Financial Strategy

Financial Strategy

INTRODUCTION

Our Financial Strategy is intended to guide the decisions we make now and in the future to ensure they contribute to our vision of *Building a Lifestyle Capital/He Whakatūtū Haupū Rawa Hei Āhua Noho* and its associated community outcomes *People/He Tangata, Place/ Tiakina and Prosperity/Āwhina*. The Financial Strategy aids in delivering a financially sustainable district in the long term, one in which its citizens can afford to live in the near future, but also in 50 and 100 years from now.

It will also help us consult with you about what we plan to do by making it clear how those plans will affect our services, rates, borrowings and investments.

The focus of the LTP 2018-2028 is ensuring that we have the appropriate investments in infrastructure to build a lifestyle capital which will enable the district to continue to grow.

CURRENT FINANCIAL SITUATION AND FORECAST

The Council is in a strong financial position. At 30 June 2017 we had assets of $2.5 billion and total liabilities of $139 million.

The Council maintains a Perpetual Investment Fund (PIF) which has a balance of $275m as at 30 June 2017.

S&P Global Ratings affirmed the Council's 'AA' long-term foreign currency and local currency rating and 'A-1+' short-term issuer credit ratings in October 2017.

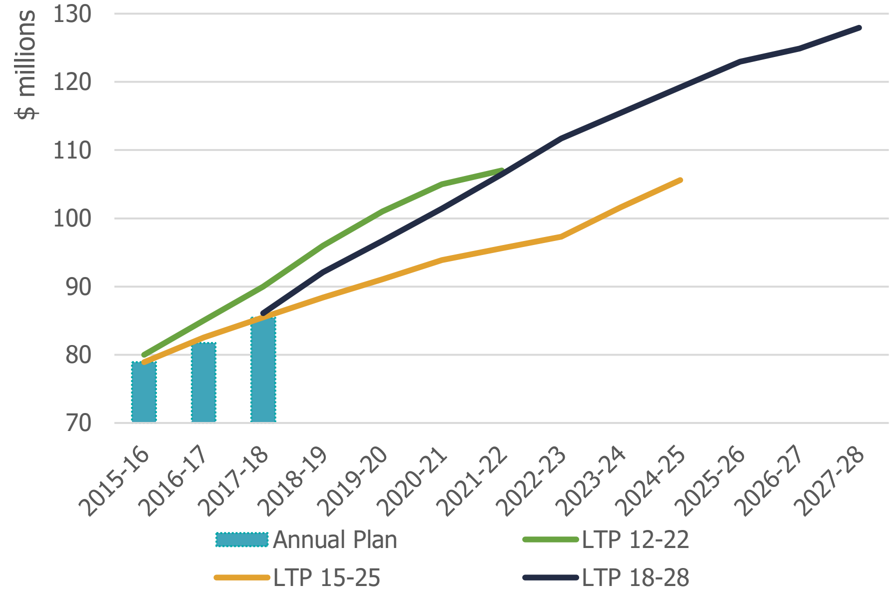

Figure 1: Total rates requirement over 2015 to 2028

Key investments in this plan include:

a) Infrastructure renewals.

b) Water, wastewater and transportation resilience programme.

c) Water master plan including a new water source.

d) Waste minimisation.

e) Waitara stormwater.

f) Coastal Walkway extension to Waitara.

Operational Expenditure

The Council is forecasting an operational expenditure of $1.71b over the life of the LTP. The level of expenditure shows the cost of continuing with the Council's programme to prioritise spend based on *Building a Lifestyle Capital: People, Place and Prosperity*. Figure 2 shows the total operational expenditure required from 2018-2028.

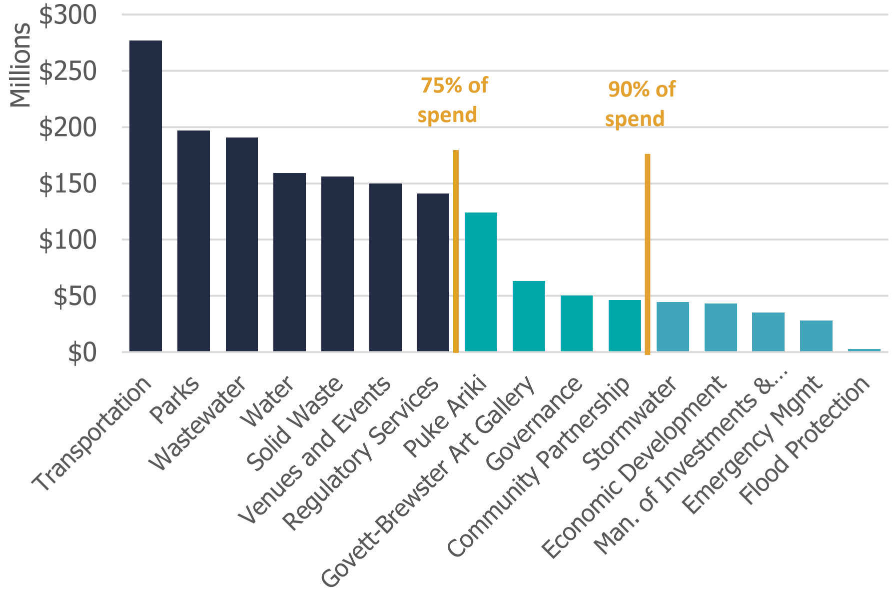

Figure 2: Total operating expenditure

Figure 3 shows how the operational expenditure is to be funded over the life of the LTP.

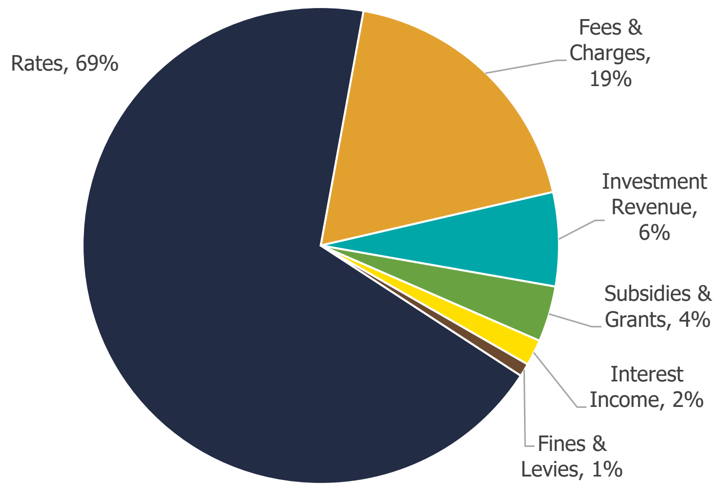

Figure 3: Revenue sources to fund operations

Capital Expenditure

The Council is forecasting a capital expenditure programme of $526m over the life of the LTP. The cost of this programme by Council activity, the driver for the project and the funding sources are shown in figures 4, 5 and 6 respectively. This expenditure includes the cost of renewing existing assets that are coming to the end of their useful lives, as indicated by Asset Management Plans. It also includes the cost of improving existing assets and investing in new assets.

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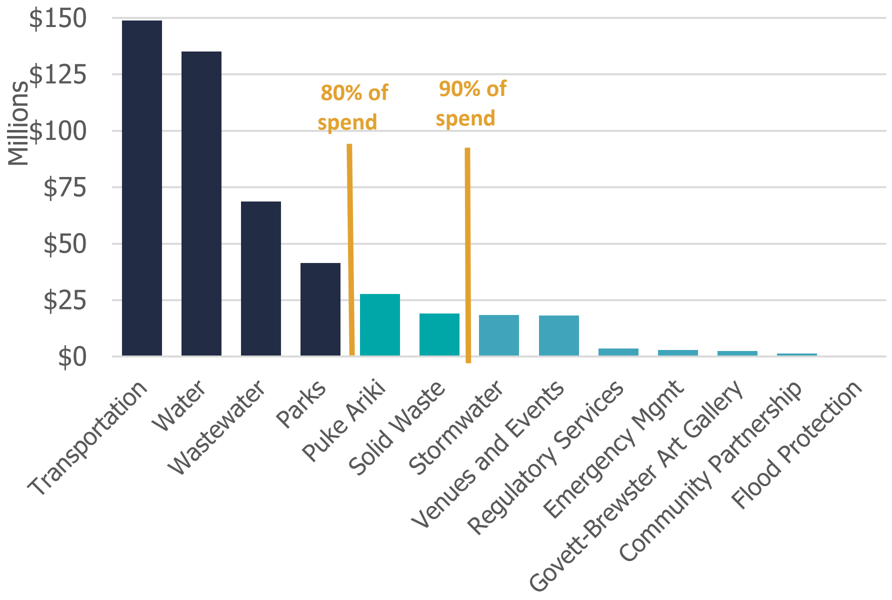

Figure 4: Total capital expenditure by Council Activity

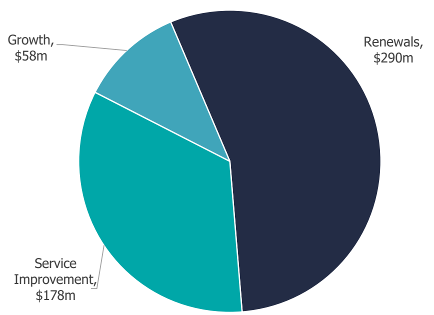

Figure 5: Total capital expenditure by driver

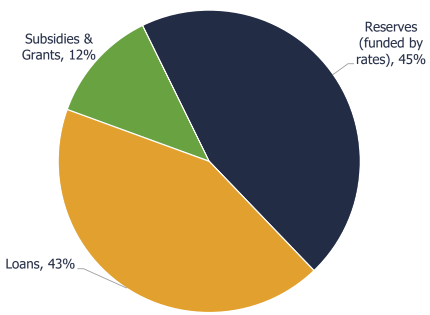

Figure 6: Capital expenditure funding source

Key investments included with this plan are:

a) Capital expenditure to maintain our current assets (renewals) $290m.
b) Investment in water supply $135m (includes $30m for new water source in years 9 and 10 and $8m for two new reservoirs in years 1 and 2).
c) Investments to enable the district to continue to grow $58m.
d) Capital expenditure $27.3m and operating expenditure $17.2m for the water, wastewater and transportation resilience programme.

GUIDING PRINCIPLES

Fairness and equity

Fairness and equity relates primarily to ensuring that the funding of expenditure is fair across both present and future ratepayers.

Intergenerational equity

The principle of intergenerational equity is that the cost on long term assets should be met by ratepayers over the life of that asset. This is reflected by debt funding new assets with a repayment of that debt between 20 to 30 years and funding replacing assets from rates, over a 10-year rolling average, based on the Asset Management Plans.

Balanced budget

The Council maintains the practice that over each LTP the projected operating revenues are set at a level sufficient to meet projected operating expenses. This ensures the current ratepayers are paying the right amount of costs for the service they receive.

Borrowings funding

The Council's debt is used to fund the purchase of assets that the Council has agreed, after consultation with the public, will add sufficient value to the district to more than compensate for the expenditure incurred on that asset. The Council's financial policies require that new assets are to be funded by debt, with assets being replaced to be funded from renewal reserves. This is consistent with the intergenerational equity principle.

Distribution of benefits

Consideration is given to each activity of the distribution of the benefits (of the activity) over identifiable parts of the community, the whole community or individuals (users). This then informs the consideration of who should pay for the activity. The distribution of benefits is explained in detail in the Revenue and Financing Policy.

Development contributions

The Development Contributions Policy provides the Council with a method to recover funding for additional infrastructure required for population and workforce growth in the district.

Market neutrality

The impact of the Council's funding mechanisms on commercial markets should be neutral where possible, and where appropriate.

Willingness to pay

Ratepayer concerns may reflect unwillingness rather than inability to pay.

This reflects relative satisfaction with perceived value for money from rates or with the Council's decision-making/consultation. Willingness to pay may reflect the real or perceived benefit from rates and may reflect private versus public good issues (for example, ratepayers may perceive that they are paying for services that largely benefit others).

Value for money

Value for money considers:

- The contribution of a proposal to the community.
- The degree of outcome contribution per dollar of cost.
- That the total cost is reasonable.

It also considers whether the means chosen to fund the expenditure is the most cost effective. This analysis includes the cost of financing an initiative, market maturity and demand analysis, an assessment of risks, and ensuring market neutrality where appropriate.

Risk management and assessment

Risk management is important when managing public services and assets and includes consideration of insurance, self-insurance reserves and any other provisions and/or reserves (for example, weather-tight homes provision).

Risk assessments consider the likelihood and consequence of risks associated with an expenditure proposal. Following a risk assessment consideration needs to be given to risk mitigation. In a financial context this can include insurance and provisions.

Good financial governance and stewardship

Good stewardship of the Council's assets and finances requires the Council to ensure that its actions now do not compromise the ability of future councils to fund their needs. Under this principle:

- Assets are not run down for future generations to pay for.
- Debt is not used to fund operating expenditure other than specific exceptional circumstances.
- The level of debt is regularly reviewed to ensure it is at a level that is both aligned with the Council's assets and rating base, and that it will not restrict a future council's ability to fund new assets through debt.
- The operational expenditure implications of capital expenditure decisions are considered.

RATES AND RATE LIMITS

The Council is very conscious of rates affordability. The Financial Strategy sets a limit on percentage increases in the rates requirement of five per cent in any one year with a 10 year average increase in rate requirement of between 3.5 per cent and 4.5 per cent. The increase in rates over the period of the LTP exceeds the limit in year one of the Plan as a result of additional costs and investment in response to the storm events in February 2018 which resulted in disruption to the water supply to a portion of the district. Further investment in the resilience of our water networks and improvements to our asset management systems have been added to our LTP which has increased rates by 6.9 per cent in 2019, 4.9 per cent in 2020, 4.8 per cent in 2021 and 4.9 per cent in 2022. Without these additions the rates ceiling limit of five per cent would have been complied with.

The 10-year average increase in the rates requirement is 4.0 per cent which is within the target of between 3.5 per cent and 4.5 per cent.

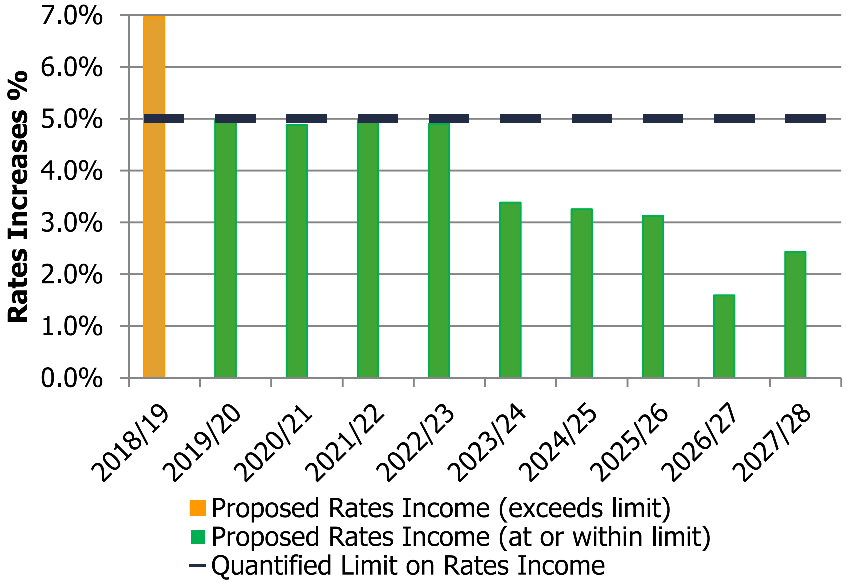

Figure 7: Rates affordability benchmark

With estimated growth within the district over the next 10 years of approximately one per cent per year this will mean the majority of individual residential properties will face a rates increase of approximately one per cent less than the overall rates requirement increase.

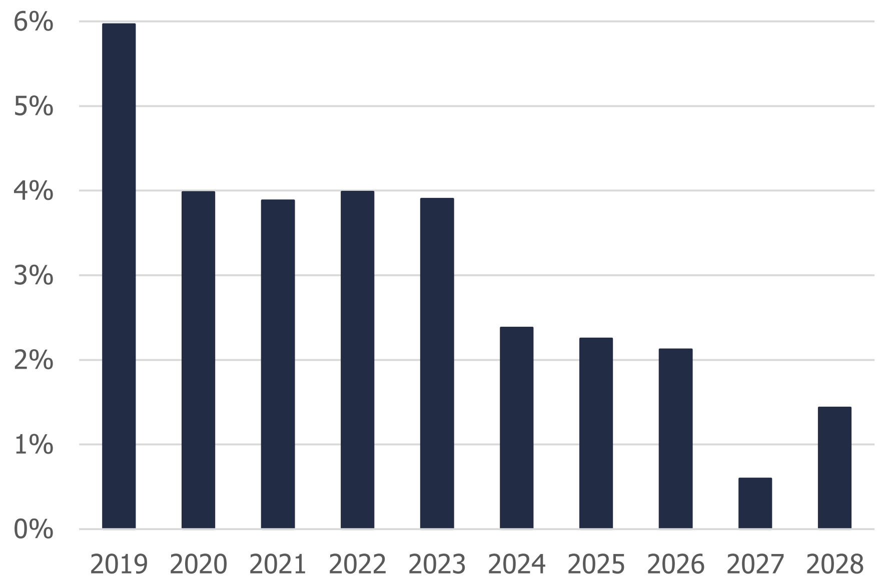

Figure 8: Average increase for individual residential ratepayers

Over the life of the LTP, the residential rate for the average individual ratepayer is proposed to increase by approximately three per cent annually. For the first year, of the Plan, it is approximately six per cent.

CAPITAL EXPENDITURE PROGRAMME

Capital expenditure is categorised into renewals (renewing existing assets), service level (new assets that improve the services provided to the community) and growth (new assets required to accommodate growth within the district).

Total capital expenditure for the LTP is $526m. This amount is then allocated for each capital project to renewal, service level and/or growth components regardless of the driver. The driver for capital projects is the main reason for the project to take place, but there may be a renewal portion or an opportunity to increase the size or capacity of an asset to include service level improvements or cater for a growing district.

The allocation for each component by driver is represented in the following table.

Cost allocation of capital expenditure by driver	Renewal ($m)	Service level ($m)	Growth ($m)	Total ($m)
Renewal	265.5	20.3	5.4	291.1
Service level	22.5	123.3	2.0	147.8
Growth	1.7	34.2	50.9	86.9
	289.7	177.8	58.3	525.8

Climate change implications

The Council is aware that climate change is having an effect on its stormwater and flood protection assets and the level of service they provide. The ex-cyclone Gita event that damaged a main water pipe near New Plymouth on 20 February 2018 has been a wake-up call. Together with the Havelock North Water Inquiry, it has highlighted the importance of our water network and providing safe drinking water to our community, and by extension the importance of our wastewater and stormwater infrastructure.

We are introducing an increase in rates, to enhance the resilience of our water and wastewater networks.

We have also budgeted for the development of a Stormwater Master Plan which will include detailed engineering models and catchment management plans. This planning will help inform future plans for targeted interventions and performance management of our stormwater and flood protection assets.

The Council has also accounted for the effects of climate change across our other asset classes. For example, work currently underway on our Water Master Plan to find a new water source accommodates the effects of climate change over the long-term when making water demand and availability forecasts.

Renewals (looking after what we have)

It is important the Council continues to renew/replace assets with this level of spend to ensure the assets are fit for purpose and deliver the level of service that is required. Funding for renewal expenditure is rates funded and is based on a long run average renewal approach based primarily on the age and condition of our assets. As outlined in the 'Balancing the Budget' section, depreciation is not fully funded on long-life assets. The Council carries renewal reserves to ensure the right level of funding is held for renewal expenditure. Detailed rationale and analysis of the renewal expenditure is contained within the Asset Management Plans. A summary of core infrastructure renewal expenditure is shown in figure 9.

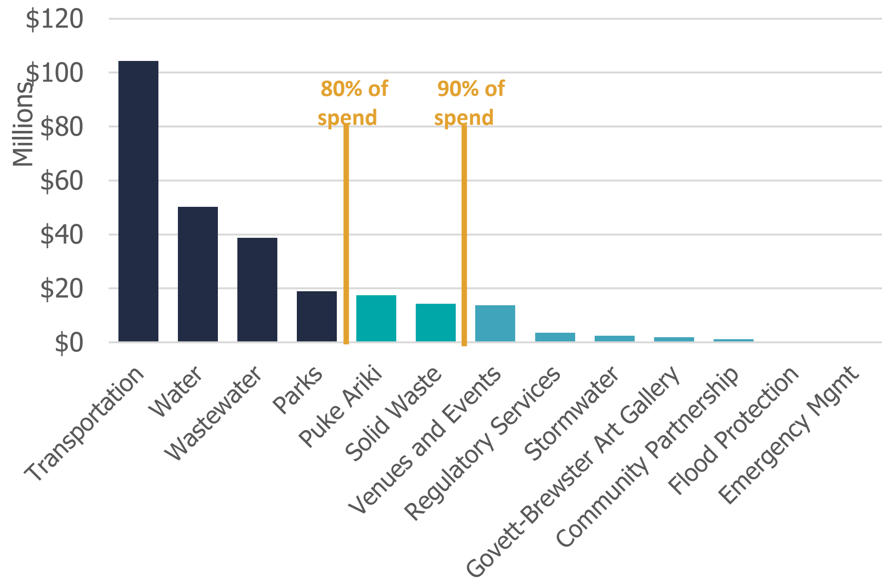

Figure 9: Renewal capital expenditure by Council Activity

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Service level

Total service level (new capital) spend for the LTP is $209m with this amount representing the service level improvement portion of any capital project.

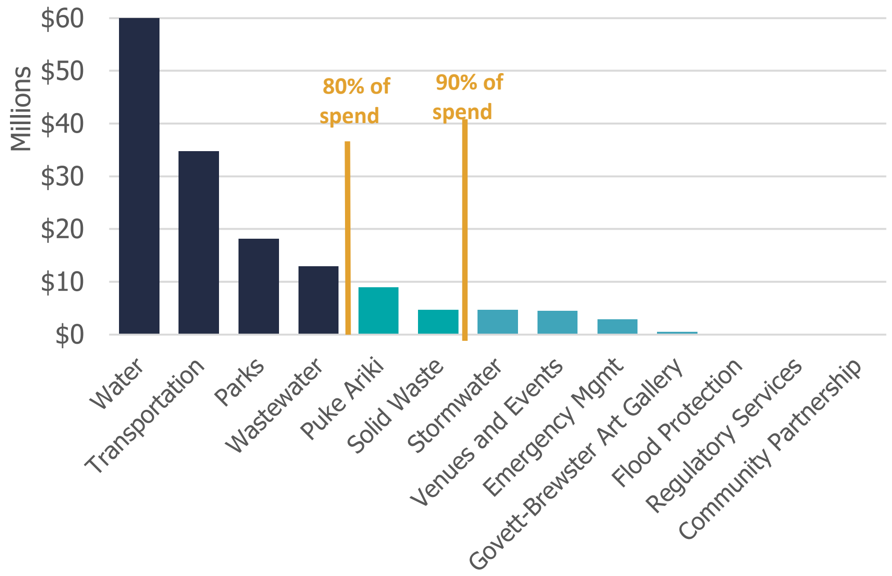

Figure 10: Service level capital expenditure by Council Activity

The major projects covered by this expenditure include:

a) New water source $30m (subject to consultation at the appropriate time).

b) Waitara stormwater upgrades $9m.

c) Coastal Walkway extension to Waitara $9m.

d) Wastewater pump station overflow prevention $5m.

Growth

A key change from the previous LTP is the recognition that a number of the key growth items will need to be funded by the Council rather than developers as a result of the introduction of the National Policy Statement on Urban Development Capacity.

The district population is forecasted to grow by 9,000 people (11 per cent) over the life of the LTP. This will equate to an estimated 370 dwellings per annum, which is approximately a one per cent growth rate.

The Asset Management Plans and Infrastructure Strategy have taken these growth forecasts into consideration, and our existing assets, together with the growth projects included in the Plan, will ensure the district continues to meet the levels of service outlined in this Plan.

There is also adequate land supply and provisions within the District Plan to ensure the adequate availability of land as required by the National Policy Statement on Urban Development Capacity.

Total growth spend for the LTP is $58m with this amount representing the growth portion of any capital project.

There are three types of growth related capital expenditure: network catchment costs, local area catchments costs and specific growth area costs.

This three-tier approach under the Development and Financial Contributions Policy groups together developments by area so that costs are allocated according to those that benefit in a manner that balances practicalities and administrative efficiencies with considerations of fairness and equity.

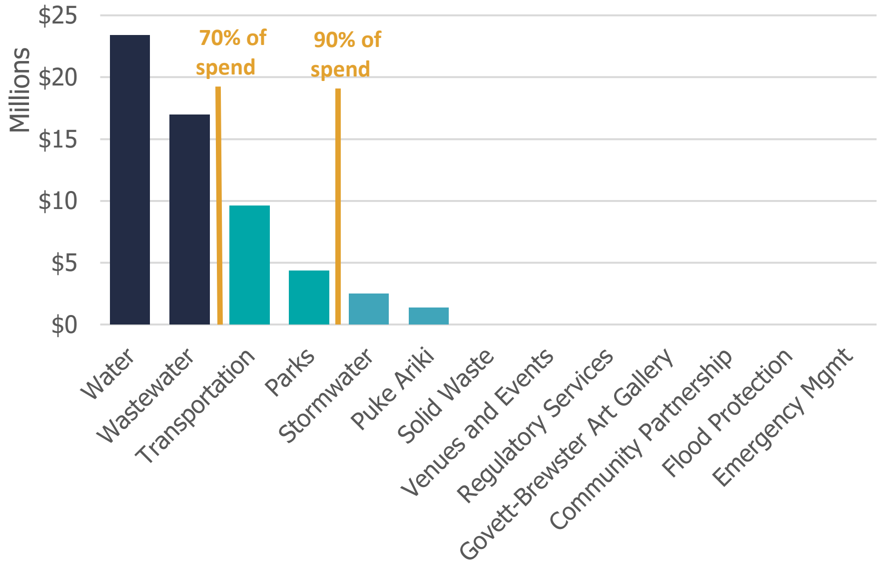

Figure 11: Growth capital expenditure by Council Activity

Network catchments $49m

Network catchments are used for district-wide services and for where everyone that connects to the network (i.e. receives that service) has an impact on the network but the effects cannot be isolated to a specific growth area.

Key projects include:

Cost allocation of Capital Expenditure by Network Catchment	Renewal ($m)	Service Level ($m)	Growth ($m)	Total ($m)
Transportation	2	17	5	24
Water Supply: New Plymouth	-	-	19	19
Water Supply: All networks	-	11	4	16
Wastewater Treatment	1	1	11	13

Network catchments either refer to specific reticulated networks such as water, wastewater and stormwater or other non-reticulated systems such as the roading and parks and open space networks. The Council only operates one wastewater network serving New Plymouth, Ōākura, Waitara and Inglewood; whereas there are four water networks in New Plymouth (also serving Waitara), Inglewood, Ōākura and Okato.

Local area catchments $1m

The geographical area costs are for assets that are required for growth, but are not directly related to a defined growth area in the District Plan. For example, the Ōākura village requires a roundabout for transport efficiency and safety. This cannot be directly attributed to an Ōākura growth area, but is not considered to be a district-wide project.

Specific growth areas $10m

Capital expenditure related to specific growth areas is separated out from network catchments because they represent large scale areas of development. For example, the Bell Block growth area, also referred to as Area Q, occupies the area from Wills Road in the west to Airport Drive in the east and from SH3 in the south to a significant area to the north. These growth areas provide land for additional residential development to occur in the district in a planned and controlled way, but are not yet serviced by core infrastructure such as water services, wastewater treatment, stormwater systems or suitable transportation or parks.

BORROWINGS AND INVESTMENTS

The Council's debt profile is outlined in Figure 12. The growth in overall debt over the LTP is $109m to a total of $230m.

The Council's policy requires debt to be repaid between 20 and 30 years from the date of borrowing. The average repayment period over the LTP is 23 years. The Council's Treasury Management Policy also provides that where there are surplus funds with no planned or approved purpose, these funds may be used to repay debt.

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Managing debt in a prudent manner helps the Council build resilience and sustainability, as it provides the Council with the financial capacity to cope with exceptional circumstances, or unforeseen events.

Within the Treasury Management Policy there are five different measures the Council uses to limit the level of debt.

These are set at prudent levels and well within the requirements of our rating agency, Standard and Poor's, and the Local Government Funding Agency.

The two key ratios relate to the overall debt level to total revenue and Interest as a percentage of rates.

The first key measure relates to limiting the level of debt to 135 per cent of total revenue (excluding development contributions and vested assets).

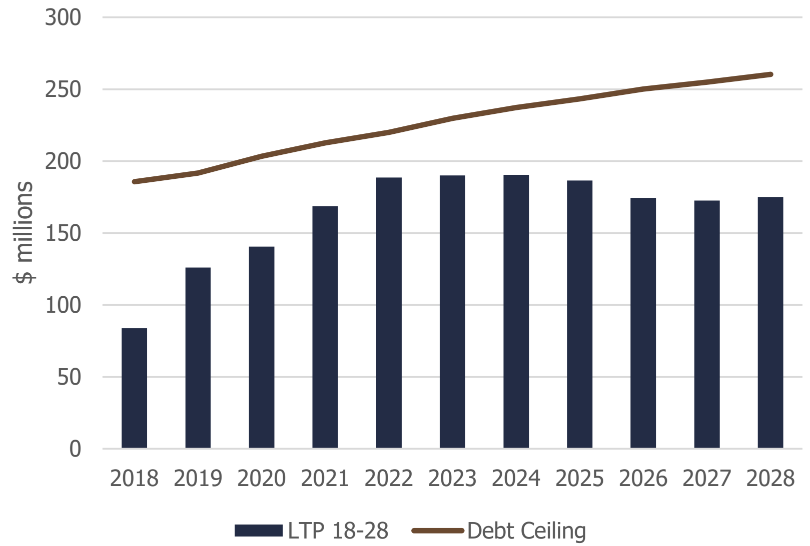

Figure 12: The Council's borrowing

The second key measure is for the Council to have a maximum external debt level where net interest costs are no more than 12.5 per cent of rates income, occurring within the life of the LTP.

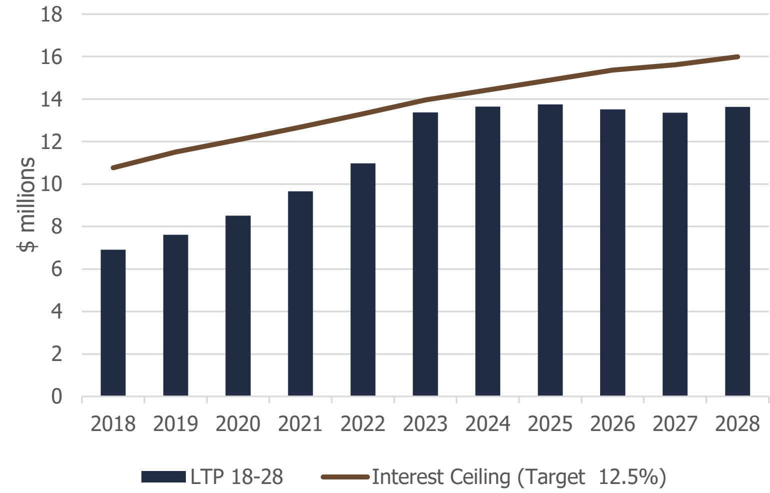

Figure 13: Interest rate ceiling based on 12.5 per cent of rates

For further details on debt management refer to the Treasury Management Policy.

Land holdings

The Council has a programme of land sales included within the LTP.

	Approximate cash after costs	Approximate timing
Land sales	$5m	2018-2022

The Council will continue to review its land holdings and identify surplus land for sale.

Security for lenders

It is noted that Council has a debenture trust deed dated 21 May 2009, registered in favour of Foundation Corporate Trust Limited, representing the interests of all lenders to/investors in the Council. The security is a floating debenture, but provides the lenders/investors with a specific charge over the rates (levied under the Local Government (Rating) Act 2002) revenue of the Council.

Investments

The Council holds investments in short-term deposits which mainly relate to restricted reserves and renewal funds. These investments are managed in line with the guidelines set out in the Treasury Management Policy.

The Council's current main investment is the Perpetual Investment Fund (PIF). Council's expectation is that the real value of the fund is maintained over the long term.

The organisational architecture for the management of the PIF has been restructured and moved to a fully outsourced model with a Board of PIF Guardians managing the outsourced agent – Mercer's.

While investment returns are always uncertain, an annual release of 3.3 per cent of the capital base is considered conservative and should see the release slowly increase over the life of the LTP, as the capital base of the fund grows. The release payment is set by the PIF Guardians and is subject to a three yearly review. The strategic asset allocation currently has a target return of 5.2 per cent after costs and before inflation.

The annual dividend to the Council from the PIF is an important component of the annual income.

Expected return on investments and main ownership objectives

The Council's most significant investments are held within the PIF. The objectives for the management of the PIF are set out in the Governance Deed between the Council and the New Plymouth PIF Guardians Ltd:

a) to at least maintain the real capital of the PIF as a sustainable Perpetual Investment Fund in the long term (the Founding Principle) whilst generating a sufficient return to maintain a sustainable release to the Council; and

b) to ensure that the following principles underpin the operation of the PIF:

   – all investments are made on purely commercial terms;

   – the PIF will be managed on the basis of a prudent diversified portfolio investment style and assets allocation, which manages risk to further the Founding Principle.

Figure 14 shows the expected increase in the PIF balance that meets the objective of maintaining the real capital of the PIF. This is based on a long term minimum return for the PIF of 5.3 per cent per annum.

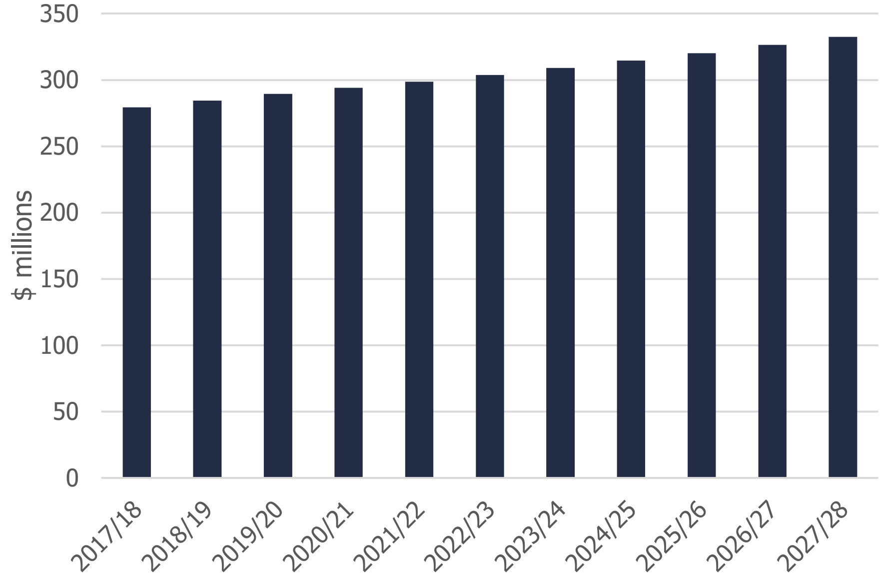

Figure 14: Projected PIF balance

IMPACTS OF OUR STRATEGY ON SERVICES

The Financial Strategy is focussed on the Council's strategic framework of *Building a Lifestyle Capital: People, Place and Prosperity.*

Within the LTP there are no proposed decreases to levels of service.

Service level improvements are focussed on improving infrastructure and advancing the Council's strategic framework.

Growth projects are focussed on enabling the district to grow to meet expected population growth while ensuring that the high level of services provided to the community are still maintained.

The forecasts include high level operating expenditure estimates in the last five years of the LTP of $14.5m ($2.9m on average per annum) to allow for outcomes from the Tapuae Roa: Make Way for Taranaki Strategy and Action Plan, a new waste management plan in 2024, increasing costs associated with emergency management, allowing for impacts from climate change and other service improvements not yet specified.

BEYOND 10 YEARS

The Infrastructure Strategy identifies the significant infrastructure issues the Council will face following this LTP for the next 20 year period.

This LTP places the Council in a good position to meet these challenges with the investment in maintaining our current assets, improvements in service levels and enabling growth of the district.

While making these investments the level of debt is such that there is still resilience for unforeseen events and capacity for future projects.