

SOUTH WAIRARAPA DISTRICT COUNCIL

14 DECEMBER 2011

AGENDA ITEM C5

CIVIC ASSURANCE CAPITAL RAISING

Purpose of Report

To obtain approval for South Wairarapa District Council to purchase an additional 38,965 shares in the New Zealand Local Government Insurance Corporation Ltd ("Civic Assurance").

Recommendations

Officers recommend that the Council:

Receive the information.

Agrees to the resolution being put to Civic Assurance's shareholders at its Special General Meeting on 16 December 2011 (or any adjournment thereof) that in accordance with clause 2.1.1 of its constitution, Civic Assurance undertakes the Rights Issue, Placement and Shortfall Offer whereby Civic Assurance issues up to 7,206,790 new shares for a consideration of \$0.90 per new share.

Agrees to the resolution being put to Civic Assurance's shareholders at its Special General Meeting on 16 December 2011 (or any adjournment thereof) that clause 2.1.2 of its constitution is deleted and that a new clause 2.1.2 is inserted as follows: "Section 45(1) of the Act does not apply to the issue of shares in the company."

Subscribes to Civic's share offer for the rights issue and placement for 38,965 shares. The investment will be \$35,068.50.

Rejects *Civic's Shortfall Offer for an additional 36,052 shares.*

Authorises the Chief Executive to appoint and instruct a representative or proxy to vote at the Special General Meeting (or any adjournment thereof) in accordance with resolutions 1 and 2 above.

1. Background

New Zealand Local Government Insurance Corporation Ltd ("Civic Assurance") have called a Special General Meeting to discuss:

- Issuing up to 7,206,790 new shares
- Raising additional capital through a "rights issue"
- Raising further capital through a new share purchase plan "placement"

The rationale for raising this additional capital is to strengthen Civic's balance sheet, which will improve the credit rating to the extent it will be able to re-enter the local authority property insurance market

SWDC currently holds 29,695 shares out of total issued 6,390,790, or 0.4%

2. Discussion

The following draft paper has been received from Civic Assurance. The paper has been left in draft form as it sets out all issues, however the final recommendations above are not identical to those included in the draft paper below.

2.1 Draft Paper

2.1.1. Background

Council holds 26,965 ordinary shares in New Zealand Local Government Insurance Corporation Ltd (trading as Civic Assurance). Following the large claims cost from the Christchurch earthquakes (costing Civic three deductibles of \$3.6 million each – the rest being covered by reinsurance), Civic Assurance wishes to raise extra capital. To do this Civic is holding a Special General Meeting on 16 December 2011 at which shareholders will be requested to approve:

1. A change to Civic Assurance's constitution by replacing clause 2.1.2, which seemingly says (it is ambiguous) that section 45(1) of the Companies Act applies, with a clause that says that section 45(1) of the Act does not apply. The change is required to allow the placement offer. Note: Civic's shareholders will still be protected by clause 2.1.1, which requires changes to its share capital to be approved by a 75% majority, and that changes to Civic's constitution require the consent of the Minister of Finance under the Municipal Insurance Act 1960. Consent from the Minister of Finance to make this change has been obtained.
2. The issue of up to 7,206,790 new shares in a rights, placement and shortfall offer to existing shareholders at \$0.90 per share.

It is recommended that the Council approves the following resolutions:

1. That the Council votes in favour to the resolution being put to Civic Assurance's shareholders at its Special General Meeting on 16 December 2011 (or any adjournment thereof) that in accordance with clause 2.1.1 of its constitution, Civic Assurance undertakes the Rights Issue, Placement and Shortfall Offer whereby Civic Assurance issues up to 7,206,790 new shares for a consideration of \$0.90 per new share.
2. That the Council votes in favour to the resolution being put to Civic Assurance's shareholders at its Special General Meeting on 16 December 2011 (or any adjournment thereof) that clause 2.1.2 of its constitution is deleted and that a new clause 2.1.2 is inserted as follows: "Section 45(1) of the Act does not apply to the issue of shares in the company."
3. That the Council subscribes to Civic's share offer for the rights issue and placement for 38,965 shares. The investment will be \$35,068.50.
4. That the Council applies under Civic's Shortfall Offer for an additional 36,052 shares for an investment of \$32,446.67. *[These figures have been used for illustration only.]* If Civic's Shortfall Offer is fully subscribed and Council gets its full allocation, then this would take the percentage of Civic's shares held by the Council from 0.42% to 0.75%.

3. Options

3.1 Option 1

Option 1 is to do nothing – not participate in any of the capital raising options.

This option is **not recommended**, the key reason for not recommending this option is that the Local Authority insurance market needs competition.

The additional capital Civic is seeking will strengthen its balance sheet, which will in turn allow it to re-enter the local authority property insurance market.

We have seen "supernormal" increases in premiums due to the fact that there is no competition in the market.

We had anticipated a significant increase due to the Canterbury events; however the premiums rose to an even higher level (supernormal) than would have been attributed solely to that event due to the lack of competition.

3.2 Option 2

Only participate in the "rights issue" aspect of this proposal.

This is the **recommended** option.

This option is recommended as the key outcome from this exercise is to strengthen Civic' balance sheet to the extent it can participate in the local government property market, thus creating competition.

The cost of this option is \$35,068.50, being 38,965 shares at \$0.90 per share.

This is the least cost option where we can ensure Civic return to the market.

There is a risk, that even if the capital is raised, the credit rating agencies do not lift Civic's rating to a level that would allow it to re enter the market. This question was put to Tim Sole; Chief Executive of Civic Assurance, Tim's response is below:

"I am as confident as I can be that raising the \$6.486M will achieve the increase in credit rating sufficient to allow Civic to re enter the property market."

Another key reason for recommending participating in the purchase of additional shares is that the cost over time will be neutral or positive. While it is virtually impossible to ascertain the "supernormal" increase in premiums, it could well be many thousands of dollars, and over time I am confident the cost will be recovered.

3.3 Option 3

New Share Purchase. This option is the **not** recommended, simply due to the cost of exercising this option, which is in addition to the rights issue.

The cost of this option will be up to (we can purchase lesser amounts) 36,052 shares at \$0.90c = \$32,446.67.

A further reason for not recommending this option is that the fundamental goal of this capital raising exercise is to raise the credit rating from B++ to A-, and this should be achieved through the "Rights Issue".

Note however that if all other LA's take up the share purchase plan, and SWDC does not take up the New Share Placement, then SWDC proportion of shares will diminish.

In reality this will have no practical effect, as our existing 36,052 shares represent only 0.4% of total issued shares.

4. Financial Considerations

It is recommended this investment be funded as part of our existing investment pool.

5. Appendix

Appendix 1 – Civic Assurance Background Papers

Contact Officer: Paul Crimp, Group Manager Corporate Support

Appendix 1 - Civic Assurance Background Papers

15 November 2011

Dr Jack Dowds
Chief Executive
South Wairarapa District Council
PO Box 6
Martinborough 5741

Dear Jack,

Civic's Proposed Capital Raising

I am writing to advise you that in the next few days you will receive formal notice of an SGM (Special General Meeting) being held by Civic for its shareholders. Today's letter and its enclosures give some background to the SGM as well as a draft paper that you may find useful when advising your Council on this matter.

In summary, following the large claims cost from the Christchurch earthquakes, Civic Assurance wishes to raise extra capital. To do this, Civic's shareholders will be requested at an SGM to be held on 16 December 2011 to approve:

- A change to Civic Assurance's constitution to allow the placement offer.
- The issue of up to 7,206,790 new shares in a rights, placement and shortfall offer to existing shareholders at \$0.90 per share.

The aim of this capital raising is to return Civic's AM Best credit rating from B++ (Good) to at least A- (Excellent) in order that Civic can compete successfully in the June 2012 property insurance renewals. This will be good for local authorities, but it should also be good for Civic's shareholders. Using the latest available (but unaudited) figures, net asset value per share is \$1.70, so the proposed issue price of \$0.90 per share represents a 47% discount to net asset value making the offer and in particular the pricing of the 'shortfall shares' (shares not taken up by other councils) quite attractive.

A booklet Civic published last month concerning the offer is enclosed together with a sheet of 'Questions and Answers'. Any other questions you may have, please ring me.

Yours sincerely



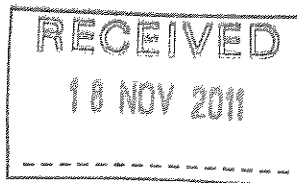
Tim Sole
Chief Executive
DDI: 04-978-1254

Civic Assurance,
114 Lambton Quay,
PO Box 5521, Wellington 6145,
<http://www.civicasurance.co.nz>
Tel: (04) 978 1250 Fax: (04) 978 1260



Civic Assurance

PROTECTING COMMUNITY ASSETS



17 November 2011

Mr Jack Dowds
Chief Executive
South Wairarapa District Council
PO Box 6
MARTINBOROUGH 5741

Dear Jack,

New Zealand Local Government Insurance Corporation Ltd (“Civic Assurance”)

Notice is hereby given pursuant to clause 13.6.1 of Civic Assurance’s constitution that a Special General Meeting of Shareholders of Civic Assurance will be held at Civic Assurance House (9th floor), 114 Lambton Quay, Wellington on Friday, 16 December 2011, commencing at noon (“**Meeting**”).

EXPLANATORY NOTES

Capital Raising

The Directors of Civic Assurance propose to raise an additional \$6,486,111 of capital by offering its existing shareholders the opportunity to participate in a Rights Issue and Share Purchase Plan (together, **Capital Raising**) whereby each shareholder will be provided with an entitlement to both:

- One Share for every Share already held, at an issue price of \$0.90 per New Share (**Rights Issue**); and
- 12,000 Shares at an issue price of \$0.90 per New Share (**Placement**).

The \$0.90 Issue Price using Civic Assurance’s unaudited management accounts as at 30 September 2011 represents a 47% discount to the current net asset backing per share of Civic Assurance.

In addition to the Rights entitlement and the Placement entitlement, it is proposed that eligible shareholders who take up their entitlements in full may apply for additional New Shares in the event some shareholders do not subscribe for all their entitlements.

Civic Assurance,
114 Lambton Quay,
PO Box 5521, Wellington 6145,
<http://www.civicasurance.co.nz>

The new capital raised pursuant to the Capital Raising should better enable Civic Assurance to re-enter the property insurance market for the benefit of the Company and its shareholders by virtue of an improved rating from AM Best Ratings (from 'Good' to 'Excellent', Civic Assurance's rating before the Christchurch Earthquakes), which is considered likely if sufficient additional capital can be raised through this Capital Raising.

Pursuant to clause 2.1.1 of the Constitution, the Directors seek the approval of shareholders to the issue of up to 7,206,790 New Shares, at a value of \$0.90 per New Share, for maximum total consideration of \$6,486,111.

Amendment to Constitution

Clause 2.1.1 of Civic Assurance's constitution ("**Constitution**") states that:

"The board may only issue additional shares, with the approval of the shareholders, by special resolution."

A special resolution is a resolution of shareholders approved by a majority of seventy five percent of the votes of those shareholders entitled to vote and voting on the question.

Clause 2.1.2 goes on to state that:

"Unless the terms of issue of any class of shares specifically otherwise provide, the board may only issue shares that rank equally as to voting or distribution rights or both, with existing shares, and the shares shall be first offered to existing shareholders."

The Directors consider that Clause 2.1.2 is not clearly drafted and is ambiguous. Civic Assurance has received legal advice confirming this. Given the protection granted to shareholders in clause 2.1.1, that the board may only issue additional shares with the approval of shareholders by way of special resolution, the Directors are of the opinion that clause 2.1.2 should be deleted from the Constitution.

Further, pursuant to the Companies Act 1993 (**Act**), section 45(1) provides that, unless the constitution states otherwise:

"Shares issued or proposed to be issued by a company that rank or would rank as to voting or distribution rights, or both, equally with or prior to shares already issued by the company must be offered for acquisition to the holders of the shares already issued in a manner and on terms that would, if accepted maintain the existing voting or distribution rights, or both, of those holders."

The Placement component of the Capital Raising does not comply with section 45(1) as offering 12,000 Shares to each shareholder will not maintain the existing voting / distribution rights of each shareholder.

The Directors propose that the Constitution is amended to provide that section 45(1) of the Companies Act does not apply to Civic Assurance. As well as allowing the Capital Raising to proceed, this would mean that the board would have greater flexibility in any

future share issues (including the possibility of adding new shareholders if it is deemed appropriate). Any new share issue will still be subject to the protection in clause 2.1.1 of the Constitution (set out above).

Changes to the constitution of Civic Assurance require the agreement of the Minister of Finance under the Municipal Insurance Act 1960. The agreement from the Minister of Finance to make the changes detailed above has been obtained.

RESOLUTIONS

At the Meeting, the following resolutions will be considered and voted upon:

1. That in accordance with clause 2.1.1 of the Constitution, Civic Assurance undertakes the Rights Issue, Placement and Shortfall Offer whereby Civic Assurance issues up to 7,206,790 New Shares, for consideration of \$0.90 per New Share.
2. That clause 2.1.2 of the Constitution is deleted.
3. That a new clause 2.1.2 of the Constitution is inserted as follows: "Section 45(1) of the Act does not apply to the issue of shares in the company."

PROXIES / APPOINTED REPRESENTATIVES

A Shareholder Member entitled to attend and vote but unable to do so may appoint a proxy for this meeting or any adjournment thereof. Alternatively, Shareholder Members may appoint a representative to exercise its right at the meeting or any adjournment thereof, pursuant to Clause 14.3 of the Constitution of the Company. A completed proxy form/notice in writing of appointment of a representative signed by the Shareholder Member, must be lodged at the registered office of the Company not less than 24 hours before the start of the meeting.

I look forward to seeing you at the Meeting.

Yours sincerely,



Bryan Taylor
Chairman

Proposed Amendment to Constitution – More Detailed Explanation

Clause 2.1.1 of Civic Assurance's constitution ("**Constitution**") states that:

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The Placement component of the Capital Raising does not comply with section 45(1) as offering 12,000 Shares to each shareholder will not maintain the existing voting / distribution rights of each shareholder.

The Directors propose that the Constitution is amended to provide that section 45(1) of the Companies Act does not apply to Civic Assurance. As well as allowing the Capital Raising to proceed, this would mean that the board would have greater flexibility in any future share issues (including the possibility of adding new shareholders if it is deemed appropriate). Any new share issue will still be subject to the protection in clause 2.1.1 of the Constitution (shown above).

Capital Raising ‘Questions & Answers’

1. *Is Civic going bust?*

No. Civic at 30 September 2011 had (unaudited) net equity of \$10.86 million, it is still offering insurance cover for other than buildings, and it is still receiving fee income to cover its overheads from administering LAPP, Riskpool and SuperEasy (which incidentally has just exceeded \$100 million of funds under management). Civic’s credit rating from AM Best is B++ (Good), which is OK, but the aim of the capital raising is to get that rating to at least A- (Excellent).

2. *Is there general support for this capital raising?*

LGNZ National Council at their October meeting gave Civic’s proposed capital raising their full support. Civic’s largest shareholders have indicated their support. Zone meetings (the five out of six that have so far been held in the current round) have also been supportive.

3. *What if Civic doesn’t raise the full \$6.5 million it is seeking?*

Civic might need to take a lower reinsurance deductible so it would then expect to be a little less profitable. See also the answer to question 12.

4. *What is Civic’s dividend history?*

There was no dividend in 2010 as that year Civic made a loss as a consequence of the 2010 Darfield earthquake. Dividends in the five years before that were:

Year	Dividend as Cents Per Share
2005	12.0
2006	12.6
2007	13.2
2008	13.9
2009	7.6
Average	11.86

If Civic’s capital raising is fully subscribed, then the number of shares will increase from 6,390,790 to 13,597,580. On this number of shares the comparative average dividend as cents per share for the five years to 2009 is 5.57.

5. *How safe is the money due to Civic from its Christchurch earthquake reinsurers?*

All of Civic’s earthquake reinsurers have an ‘A-’ rating or better.

6. *How much capital does Civic need to buy reinsurance?*

Capital strength is not needed to buy reinsurance any more than a buyer of car insurance would be expected to prove their creditworthiness. Buyers of insurance such as local authorities however would usually require their insurer to have a good credit rating, and that usually means a rating of A- or better.

7. *Have insurance premiums peaked?*

Probably not. Much depends on what other events happen in the next six months within New Zealand, the Pacific region, and actually the whole world.

8. *How many Councils hold shares in Civic?*

67 out of a possible 78.

9. *What are the 'Shortfall Shares'?*

If a shareholder does not take up its share allocation in full, the shares not subscribed for become 'Shortfall Shares' and the other shareholders can apply for these. Councils who do not hold shares in Civic cannot subscribe at this time.

10. *Does Civic have any profit projections?*

There is too much uncertainty in the insurance market for Civic to make meaningful profit projections. However, it can be said that Civic was profitable for 48 years in a row before recording its first loss in 2010.

11. *Will this investment fit my Council's investment policy?*

Most councils have a requirement that all or most of their fixed interest investments should have a credit rating of A- or better and that any banks they use for their deposits must be similarly rated. They would not have such a requirement for their investments in shares because shares (just like property investments) do not carry credit ratings.

12. *What if Civic is hit by another disaster?*

Civic is aiming to raise a bit more capital than it needs so as to allow for a safety margin should it experience another set of large claims.

13. *Should councils self insure?*

Only to a limited extent. In a large event there are usually significant uninsured costs anyway and commonly the situation is aggravated by reduced revenues. At the risk of stating the obvious, a council that uses its own capital to support itself in a disaster will not have that capital to use again after that disaster has occurred. Insurance allows each generation to meet the costs of their risk exposures.

14. *What else can councils do to help Civic?*

Ask for a quote in 2012! However, for Civic to provide you with a quote you will need to provide much more information on what you wish to insure than you have done in the past. For example, instead of just an address and a sum insured, Civic will need to know (so it can tell its reinsurers) the age of the building, the construction, its earthquake rating, what it is used for and the number of storeys.

Other questions? Contact Tim Sole on (04) 978 1254 or tim.sole@civicassurance.co.nz.

New Zealand Local Government Insurance Corporation Limited Proxy Form

The _____ (Council Name)

of _____ being a Member of the New Zealand Local Government Insurance Corporation Limited hereby appoints

_____ of _____ or, failing him or her

_____ of _____ as its proxy to vote for it and on its behalf at the Special General Meeting of the Company to be held on 16 December 2012 and at any adjournment thereof (Refer reverse page).

Unless otherwise directed as below, the proxy will vote or abstain from voting as he or she thinks fit.

Should the Shareholder Member wish to instruct its Proxy or representative how to vote the following should be completed:

Agenda Item

In Favour (✓)	Against (✓)
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1. **To approve the Rights Issue, Placement, and Shortfall Offer**

That in accordance with clause 2.1.1 of the constitution, Civic Assurance undertake the Rights Issue, Placement and Shortfall Offer whereby Civic Assurance issues up to 7,206,790 New Shares, for consideration of \$0.90 per New Share.

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2. **To delete clause 2.1.2 of the Constitution**

That clause 2.1.2 of the Constitution is deleted.

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3. **To insert a new clause 2.1.2 of the Constitution**

That a new clause 2.1.2 of the Constitution is inserted as follows:
“Section 45(1) of the Act does not apply to the issue of shares in the company.”

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EXECUTED this _____ day of _____ 2011.

Signature of Shareholder(s)

Position(s) Held

Please return to: General Manager-Finance, Civic Assurance, PO Box 5521, Wellington 6145, or Fax (04) 978 1260 to be received prior to 12 noon 15 December 2011.

ATTENDANCE AT MEETINGS OF THE COMPANY

The Constitution provides for members to be represented at meetings of the Company **only** by proxies or appointed representatives.

Clause 14.3 (as amended in May 2004) provides:

“A shareholder may exercise the right to vote by being present by a representative or by proxy.

The representative or proxy for a shareholder is entitled to attend and be heard and vote at a meeting of shareholders as if the representative or proxy were a shareholder.

A proxy must be appointed in writing signed by the shareholder and the notice must state whether the appointment is for a particular meeting or a specified term not exceeding twelve months.

No proxy is effective in relation to a meeting unless a copy of the notice of appointment is produced to the registered office of the company not later than twenty-four hours before the start of the meeting.

A shareholder may appoint a representative to attend a meeting of shareholders on its behalf in the same manner as that in which it could appoint a proxy”.

Accordingly, proxies/notification of appointed representatives must be received at the Company’s registered office by 12 noon 15 December 2011.