



SUBMISSION: Exemptions for small offers of co-operative shares

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A handwritten signature in black ink, appearing to read "Andrew Curtis".

(Andrew Curtis, CEO IrrigationNZ)

Irrigation New Zealand would be happy to engage with the FMA around this submission.

OVERVIEW

1. IrrigationNZ (INZ) is a national body that promotes excellence in irrigation. INZ represents the interests of over 3,600 irrigators (irrigation schemes and individual irrigators) totaling over 360,000ha of irrigation (over 50% of NZ's irrigated area). It also represents the interests of the majority of irrigation service providers (over 150 manufacturers, distributors, design and install companies and consultancies).

SUBMISSION

Question 1

2. There are a growing number of co-operative irrigation schemes that do not meet the small investment test. When co-operative schemes modernise they typically revalue their nominal share values to reflect market value. This enables them to more easily debt fund their scheme modernisation programs. Share market values range between \$1,750 and \$8,000 per hectare depending upon water scarcity, reliability of supply and annual water charges. A typical irrigated farm is in excess of 100 ha so per shareholder investment is therefore well in excess of the proposed \$5,000 threshold.

3. There are five existing irrigation scheme co-operatives that do not meet the revenue test relief for small co-operative exemptions. These are Ashburton Lyndhurst Irrigation Ltd, Barrhill Chertsey Irrigation Ltd, Mayfield Hinds Irrigation Ltd, Opuha Water Ltd and Waimakariri Irrigation Ltd. Four of these are due to scale (16,000 - 32,000 ha irrigated) so annual revenue sits between \$2.5 - 4.5 million, and the other is due to scale (>20,000 ha irrigated) and cost of infrastructure (a recently established modern piped scheme) so annual revenue is approximately \$15 million.
4. It is INZ's viewpoint that it would be a nonsensical approach to discriminate between co-operative irrigation scheme standard offer information, reporting and auditing obligations based on scale. This is effectively what the \$2 million revenue threshold test does. There is no fundamental difference between the investment held in a co-operative company or IPS by an individual shareholder in a small <2,000 ha scheme and a large >20,000 ha one, however the latter will have no relief from the FMC Act.
5. Two possible options to address this issue are:
 - a. Raise the threshold for co-operatives to take account of the above revenues
 - b. Devise an alternate test such as a % profit threshold based on revenue is applied

Questions 2 - 5

6. INZ agrees the principles put forward capture the key elements of irrigation schemes structured other than a co-operative or IPS. However, there are a few irrigation schemes that have made provision for non-transacting shareholders in their constitution. This provides one potential pathway for outside investors, Crown Irrigation Investments Ltd or Local Government for examples, to become investors in new irrigation scheme developments (as dry shareholders). Outside investors are frequently required in the early stages of irrigation scheme development to help bridge the uptake gap. Without this sub-optimal infrastructure development would occur foreclosing the future opportunity from water. Based on past uptake rates, for large scale developments it typically takes between 5 - 15 years for new irrigation scheme to become fully subscribed (dry shares to become wet ones).
7. It is INZ's understanding that many irrigation schemes structured other than a co-operative or IPS already have principles 1 and 2 enshrined in their constitutions. However as above a few have made provision for non-transacting shareholders.

Questions 10 – 11

8. As per the answer to question 1 there are a number of existing irrigation schemes structured other than a co-operative or IPS that do not meet the small investment test.

9. For developing irrigation schemes, it is extremely unlikely they will be able to structure their shareholder investment so as to rely on this test. New schemes such as Central Plains and North Otago Irrigation Company have share values of between \$1,750 and \$4,500 per ha and an irrigated farm (shareholder investment) is typically greater than 100 ha. Share values for developing irrigation schemes are determined through balancing the upfront capital investment with the annual debt servicing cost (in combination with operating costs this makes up the annual charge) after consultation with potential scheme shareholders. It would be highly illogical to structure an irrigation schemes commercial model so as each shareholder's total investment remained below \$5,000.

Question 13 - 14

10. There are currently two existing irrigation schemes structured other than a co-operative or IPS that do not meet the revenue test relief for small co-operative exemptions - North Otago Irrigation Company and Central Plains Water Ltd. These are due to scale (>20,000 ha irrigated) and cost of infrastructure (recently established modern piped schemes) so annual revenue is between \$15 - 16 million.

11. These two scheme will soon be joined by Amuri Irrigation Company Limited (>20,000 ha). Their current revenue is approximately \$1.5 million, however, the \$92 million scheme piping upgrade for which construction started September 2016 is estimated to increase their annual revenue to in excess of \$4 million (the Amuri modernisation is comparable to the Ashburton Lyndhurst one).

12. There are also four other irrigation schemes forecast to be under construction by 2020 - Manuherikia, Hunter Downs, Hurunui Water Project and Water Wairarapa, that will likely be structured other than a co-operative or IPS but run on co-operative principles. These will not meet the revenue test relief for small co-operative exemptions. Each of these schemes are of scale (>15,000 ha) and will involve infrastructure development costs in excess of \$100 million.

13. As per co-operatives, it is INZ's viewpoint that it would be a nonsensical approach to discriminate between irrigation schemes reporting and auditing requirements based on scale. There is no fundamental difference between the investment held by shareholders in a small <2,000 ha scheme and a large >20,000 ha one, however the latter will have no relief from the overly complex financial reporting and auditing of the FMC Act.

14. As per before the options to address this issue are:

- a. Raise the threshold for structures other than a co-operative or IPS to take account of the above revenues, noting the co-operative principles will prevent others from taking advantage of this provision

- b. An alternate test such as a % profit threshold based on revenue is applied
15. It should also be noted regardless of structure all schemes >20,000 ha will soon trip the threshold. In addition to Amuri Irrigation Ltd there are two remaining schemes of scale, Lower Waitaki Irrigation Ltd and Moreven Glenavy Ikawai Irrigation Company Ltd. These currently have incomes in the \$1.2 - 1.5 million range but also have future modernisation opportunities, meaning their threshold will be exceeded at some point in the not too distant future.

Questions 15 – 17

16. From INZ interactions with irrigation schemes, in addition to the increased cost when moving from the Companies Act reporting and auditing obligations to those under the FMC Act, there are two further issues the new obligations have created -
- Literacy of annual accounts by shareholders at the AGM. Many schemes have had and still have issues 'retraining' their shareholders in the different format and have subsequently continued to provide annual accounts at the AGM in the previous format. This comes at an additional reporting cost to the scheme.
 - It has been noted the reporting and auditing expectations (IFRS) now required under the FMC Act have changed (become more onerous) year on year. This compounds upon the already marked cost differential between the two approaches.

Question 19 – 23

17. With regard to the standard offer information relief, there is no difference in the nature of irrigation schemes regardless of their structure. The principles section of the consultation document highlights this. Standard offer information relief as for co-operatives and IPS's should therefore be included for other structures.
18. The savings that would be generated from an ability to better tailor a PDS for irrigation schemes to highlight the benefits and risks of becoming an irrigation scheme shareholder are of greatest benefit to the four developing schemes listed in point 12. For the existing irrigation schemes, it is a mixed bag, some have already worked their way through the new requirements and others are yet to do so and thus see an advantage in the relief.

SUBMISSION ENDS