Investing in the Trust Waikato region

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1.1 Executive summary

Trust Waikato is considering investing directly in its region in order to meet felt or expressed needs to be seen to be more active locally and to be seen to support development in its community. Regional investing may allow TW to become more engaged with the business sector in the region.

Having spent over six weeks studying this, we are wary of regional investment and believe that investment performance would suffer. It still remains unclear why engagement with the business community is necessary or how it meets the purposes of TW.

Regional investment means moving away from investing widely through managed funds with decisions made by skilled professionals. Instead, to become direct investors in the region, Trust funds would be used to purchase specific business, properties or to make loans to individuals or entities and the Trust would need to develop skills that it does not already have. The Trust currently invests indirectly mostly in publically traded markets with known risk/return. Direct investment in non-publically traded markets is much more opaque and would reduce diversification.

Regional and direct investment diminishes the investment 'universe' of opportunities for Trust Waikato and is likely to result in lower returns and/or greater risk. Regional and direct investments should only be made if risks and returns are commensurate with investments made elsewhere and this would always be difficult to predict and measure in opaque markets. Nevertheless, it is most likely that if investment returns can be maintained, regional investment with its smaller universe would see increased risk. If the Trust chooses to proceed we recommend that expert advice is used at every stage and level.

There does not appear to be any clearly identified need for the Trust's investment funds in the TW region. Good quality investments are generally well bid in the region.

The trust should be wary of split objectives when investing – investment objectives do not always sit well with economic development and regional support goals. Split objectives are always a problem in investment:

- Good returns require a pure commercial approach
- Investments that satisfy the required criteria are hard to find
- Social objectives compromise returns or increase risk
- There is a chance that neither objective is met

Regional support goals may be better met through the granting arm of TW – likely in combination with other potential funders in the region who share similar goals.

The role of the Trust is very clearly to support social development not economic development – economic development is not a charitable purpose. It is important that the two are not confused.

Engagement with the community needs to be evaluated and if found to be important (and insufficient for the Trust's purposes) should be sought in other ways.

Investing in the region may mean competing with the private sector: the Trust's own people. Competing with the private sector:

- May indicate TW's involvement was unnecessary
- May irritate players in that sector
- May arouse jealousies and perceptions of playing 'favourites' or inequitable treatment

At the same time any investment that cannot attract capital is unlikely to be suitable for Trust investment.

Regional investments may tie the hands of future trustees as not only are these investments relatively illiquid but there would be other considerations given that they are in the TW communities. The Trust is perpetual but the Trustees are not.

There is considerable reputation risk for TW if investments fail, perform poorly, attract undue publicity or in any way become a 'white elephant'. Trustees should beware of the front page of the 'Waikato Times' test.

If TW chooses to become a direct investor in the region, individual trustees could be exposed to considerable lobbying. There is also a risk of fracturing the board over particular investments.

If the Trust decides to invest regionally and directly it should set up a special purpose vehicle with its own board. This vehicle could be a limited partnership but advice should be taken on this.

Regional investment will necessarily be direct investment meaning the purchase of specific investments rather than via expertly advised managed funds. However, if it went ahead, TW may be able to contract out all or part of the management functions. There are considerable costs and difficulties attached to managing regional investment whether outsourced or managed internally. There is little current capacity to manage direct investing within TW.

The amount in play for regional investment is a very important decision. Quantum issues include:

- Too little investment has no effect either for investment returns or socially/economically and would be relatively expensive (though it may build engagement)
- Not enough investment would compromise the ability to purchase investments of quality in either the property or private equity markets

- Too much in a few investments carries a lot of concentration risk
- A relatively modest sum spread enough for sector and asset class diversification would lead to quality compromises.
- Too much invested regionally could inhibit granting when the economic cycle in region turns down.
- Too much investment and loss of liquidity would make rebalancing and tactical asset allocation difficult.

Business engagement, if any, may be spotty, and piecemeal. We question the purpose of that engagement – there appears to be little or no social good and it does not seem to add to the work of the Trust.

This report provides consideration of possible regional investment including the purchase of businesses, commercial property and making loans via third parties for photovoltaic cell installation. However, we think it unlikely that any of these satisfy the risk and return criteria we would expect the Trustees to require.

In the event that TW does want to proceed with any of these, we recommend thorough detailed analysis of specific projects and that the smallest amounts possible be invested initially. We also recommend an arm’s length structure for any such investment.

Although we explore options and means of regional investment in this report, it is our firm advice that the Trust should not proceed with making such investments. We believe that the various risks outweigh the benefits that might accrue and recommend that the Trust maintains its investment approach as it is.