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McKinlay Douglas Ltd

Proposed Opotiki Community Trust

Guidelines prepared for the assistance of the Steering Group responsible for the establishment of the Opotiki Community Trust

McKinlay Douglas Ltd

April 2007

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GUIDELINES FOR THE ESTABLISHMENT OF THE OPOTIKI COMMUNITY TRUST

INTRODUCTION

This paper has been prepared to assist with the process of establishing a community trust for the benefit of the Opotiki District. It first covers the background leading up to the decision in principle that such a trust should be established, then considers the nature of the proposed trust and its establishment and finally works through five matters identified by the steering committee as central to the effective operation of the trust (the steering committee is group invited by the Council to assist it with the establishment of the trust).

BACKGROUND

The idea of establishing a community trust for the benefit of the Opotiki District was first in floated in 2005. The reasons included creating something which could capture part of the expected commercial benefits from the Opotiki Harbour redevelopment.

The council believed it important that, to the extent it was reasonably possible to do so, the associated commercial benefits from the Harbour redevelopment should flow back to the Opotiki community. At the same time, the council did not believe that it was part of its business to become actively engaged in commercial activity. "There are things the council should not be doing but that the community should".

It also considered that the trust could play an important role, within the community, as a body which could act on behalf of individuals or groups who wanted to make donations or leave bequests for the benefit of the community. It is now becoming common for grantmaking trusts to be set up as a means of assisting individuals or groups who wish to benefit the community by providing a means for ongoing oversight and management of donations and bequests, and a process for making decisions on how best to apply the benefit of those donations and bequests for the community.

A report adopted by the Council at its meeting on the 27th of February 2007 proposed the following purpose and functions for the trust:

Purpose

To increase the social and economic well-being of the Opotiki District Community.

Functions

1. Maximising commercial returns from particular assets, including assets leased from Council.
2. Developing opportunities for community investment.
3. Receiving grants and bequests.
4. Distributing grants.
5. Developing opportunities for economic transformation of the district.

NATURE OF THE TRUST

The Council considered three possible options for the proposed purpose and functions:

1. An in-house business unit.

2. A council controlled organisation (that is an organisation separate from the council, but with at least the majority of its governing board appointed by the Council).
3. A separate entity, independent from but working closely with the Council.

It considered that an in-house business unit was not appropriate as it would involve the council itself undertaking a range of commercial activities outside its normal core business. The second option of a council controlled organisation has a number of disadvantages - for example, even if it was set up as a charitable entity, its income would still be taxable.

The Council accordingly preferred the third option of a separate entity constituted as an incorporated charitable trust. The benefits of this include the fact that it can be directly accountable to and controlled by the community, rather than indirectly through the Council.

Forming the trust as an incorporated charitable trust means that its purpose must be one or more of the four purposes recognized as a charitable under New Zealand law. These are that the trust:

1. Advances education; and/or
2. advances religion; and/or
3. relieves poverty; and/or
4. is otherwise beneficial to the community

As well, the purpose must be of benefit to the public as a whole and not just to a narrowly defined group of individuals.

The proposed purpose "to increase the social and economic well-being of the Opotiki District Community" generally fits within the purposes recognized as charitable although some fine tuning of the exact wording may be required.

The proposed functions can be seen as a mix of wealth creation, wealth management and wealth distribution. It is relatively uncommon for a New Zealand charitable trust to combine all three of these functions (the best-known community trusts, those formed from the former trustee savings banks, are wealth managers and wealth distributors rather than wealth creators in the sense of proactively undertaking commercial activity). However, this type of trust is quite common overseas. Examples include development trusts in England and community development corporations in North America. These all combine the role of wealth creation through commercial activity, with wealth distribution through a grant making/community development arm.

What this does require is care in the design of the trust to ensure that its commercial activities are controlled and monitored by people with a strong commercial background and capability, and that its grantmaking and community development focus is equally under the control of people with skills and experience in those activities.

TRUST ESTABLISHMENT

The formal legal process of setting up a trust is a bit like entering into a contract. Two parties are involved, each of which may be just one person or a number of people. The first is known as the settlor. This is the person or people who formally establish the trust. In legal terms what they do is "settle" an asset[1] on another person or people, the trustee or trustees, who then have the responsibility of managing that asset, and any

[1] It is common with a charitable trust such as the Opotiki community trust for the amount actually settled on trustees at the time of establishment to be purely nominal - say $100. The real assets then come in through later donations grants or other asset generating activity.

other assets the trust receives, in accordance with whatever the terms of the trust deed require.

With a trust such as the Opotiki community trust the role of the settlor may be a pure formality. Usually, the settlor's role finishes with the signing of the trust deed. Especially with trusts establishing not for profit organisations, the position is a technical formality. You have a settlor because you need to have a settlor to set up a trust but once it is set up, your focus is then on the trustees.

In this case, it may be worth doing things somewhat differently. Instead of having a single settlor (perhaps the Council) it may make sense to have a group of settlors who become in essence the trust's ancestors, coming together to give their blessing to the endeavour, and signalling a broad-based community commitment, which could be recorded in the trust deed itself.

MATTERS CENTRAL TO ESTABLISHING THE TRUST

A meeting of the steering group on Friday the 13th of March 2007 identified five areas for attention in establishing the trust. These were:

1. Structure/model to achieve the purpose - trust design and operation.
2. Trustee selection and succession.
3. Resources to sustain the trust.
4. Ensuring local benefits - distributing grants.
5. Trust accountability.

Each of these five matters is now considered in turn.

1. Trust design and operation

Basic principles

There are some basic principles to follow in the design of any charitable trust. They include that:

1. The charitable purpose should be broadly defined to avoid the risk that, if circumstances within the Opotiki community change, the trust purpose may no longer fit. The broad general purpose proposed of increasing the social and economic well-being of the community satisfies this requirement (although, as noted, it may require fine tuning during the drafting process to satisfy the Charities Commission and the Inland Revenue Department).

2. The trust deed should give the trustees broad powers for the operation of the trust's affairs including full commercial powers (but subject to including adequate provisions to ensure that trustees protect the assets of the trust against risk). One intention in the formation of the trust is that it is able to take advantage of whatever commercial opportunities may present themselves, provided that doing so can add value for the Opotiki community. It would be inconsistent with this to try and artificially limit the powers available to trustees.

3. The trust itself should be incorporated under the Charitable Trusts Act. This has a number of advantages including giving the trustees themselves substantial protection against personal liability. It also means that the trust can adopt a single name in which to hold trust assets, rather than needing to list all the names of individual trustees and change those as trustees change.

As a community trust, the trust will be accountable to and ultimately controlled by the community. This means that particular care needs to be taken over matters such as appointment and succession of trustees, and the arrangements for accountability to the community. This is a matter of balancing different considerations including:

1. The need to be able to act commercially, when taking commercial decisions - this can include matters such as confidentiality, and timeliness in decision-making.

2. The natural interest of the community in ensuring that the trust is responsive to community interests and priorities in undertaking its activities.

3. The need in a community-based organisation to balance representation and inclusiveness with the requirements for effective decision-making and management of trust assets.

Trust structure and skill sets

The expectation that the trust will have three separate principal roles, wealth creation, wealth distribution and wealth management, has implications for the actual structure of the trust. The wealth creation role will require strong commercial and entrepreneurial skills ideally with a background of experience in activities similar to those the trust will carry out in its wealth creation role. The wealth distribution role is the one of setting priorities for grantmaking or other support for community-based activities. It will require a good understanding of social/community development issues, familiarity with social and community development priorities within the Opotiki district, and good networks with the community sector, including iwi Maori. The wealth management role is the traditional trustee role of acting as a prudent steward of trust assets.

The immediate focus will be on the wealth creation role. It will not be until the trust has built up sufficient resources, and has an available surplus, that there will be funds that could be available for wealth distribution. The wealth management role is likeliest to apply if (when) the trust becomes the recipient of significant funds through donations and/or legacies with a commitment to investing them long-term and using the income for the trust's charitable purposes.

As a means of managing risk, and sharpening the commercial focus of the activities, the trust may decide that the wealth creation role should be undertaken through a subsidiary company (which could be incorporated as a charitable company). The board of that company would operate under a statement of intent/business plan relationship with the trust. Its directors would be appointed by the trustees. Some or all might themselves be trustees but there would be the opportunity to bring in additional commercial expertise.

The wealth distribution role could be undertaken by the trustees as a whole but the trust might decide it makes better sense to establish a distribution subcommittee whose membership could be enhanced by bringing in people with specific community/social development expertise.

The wealth management role, once that becomes a requirement, should remain with the trust itself, that is with the parent trustees, but the advice of the subsidiary company might be sought in helping determine and implement investment strategy.

A matter for the establishment group to decide is whether these structural arrangements should be specifically required by the terms of the trust deed, or whether they should be left to the discretion of the appointed trustees.

2 Trustee selection and succession

The success of the trust will be crucially dependent on the personal qualities, capabilities and commitment of the trustees. Especially for the initial trustees, the job will be creating both the business operation and the community development instrument which the trust is intended to be. This makes it important that the trustee selection process produces trustees who are "fit for purpose ".

The task is made more complex by the fact that the trust will have two separate functions - developing and running the trust's commercial activities, and grantmaking/community development - which would normally be seen as requiring different sets of skills, capabilities and experience.

As well, the trustees need to be both accountable to the community (and this means the whole of the community, with its different geographic and other interests) and accepted by the community as their representatives for managing the trust's activity.

Election or appointment?

In broad terms, there are two possible options; election or appointment.

Election of trustees to a trust of this type is not a favoured option. Experience makes it clear that it is extremely difficult - virtually impossible - for the election process to produce the mix of skills, capability and experience, as well as the appropriate representative basis, required for the effective operation of the trust.

This leaves the option of **appointment** and the question of how appointment should be handled. One possibility is for each of a group of named organisations (the Council, iwi, business organisations, defined community groups) to have the right to appoint one or more trustees. Although this can seem a good way of getting a representative cross-section of people, it does have a number of drawbacks. They include:

1. It can be very difficult to get a consistency of approach in terms of selecting people on the basis of required skills, capability and experience. This becomes particularly difficult when a mix of experience is required.

2. Experience suggests there is a very real risk that people will see themselves as appointed to act on behalf of the group or interest which appointed them, rather on behalf of the community as a whole.

3. Related to this is the question of trustee accountability – are trustees accountable to the community as a whole or accountable individually to the organisations which appointed them?

4. Problems arise if one or more of the appointing bodies goes out of existence, or becomes less committed to its appointment role.

A further issue is the relationship between the number of appointing bodies and the number of trustees. For a trust of this type, the ideal number of trustees would be either five or seven. It is likely that the number of local organisations which would be entitled to be involved in appointment is at least 12-15. If each organisation was to appoint one trustee, it would raise the number of trustees to 12-15, much too unwieldy for effective governance. The alternative of trying to pair organisations so that each trustee was appointed on the nomination of two named organisations is not attractive.

An electoral college?

One way of resolving the appointment issue, and balancing the need for broad-based community representation in the appointment process with the need to create a relatively small and highly qualified trust board, is to use what is known as an electoral college approach.

Under this process, a single body, the trust electoral college, would be responsible for appointing all trustees (five or seven). The trust deed would set out the rules for how the electoral college would be formed, and its role in appointing trustees.

The electoral college could be set up as one representative of each of a number of named organisations, and could be large enough to make sure that it was representative of the whole community.

Its task would be to select and appoint trustees. The trust deed should spell out how the selection and appointment process would operate. A common process would include:

1. Preparing a job description, and a person description (what kind of personal characteristics, background, experience etc was required). It would be usual for the trust deed to set out the key requirements both for the job description and the person description but with discretion for the electoral college itself to complete the detailed descriptions following the guidance in the trust deed.

2. Publicly advertising for applications.

3. Reviewing applications and preparing a shortlist for consideration by the electoral college, with the electoral college deciding which applicants should be interviewed.

4. Interviewing applicants.

5. Preparing recommendations for the electoral college's consideration.

6. Deciding which applicants should be appointed as trustees.

It would be usual, if the electoral college has a large number of members, for the detailed work of preparing job and person descriptions, advertising, preparing a shortlist and interviewing applicants to be handled by a subcommittee of the electoral college. However, the electoral college itself should approve the shortlist, and make the final appointments. This could include the electoral college itself interviewing the candidates recommended for appointment to be satisfied that they agree with the recommendations.

It is important that, once people are appointed as trustees, they are accepted as genuinely representative of the community. This means thinking carefully about how the electoral college itself takes decisions. If it had 15 members, and made decisions on a simple majority, this could result in someone being appointed on an 8 to 7 vote. If, as may be the case, two or three members were absent from the decision-making meeting, someone could be appointed as a trustee with the support of only a minority of members of the electoral college.

It is also possible, if a simple majority vote was sufficient, that someone could be appointed without the support of any organisations from a key grouping within the community.

To deal with these sorts of problems, the electoral college's decision rule might include requirements:

1. For a super-majority - this could be expressed as (say) a requirement for two thirds of those present and voting to support appointment. It could be a requirement that two thirds of the membership support appointment.

2. That the majority include a stated proportion of the representatives of certain key organisations. For example, if three iwi were represented on the electoral college, then the decision rule might include a requirement that the successful candidate(s) have the support of at least two of the iwi representatives.

Duration of appointment

The next question involves the length of time for which someone is appointed as a trustee and when and how they cease to hold office.

First, it is very usual for trust deeds to set out a number of situations in which a trustee would automatically cease to hold office. Bankruptcy, a criminal conviction which carries with it liability to a jail term for a stated minimum period of years, and insanity are among them.

Next, it is usual for trustees to be appointed for a three year term. Apart from the actual term, there are two other important issues:

1. How many terms should a trustee be able to serve?

2. Should all trustees' terms expire at the same time, or should they be staggered?

Deciding on the number of terms requires balancing the need to bring in new blood from time to time (and move on people who have passed their "use by date") with building up the skills of the trust board itself - often, it will take new trustees 12-18 months to really get to understand their role, so that unless they can be appointed to one or two further terms, there is a risk that the trust board as a whole would be relatively inexperienced. Balancing these two different requirements is normally done by limiting the number of terms to (say) three, that is, a maximum of nine years.

Deciding whether all trustees' terms should expire at the same time, or whether they should be staggered, involves balancing two different objectives. The first is being able to deal quickly with a poorly performing trust board. The second is maintaining a level of experience and institutional knowledge.

If trustees are appointed for a three-year term, the normal approach to staggering their terms is to require that one third retire each year (in the first two years of a trust board's existence, it is usual for trustees to draw lots to decide which ones will retire at the end of the first, and then at the end of the second year). This means that, if a trust board is not performing well it can take upwards of two years to fully replace it.

On the other hand, if all trustees' terms expire at the same time then:

1. The opportunity to bring new trustees on comes up only once every three years.

2. There is a very real risk, if the people appointing trustees decide they want a "clean out", of losing institutional knowledge.

On balance, the better approach is to stagger trustees' terms and rely on using good appointment processes to minimise the risk of ending up with a poorly performing board.

Paying trustees

Another, and a very important question, in establishing a board of this type (a community organisation, but requiring strong commercial skills) is whether and how much trustees should be paid.

If trustees are not paid, there is a possibility that they will give a lesser priority to their trustee responsibilities, preferring to work on other things which will actually generate an income for them. On the other hand, if they are paid, there is a very real risk that much if not all of the trust's income after other expenses will go on trustees' fees. As an example, if it was decided to pay trustees $5,000 per annum each (a relatively low fee for a role requiring strong commercial skills) and there were seven trustees, that is $35,000 a year. In Opotiki, that would be quite a significant amount for community grants. Alternatively, it could also be an attractive salary for a part-time manager (and it is likely that the trust will need to appoint someone in that type of role once it starts undertaking a range of activities).

This trust will have a strong community commitment, and it is reasonable to expect that people putting themselves forward as trustees will see their role as at least in part a chance to give something back to the community. This suggests that trustees should be more attracted by the potential of the role, than the fees they might receive. At the same time, especially as the trust grows, there is a case for paying some remuneration.

A compromise solution might be to provide in the trust deed that trustees can pay themselves remuneration but with the amount capped. One possibility is to provide that trustees' fees should not exceed the greater of $1000 per annum times the number of trustees, or (say) 20% of the trust's income after expenses other than trustees' fees.

3 Resources to sustain the trust

Ultimately, the trust should be self-sustaining. However, during the establishment phase and the trust's early years, there will be a need for funding to cover both establishment costs, and operating costs until the trust is able to cover those from its own resources.

Funding for the establishment phase should be sought from grantmaking bodies with an interest in facilitating social and community development within Opotiki. These are likely to include the Bay of Plenty Community Trust, (possibly) the Eastern Bay Energy Trust (or, if not the trust, Horizon Energy Distribution Ltd which, because of its infrastructure role within the Eastern Bay, may see merit in being a founding sponsor of the trust), government grantmaking bodies such as MED/NZTE from a regional development perspective and MSD in its social/community development role, gaming trusts and private trusts such as the Tindall Foundation.

Funding for operational expenses could also be sought from those sources, but a more likely funder is the Opotiki District Council. Any funding it provides should be against a trust business plan specifying activities, and expected revenues and expenses.

As well as resources to sustain the trust, the trustees will have a focus on resources to support the trust's wealth creation role. Possibilities which have been discussed include development rights over Council owned land which will benefit from the proposed Harbour development, and the possibility of obtaining development rights/options to purchase over privately owned land suitable for development. These are initiatives which the incoming trustees themselves will need to identify and develop.

An important point to note is that, to the extent that any privileges are granted to the trust by the Opotiki District Council, those should be granted in the context of a trust strategy/business plan spelling out how those privileges will be used. Those privileges should also be conditioned by the Council so that if development does not proceed within an acceptable timeframe, the Council has the option to cancel them.

4 Ensuring local benefits - distributing grants

The immediate priority of the trust should be on building up a core asset base so as to underpin its medium-term financial viability. This is an important risk management strategy whose purpose is to limit the trust's dependence on grantmaking bodies. It is also effectively a condition precedent to the trust having the freedom to undertake commercial activity outside those limited cases where it has some special privilege (such as development rights over Council property).

Another factor for the trust to consider is that distributing grants is only one means of giving benefits from the trust's activities back to the community. Others could include creating employment generating activities, investing in affordable housing, or acting as a local source of "venture capital" for new business enterprise.

It will be over to the trustees themselves (subject to the accountability matters discussed in the next section) to determine when and to what extent funds can be made available for distribution as grants.

If the structural arrangements discussed above are adopted, what would happen in practice is that the trustees themselves would make a decision that a certain sum was available for distribution and then delegate the authority for making the distribution decisions to the proposed subcommittee.

Questions of criteria, process etc are discussed under accountability.

There is one further function which the trust could consider in its grantmaking (wealth distribution) role. It is now becoming quite common for trusts to be established specifically to hold and manage donations and bequests on behalf of individuals or groups within the community. Those donations or bequests may be made with quite explicit instructions as to who should benefit from them, in which case the principal role of the trust is acting as a long-term manager of the bequest or donation funds, and of distributing them to the intended beneficiary. They may be made with the general intention that they should benefit the community or some defined sub-set within the community. In this case the role of the trust is not just that of managing the capital and passing the benefit to a named beneficiary. It also becomes the role of determining what interests within the community should benefit.

The main reason for establishing trusts of this type is that it is often difficult for people who want to provide funds for long-term community benefit to find effective means of doing so. As a result, many may go to a quite inappropriate body possibly because there was nothing else available. Alternatively the donation or bequest may not be made in the first place. The trust, once established, could provide an important service by filling the gap.

5 Accountability

The starting principle is that, as a public body, the trust should be accountable to its community. This principle is only a general guide. In any particular case, there needs to be a careful assessment of what the accountability requirements should be.

There are different kinds of accountability. One common distinction is between retrospective and prospective accountability.

Retrospective accountability

Retrospective accountability is accountability which says "this is what we did". A common example is the production of audited financial accounts. These show where the money went, and the assets and liabilities of the organisation, but they are looking backwards rather than forwards.

Retrospective accountability in the sense of producing audited financial accounts is important for any organisation.

For community organisations, however, prospective accountability is now seen as essential.

Prospective accountability

Prospective accountability is accountability which says "this is what we are going to do" and is followed up by reporting which says "this is what we did compared with what we said we were going to do".

If the organisation is acting on behalf of its community, then it should be giving its community an opportunity to state what it believes its priorities should be and how they should be achieved.

Within this general approach, the accountability requirements will differ depending on the nature of the activity. In the case of the trust much of the wealth creation activity will necessarily be confidential - commercial transactions need **confidentiality**, at least until matters such as contract negotiation have been completed. This means that prospective accountability cannot include consulting the community on the specific commercial transactions the trust might undertake.

Prospective accountability can, however, cover the following three aspects:

- The trust's business plan, at least in general terms, its intended areas of activity, and the principles it will apply - for example, the trust principles on matters such as sustainability. This can then be supplemented by an annual report which does spell out in more detail what the trust has done.

- The wealth distribution role. Different considerations arise here. Once wealth distribution becomes feasible, it would be very appropriate for the trust to set out for public feedback its proposed distribution policy and the process it intended to follow. Individual grant or other wealth distribution initiatives would still remain trust responsibility subject to the confidentiality which should apply to the affairs of individual applicants.

- The wealth management function, when that becomes a reality. This is also a matter where it is the general principles, rather than specific investment decisions, on which the trust should prospectively consult. This could include questions such as the types of investments it should make: should priority be given to investing locally? Regionally? Nationally? Or should the trust look to a balanced portfolio? What social investment principles should the trust apply?

In summary:

The trust accountability requirements could include:

1. In respect of wealth creation, annual publication of a summary business plan, including the areas of activity and general principles which the trust will apply. This could be subject to formal consultation, or simply be "out there" for people to provide feedback as they saw fit.

2. For wealth distribution, release of a proposed distribution policy for public feedback. This would not necessarily be annual, but be done when ever the trust proposed significant changes to its distribution policy.

3. For wealth management, publication of its proposed investment policy for public feedback on priorities, social investment principles etc.

4. Annual audited accounts, reporting against the business plan and other policies, coupled with. at least annually. a public meeting at which trustees would report to the community.

There may also be other specific accountability requirements imposed on the trust, through individual contractual arrangements. For example, if the trust were granted significant development rights by the Council over Council assets, then the contract establishing those development rights should include accountability requirements to satisfy the Council that the trust was meeting whatever performance requirements the Council had set as a condition of the grant of those rights.