)(b)(ii), s 9(2)(ba)(i), s 9(2)(j)

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Next steps

CIIL risks will be comprehensively assessed during due diligence, and mitigations reflected in documentation or through other mechanisms as appropriate.

Steps to final terms sheet

CIIL management will work with CPW and the senior debt syndicate 17-21 February 2014 to agree a final terms sheet.

Shareholder approval will not be required for this transaction as the proposed investment will not meet the major transactions threshold in the Companies Act 1993⁵. Shareholding Ministers will be consulted on the transaction only. The Board Chair and Chief Executive will consult with shareholding Ministers on 19 February 2014 and report back to the Board at the 21 February 2014 meeting.

With a delegation from the Board, the CIIL Chief Executive intends to send a commitment letter with a finalised terms sheet (including conditions precedent) to CPW on 28 February 2014.

A draft commitment letter is included at Appendix 3 for the Board's reference.

Process: due diligence, documentation and final board approval

Due diligence

s 9(2)(b)(ii), s 9(2)(j)

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⁵ The memorandum received from Chapman Tripp outlining this is attached as Appendix 2 to this paper



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Final Board approval process

The Board will receive a full investment case paper, the due diligence reports and loan agreement. Expert advisors will be available as required.

The full investment case to Shareholding Ministers and The Treasury as part of consultation

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Appendix 1: CIIL investment principles

Investment principles	Initial assessment
Scheme level principles. Schemes must:	
Be based on off-farm water storage and irrigation infrastructure that contribute regional economic benefits.	s 9(2)(b)(ii), s 9(2)(ba)(i), s 9(2)(j)
Be 'Investment Ready'. To be Investment Ready, schemes must: <ul style="list-style-type: none"> • Be technically feasible; • Have the required resource consents in place; • Have sound governance and management structures and appropriate capability; and • Be commercially viable subject to the need for CIIL investment to support the expected shortfall in uptake. 	s 9(2)(b)(ii), s 9(2)(ba)(i), s 9(2)(j)
Be optimally sized (an appropriate size for the area to be irrigated over the longer term).	s 9(2)(b)(ii), s 9(2)(ba)(i), s 9(2)(j)
Have appropriately allocated scheme risks between customers, suppliers, investors and lenders.	s 9(2)(b)(ii), s 9(2)(ba)(i), s 9(2)(j)
Have appropriate contractual or scheme governance arrangements in place that address any competition policy issues in a way that is not inconsistent with the long term interests of the end users of the irrigation infrastructure.	s 9(2)(b)(ii), s 9(2)(ba)(i), s 9(2)(j)
CIIL terms & scheme capital structure	
CIIL should not provide more than 50% of the proposed capital cost of a scheme.	s 9(2)(b)(ii), s 9(2)(ba)(i), s 9(2)(j)
CIIL should have a clear exit strategy and the exit mechanism should be established at the point of CIIL investment.	s 9(2)(b)(ii), s 9(2)(ba)(i), s 9(2)(j)
CIIL should seek an internal rate of return on any investment sufficient to preserve its capital in real terms.	s 9(2)(b)(ii), s 9(2)(ba)(i), s 9(2)(j)
CIIL may consider accepting other risks on a case by case basis.	s 9(2)(b)(ii), s 9(2)(ba)(i), s 9(2)(j)
CIIL should not accept an uncapped exposure to demand risk. CIIL is prepared to accept demand risk until the point of expected commercial viability with respect to demand. Equity investors or other scheme stakeholders will need to accept any residual demand risk from this point	s 9(2)(b)(ii), s 9(2)(ba)(i), s 9(2)(j)
CIIL should not invest to subsidise other investors, irrigators or contractors – this means that CIIL will only invest if it is comfortable that: <ul style="list-style-type: none"> The expected risk / return profile (and associated commercial terms) for other investors are fair That the water price for irrigators is fair; and That the construction price is fair. 	s 9(2)(b)(ii), s 9(2)(ba)(i), s 9(2)(j)
The scheme capital structure (and contracting arrangements as relevant) should be designed to incentivise all parties to drive irrigator uptake.	s 9(2)(b)(ii), s 9(2)(ba)(i), s 9(2)(j)
CIIL's default position is that it will invest in schemes via a debt instrument (given its' risk appetite). CIIL acknowledges that in many circumstances this will need to be a mezzanine debt instrument to avoid crowding out bank debt.	s 9(2)(b)(ii), s 9(2)(ba)(i), s 9(2)(j)
Investment process	
CIIL will not act as a scheme sponsor	s 9(2)(b)(ii), s 9(2)(ba)(i), s 9(2)(j)
CIIL will seek to avoid crowding out other investment and will seek to invest in a manner that encourages investment from other sources	s 9(2)(b)(ii), s 9(2)(ba)(i), s 9(2)(j)



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Appendix 2: Memorandum outlining major transaction considerations

Out of scope of request

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Appendix 3: Draft commitment letter

s 9(2)(b)(ii), s 9(2)(j)

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