Clutha District Council

FINANCIAL STRATEGY

YOUR COMMUNITY YOUR COUNCIL YOUR FUTURE 2015/25

MANAGING OUR FINANCES

This financial strategy sets out how Council intends to manage its finances during the next 10 years, including our targets for investments along with the limits we have set ourselves for rates and internal debt.

WHERE WE HAVE COME FROM

Clutha District Council was formed in 1989 with the merging of a number of boroughs and counties in varying financial positions. Since then Council has gone on to consolidate its financial position. This has been helped by asset sales and changing the way we operate e.g. contracting out the operation and maintenance of services, particularly core ones like roading, water, sewerage and solid waste.

WHERE WE ARE NOW

We are a relatively small council, but with a sound financial base. As the summary of our Statement of Financial Position shows, we expect to maintain this position during the next ten years.

We have a widespread rural district with a relatively small, stable and aging population. We also have a lot of infrastructure to maintain, particularly for roading and water supply. Like other rural areas throughout New Zealand, the Clutha District has experienced a period of population decline in recent times. Despite this, our rating base has continued to grow, albeit at a low rate.

Summary - Statement of Forecast Financial Position 2015/25

($M)	2015/16	2016/17	2017/18	2018/19	2019/20	2020/21	2021/22	2022/23	2023/24	2024/25
Total Assets	1,027.2	1,105.7	1,105.7	1,106.1	1,198.8	1,199.2	1,199.9	1,301.0	1,302.7	1,303.3
Total Liabilities	5.7	5.7	5.7	5.7	5.6	5.6	5.6	5.6	5.5	5.5
Net Assets	1,021.5	1,100.0	1,100.0	1,100.4	1,193.2	1,193.6	1,194.3	1,295.4	1,297.2	1,297.8

CHALLENGES WE FACE

THIS STRATEGY ACKNOWLEDGES THE FOLLOWING CHALLENGES AND ASSUMPTIONS WE HAVE MADE IN PREPARING THIS STRATEGY:

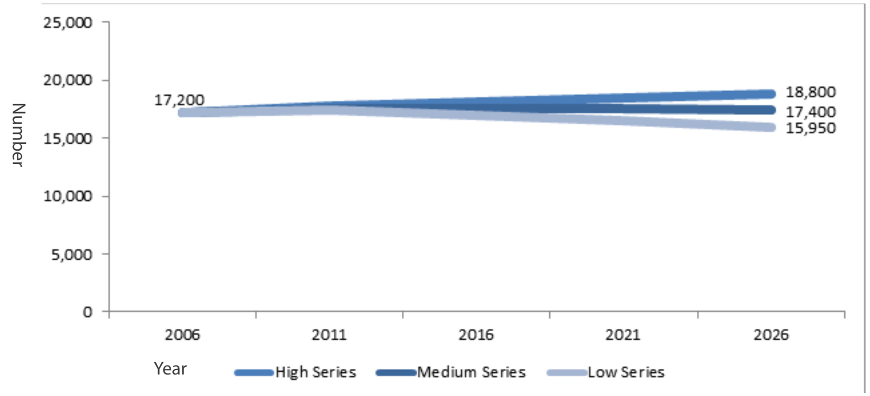
Population Trends

We have a widespread rural district with a relatively small, stable and aging population.

At the time of putting together this plan the most recent projections (based on the 2006 Census) predict the following change for the Clutha District. For planning purposes Council has assumed that the population to remain relatively stable during the life of the Long Term Plan.

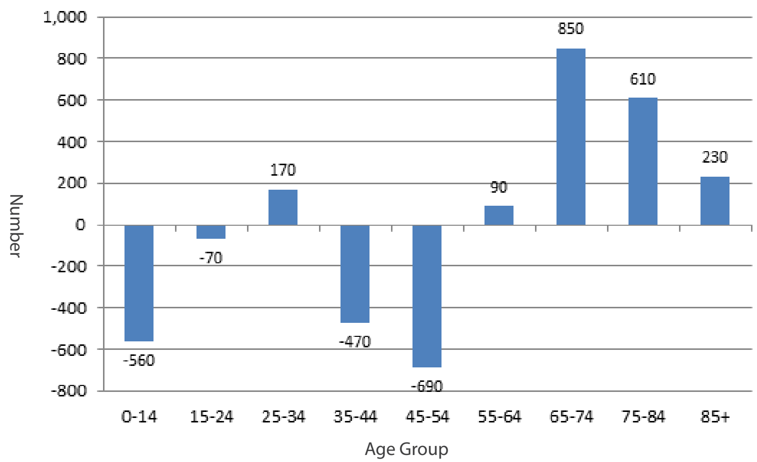
While the overall population is expected to remain relatively stable, the age structure of residents is expected to change substantially. Current projections predict a significant decrease in the number of young people and those who are of working age. At the other end of the age spectrum a significant increase in those who are 65+ is forecast.

Clutha District Summary of Population Projections 2006 (Base) to 2026*



* Source: Statistics New Zealand (September 2014). Note: The most up-to-date population projections covering the period of the Financial and Infrastructure strategies uses the 2006 Census for its base.

Projected Population Change by Age Group 2006 (Base) to 2026



* Source: Statistics New Zealand (September 2014)

Economic Trends

As our district's economy significantly depends on the primary sector, the ability to absorb and sustain labour in the district is influenced by this sector's economic performance. The sector has been positive across the previous decade, showing employment and GDP gains since 2000. Conversions to dairying have driven much of this. We assume this sector will continue to remain relatively strong over the next ten years, although its performance may be volatile due to factors the exchange rate, climate and fuel costs. Likewise, increased productivity trends and consolidation of rural processing industries will continue to impact on the number of jobs required to sustain this sector of the economy. The tourism sector has also shown growth in recent years, and is expected to continue to do so, although it is only about 3% of the district's economy.

Land use changes

No major shifts in land use are expected during the life of this strategy that will impact on Council's finances.

It is expected that conversions to dairying and increases in dairy herd sizes will continue. Conversion and intensification are expected to be subject to water availability and being able to meet increasing standards for environmental discharges. Many recent conversions have sourced their own water supply and as such provision of Council water is not expected to be a barrier to future conversion in many areas.

Maturation of forestry blocks and subsequent harvesting and processing throughout the district may impact on roading infrastructure. However, our current regulatory framework provides for any impacts to be dealt with directly with forestry owners as the demand for this infrastructure arises. Council has made provision for urban growth in some areas of the district over the last 10 years and with the growth focus into the future this is expected to continue through the District Plan review, so as to facilitate urban and industrial growth where there is demand in key areas of the district.

Changes in our rating base

Based on historical data and changes to the district's rating base Council is projecting that the number of rating units in the district will continue to grow at a rate of a minimum of 0.2% per annum. This doesn't take into account the impacts of Council's focus to grow the rating base as this is too difficult to predict in detail and at this early stage.

Roading uncertainties

Maintaining our roading network is essential to our economy. This is our biggest and most expensive asset. Through rates Council only has to fund 40%, but this is going to change wih the New Zealand Transport Agency (NZTA) under pressure to fund major projects of national significance. We have certainty from 2015 we will need to fund 41%, and have budgeted at this level for the remaining ten years of this strategy. An annual inflation-adjustment on the financially assisted roading programme of 2.4% (compounded) has also been assumed. This has been informed by the National Policy Statement on Land Transport 2015/16 - 2024/25.

Legislative and structural uncertainties

Council is assuming that the Clutha District will retain its existing boundaries, functions and status as a territorial authority during the life of this plan. Should amalgamation with neighbouring authorities or significant boundary changes take place, this could have a significant impact. Council also acknowledges the ever changing legislative environment, with further changes to legislation, such as the Resource Management Act 1991. Overall we have taggedthis as a medium risk for the ten year term of this strategy.

Natural hazard risks

Managing the risks associated with natural hazards is an issue that has been flagged. Council utilises guidance from the Ministry for the Environment, information being developed by Otago Regional Council and Risk Reductions lifelines group. Resilience and natural hazard mitigation is considered on a project-by-project basis for all capital projects.

Earthquake strengthening

Changes to the Building Act 2004 as a consequence to the Canterbury earthquakes means there will be requirements to strengthen buildings to at least 33% of the Building Code, or to demolish them. During the life of this strategy Council is expecting to need to make decisions about future capital works and funding for a number of buildings that are either Council-owned or funded. Detailed structural analyses of these buildings will help provide the information Council will need to make longer term decisions about these buildings in conjunction with local communities. Council assumes that budgets will not be significantly affected by the work required following structural assessments of Council's halls and community centres. There is a high level of risk tagged for this assumption.

WHERE WE WANT TO BE

We are expecting our district to change. We will have a similar number of people but we will be older. The primary sector will continue to be the largest portion of our economy. In developing our 2015/25 Financial Strategy, Council has taken the opportunity to examine the current and future needs of the district. It is important to look ahead and consider what our organisation can do to help future proof our district. We want to continue to consolidate and build on our sound financial base.

As is mirrored in our Infrastructure Strategy, Council has committed to continuing to sustainably manage and maintain key infrastructure for residents throughout our district. In some instances we will increase levels of service to meet compulsory requirements, such as increasing standards for sewage discharges and drinking water.

Council will also look at facilitating growth where there is potential for this, to help achieve our goal of growing our rating base. We acknowledge this is a medium to longer term goal.

OUR FINANCIAL STRATEGY IS TO:

- **Keep rates affordability at the forefront of our actions and decisions, and work to keep rates increases at a low level.**
- **Collect annual revenue sufficient to fund expenditure needs. Our strategy for funding depreciation is to:**
    - **Fully fund depreciation for water, sewerage and stormwater and phase in depreciation changes from subsequent revaluations if they are significant.**
    - **Review levels of depreciation for roading, to ensure correct levels going forward in light of proposed changes to levels of service and extending asset lives.**
- **Look at how we can increase non-rates income and maximise investment returns. But we will seek to preserve ratepayer funds when investing, and be risk averse with what we invest in.**
- **Continue to use internal borrowing/debt to fund infrastructure that residents and ratepayers will benefit from, both now and into the future (intergenerational equity approach). We will not use debt to fund operational costs.**
- **Use our solid financial position and existing infrastructure as a platform to provide for the impacts of medium to long term growth in our rating base.**

PROPOSED CHANGES IN LEVELS OF SERVICE

During the next ten years the following are notable changes in levels of service:

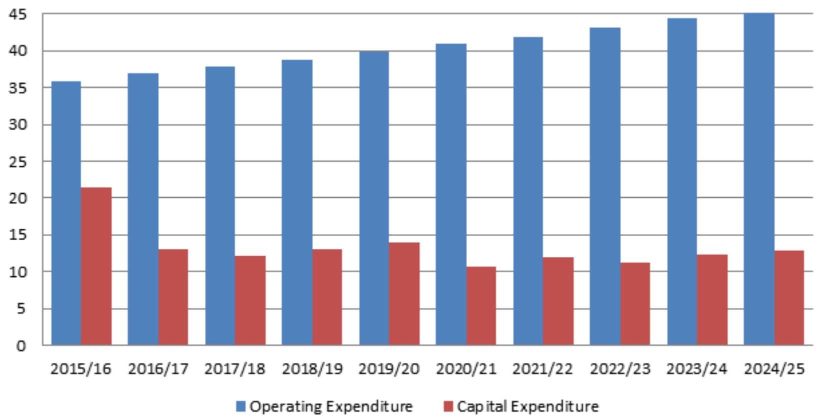
- **Increasing levels of service to meet compulsory requirements, such as increasing standards for sewage discharges and drinking water.**
- **Decreasing levels of service for the sealed roading network. Council to start taking greater risks on the timing of maintenance and renewals, i.e. by not carrying out works even if the asset is not in an ideal condition but is still useable. We are planning to reduce spending by reducing road rehabilitation and reseal work. Mitigate the greater risk (including financial risk) being taken on by earmarking existing reserve funds of $753K to a roading deferred renewal/ maintenance fund to fund work should any unforeseen failures take place.**
- **Rationalisation of some assets where they are no longer sustainable, for example Kaitangata pool and hall. We will need to do more work to determine what impact the cost of earthquake strengthening will have on the longer term sustainability of community facilities.**

OPERATING AND CAPITAL EXPENDITURE

The Forecast Operational and Capital Expenditure 2015/25 graphs below right demonstrate the dominance roading has in both operational and capital expenditure, and also water to a lesser degree.

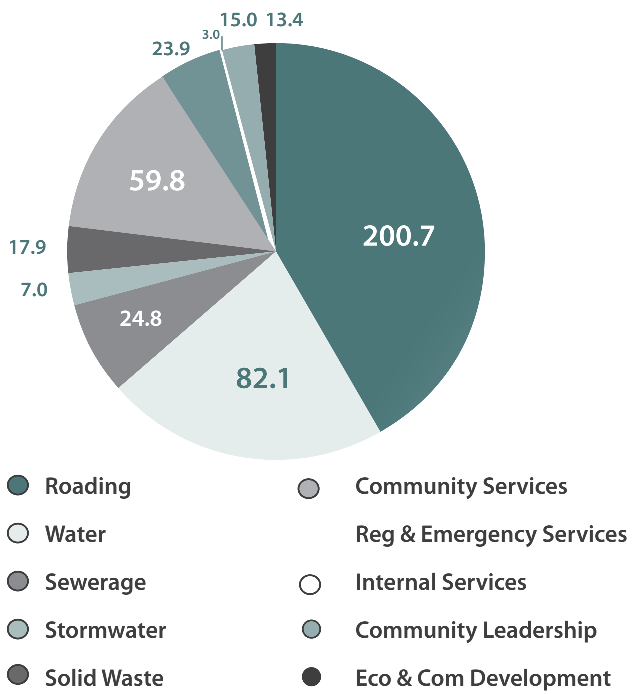
The Forecast Capital Expenditure By Type 2015/25 graph to the far right below illustrates Council's focus on renewing existing infrastructure. It also signals we are forecasting relatively similar portions of compulsory expenditure to improve level of service e.g. for sewage upgrades and drinking water standards, and discretionary level of service spending e.g. Balclutha streetscape improvements, roading safety improvements and sealing The Nuggets Road.

Forecast Operating & Capital Expenditure 2015/25 ($M)

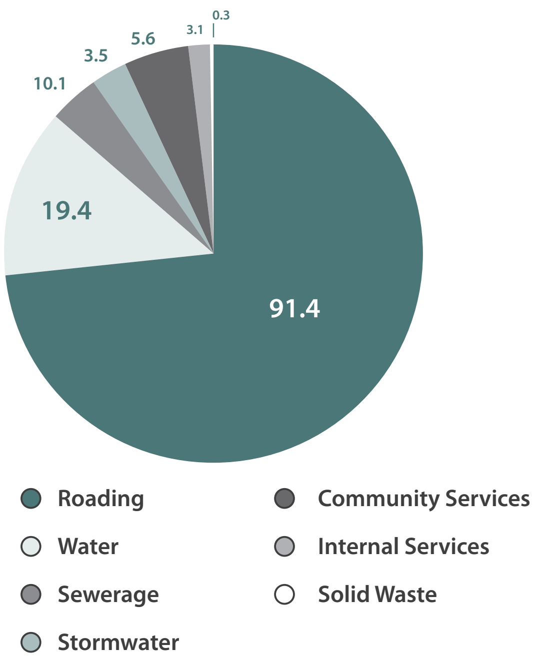


The graph above shows operating expenditure is expected in increase by the rate of inflation built into our financial forecasts. It also shows a steady programme of capital expenditure during the next ten years.

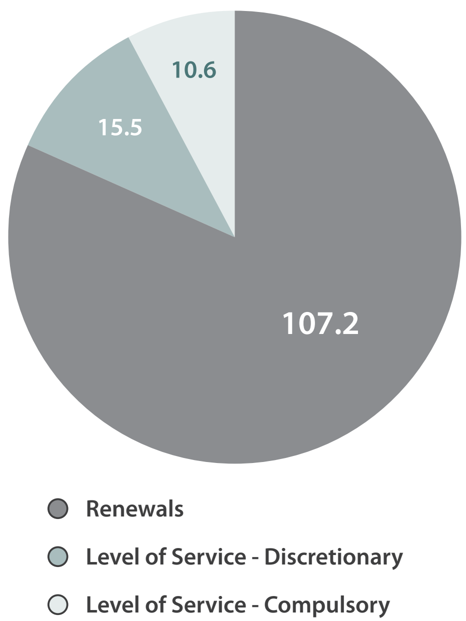
Forecast Operational Expenditure by Activity Group 2015/25 ($M)



Forecast Capital Expenditure by Activity Group 2015/25 ($M)

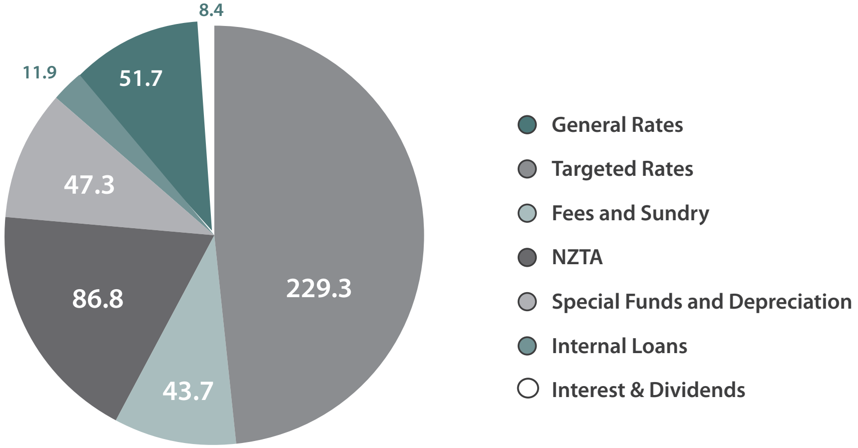


Forecast Capital Expenditure by Type 2015/25 ($M)



FUNDING PROFILE

Council will continue to fund services and activities from a number of sources, of which rates are a major component. Other main income sources include reserves, fees, NZTA funding (for roads), and internal loans.



BALANCING THE BOOKS

LIKE WE HAVE TO DO AT HOME, COUNCIL MUST BALANCE IT'S BOOKS, I.E. MAKE SURE WHAT GOES OUT ISN'T MORE THAN WHAT'S COMING IN

Council is required to ensure that each years' projected operating revenues (including rates) are set at a level sufficient to meet that years projected operating expenses. The only time that a Council can deviate from this is when it is financially prudent to do so.

When considering setting revenue at less than operating costs Council must take into account the cost of achieving and maintaining service levels over the ten years of the Long Term Plan. Council must also take into account its ability to meet the costs of maintaining the service capacity and integrity of assets over their useful life whilst ensuring the equitable distribution of those costs during that lifetime.

The surpluses we are achieving will be used to fund our capital programme. Within these calculations Council is funding the depreciation expense. As a prudent asset manager, Council treats depreciation (decline in value) as an operating cost. To balance the operating account, money must be raised from rates each year to reflect the value of the service consumed annually, reflected by the reduction in the value of the assets. This depreciation charge is a substantial item in the rates-funded operating budgets.

Council places depreciation funds in interest-earning reserves and uses them to fund future costs of renewing the asset or to repay principal on existing loans.

Council has budgeted to fund depreciation in full for water, sewerage and stormwater for the ten years of this plan. But if faced with significant increases following the 2017 and 2021 revaluations, we would elect to phase in the increases over a three year period following each revaluation.

We have identified we need to do more work to determine the impact the proposed reduction in level of service for roading will have on asset lives, particularly for sealed roads. Because of the uncertainty over asset lives we have not fully funded all depreciation for roading during the ten year period of this Long Term Plan. Work will be carried out to ensure correct levels of depreciation funding are confirmed in conjunction with the 2017 revaluation for roading.

FUNDED DEPRECIATION (000'S)

	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025
Total depreciation	12,039	12,380	12,702	13,044	13,406	13,775	14,166	14,568	14,995	15,436
Total unfunded depreciation	0	1,172	1,884	1,202	535	1,626	1,271	1,901	231	1,898
UNFUNDED DEPRECIATION										
Roads	0	1,172	1,884	1,202	535	1,626	1,271	1,901	231	1,898

Note: The unfunded depreciation is the difference between the roading programme agreed with the NZTA, and the depreciation recognised for accounting purposes. Theoretically they should match, but the difference highlights the need for further work in respect to asset lives and proposed reduction in service levels.

INVESTMENTS

COUNCIL EXPECTS AN INCREASE IN INVESTMENTS DURING THE NEXT TEN YEARS

Council manages its investment funds in a way that ensures there is an availability of operating and capital funds when needed, and that it receives an investment return competitive with comparable funds and financial market indices.

COUNCIL MAINTAINS INVESTMENTS TO:

- **Provide cash in the event of a natural disaster. Council currently has set aside a special fund of $3.6 million to meet costs resulting from a natural disaster. Council also established a separate self-insurance fund in 2013/14 for the costs associated with replacing underground assets destroyed or damaged in a natural disaster. The fund was $52,000 as at 30 June 2014.**

- **Invest amounts allocated to special funds and reserves.**

- **Invest amounts allocated for future expenditure (depreciation reserves), to implement strategic initiatives, or to support intergenerational allocations. Because we fund depreciation, these amounts are set aside in reserve funds to meet the costs of future asset renewal purchases.**

- **Invest the proceeds from the sale of assets (if any).**

- **Invest surplus cash. Cash flow surpluses often arise from day-to-day operations. These surpluses are invested in a bank money market account. The interest from these surpluses is used to offset rates.**

FORECAST INVESTMENTS 2015/25

INVESTMENTS ($M)	2015/16	2016/17	2017/18	2018/19	2019/20	2020/21	2021/22	2022/23	2023/24	2024/25
Opening	20.3	14.6	14.3	14.6	14.9	15.3	18.7	22.1	26.0	30.2
Closing	14.6	14.3	14.6	14.9	15.8	18.7	22.1	26.0	30.2	33.5
Change	(5.7)	(0.3)	0.3	0.3	0.4	3.4	3.3	3.9	4.2	3.3

Investments as at 1 July 2015 are forecast at $20.1 million. Council has budgeted on receiving 4.5% interest per annum over the ten year period and investments are projected to increase to $31.5 million by year 10.

TARGETS ON INVESTMENTS

Council's external investments are principally comprised of Government stock, bank, local authority and corporate bonds. The investment return on this portfolio is to achieve 0.8% to 1.0% per annum above the New Zealand Government Stock Index over a rolling three year period.

RESERVE INVESTMENTS

Council's equity balance shows that $31.9 million is held in reserves (June 2014). It is acknowledged that where Council borrows internally, only ratepayers who receive the benefit of those activities pay the cost of that borrowing through targeted rates and charges.

The primary objective in funding internally is to use Council reserves effectively. This creates operational efficiencies as savings are created by eliminating the marginal cost through Council separately investing and borrowing externally. The following specific reserves are used for internal borrowing purposes:

- **General Funds**
- **Special Funds**
- **Depreciation Funds**

Interest is charged by the finance function to the activity centre on quarterly loan balances at an agreed rate, which is fixed for a twelve month period and reviewed annually. Interest is paid quarterly. Interest received is allocated to the specific reserve or fund account.

The internal borrowing rate is referenced to a three year borrowing rate comprising; the three-year borrower swap bid rate as quoted by Council's principal bank and three year borrowing margin as determined by the Councils principal bank . The all-up rate is set at the beginning of each financial year. For the value of internal investments, refer to the section on debt.

EQUITY INVESTMENTS

Council does not actively invest in equity investments. The only equity investments Council holds are shares in Civic Assurance Corporation.

FORESTRY INVESTMENTS

Council has approximately 358 hectares of planted forestry. Approximately 105 hectares of that can be harvested. The status of the land under individual forests varies from reserve land to freehold. The book value of forestry is $2.8 million, and internal debt associated with it is $1.0 million (June 2014).

DEBT (INTERNAL AND EXTERNAL)

COUNCIL HAS NO EXTERNAL DEBT AND NO PLANS TO RAISE ANY DURING THE LIFE OF THIS STRATEGY. BUT WE WILL HAVE WHAT WE REFER TO AS INTERNAL DEBT.

Council is in the position whre it can borrow from its own reserves to finance capital expenditure, i.e. one part of Council lends to another.This debt is not allowed to appear in Council's balance sheet under current accounting rules. Nonetheless it is a commitment that impacts on rates, as there are interest costs and principal repayments for the internal borrowing. This approach recognises our commitment to use the funds for the purpose we have collected it from your rates.

As internal debt could be required to be borrowed externally should the reserve funds from which is is borrowed be called upon, Council has established some limits by which it will manage its internal borrowing practicies.

LIMITS ON INTERNAL DEBT

We have set ourselves the following limits for debt – that the interest cost is less than 10% of our annual rate income, and that total internal debt per capita will not exceed $1,800.

INTERNAL DEBT – CHANGES AND LIMITS 2015/25

($M)	2015/16	2016/17	2017/18	2018/19	2019/20	2020/21	2021/22	2022/23	2023/24	2024/25
Opening balance	24.3	28.5	29.1	30.1	30.6	29.7	28.9	27.6	26.3	25.2
New internal debt	5.0	1.6	2.1	1.6	0.3	0.4	0.0	0.1	0.3	0.6
Capital repaid	-0.9	-1.0	-1.0	-1.1	-1.2	-1.2	-1.3	-1.4	-1.4	-1.5
Closing balance	28.5	29.1	30.1	30.6	29.7	28.9	27.6	26.3	25.2	24.3
Interest costs as a % of rates	5.07%	5.83%	5.82%	5.83%	5.80%	5.40%	5.16%	4.77%	4.40%	4.17%
Debt per capita ($)	1,628	1,664	1,722	1,750	1,699	1,652	1,578	1,504	1,441	1,389

Overall internal debt is budgeted to move from $28.4 million in year 1, peaking at $30.3 million in year 4, then reducing to $24.1 million at the end point of the ten year period covered by this strategy.

GIVING OF SECURITY ON BORROWINGS

Council from time to time borrows externally to meet short to medium term funding shortfalls. A committed bank facility (Multi Option Credit Line or bank overdraft facility) is a practicable method for meeting these shortfalls.

Council has entered into a "negative pledge" as security for these lending facilities. A negative pledge essentially is borrowing without security that involves a promise by Council that it will not grant security over any assets to any other lender or creditor. A negative pledge is granted on the basis that Council's unsecured promise to pay should of itself be adequate comfort to the lender and that none of Councils other lenders/creditors would be put in a preferred position in the event of a default.

Whilst Council has the option to borrow externally long term is not budgeting to do so. Should the situation arise where long term funding is required it is likely that Council may have to put in a place a charge over rates by way of a Debenture Trust Deed.

RATES

RATES ARE ONE OF THE MOST IMPORTANT SOURCES COUNCIL USES TO FUND THE COST OF ITS SERVICES

The level of rates increases set out below is considered sustainable and required to enable Council to fund the proposed levels of service.

The overall funding required from rates in 2015/16 year, as shown in the table is $24.2 million. Council is forecasting that funding required from rates will increase to $31.3 million by 2024/25. This increase includes price adjustments for inflation.

VARIATIONS TO RATES

Council splits the district into 11 different areas for some types of rating: Balclutha, Clinton, Kaitangata, Kaka Point, Lawrence, Milton, Owaka, Stirling, Tapanui, Waihola and Rural. Rates in each of these rating areas vary depending on the range and cost of services in each of these areas.

It is also important to keep in mind that the values of all properties in the Clutha District are reviewed every three years. The latest values were published in November 2014 and will come into effect for rating purposes from July 2015. The exact rates percentage change for a property will depend on which of the rating area a property is in, and whether an individual property's value has changed more or less than the average increase/decrease in the district and in that rating area.

LIMITS ON RATES AND RATES INCREASES

Rates are a key funding source for Council services. We expect our overall rates to increase around 2.90% on average during the next ten years. This is marginally above the 2.88% average increase due to inflation that we are required to build into our budgets. It is also below the 4% limit we have set ourselves. But as you may have read in other sections, we want to work to improve on this and have a number of proposals to continue working towards reducing rates increases.

WHERE WE EXPECT TO BE IN TEN YEARS TIME

Council believes that this Financial Strategy will achieve the following financial end points on behalf of the District.

- **A projected increase in Council's investment funds from $20.3 million at 1 July 2015, to $33.5 million at 31 June 2025.**
- **The responsible use of internal debt to spread capital costs across the future ratepayers who will benefit from the capital expenditure on infrastructure. Council's level of internal debt will be just over $1,389 per capita by 2024/25.**
- **A level of rates and rate increases that are within ratepayers' ability to pay. Increases for most years of the plan are in keeping with inflationary factors. This is an area for ongoing work.**

FORECAST RATES CHANGES, RATES LIMITS AND INFLATION 2015/25

	2015/16	2016/17	2017/18	2018/19	2019/20	2020/21	2021/22	2022/23	2023/24	2024/25
Forecast rates ($M)	24.2	25.1	25.9	26.6	27.6	28.4	29.0	29.9	30.9	31.3
Forecast rates change (%)	3.19%	3.34%	3.23%	2.91%	3.78%	2.81%	2.13%	3.15%	3.29%	1.21%
Inflation	BASE YEAR	2.79%	2.56%	2.72%	2.84%	2.85%	2.87%	3.13%	3.20%	2.98%
Rates limit at 4% ($M)	24.4	25.2	26.1	26.9	27.7	28.7	29.5	30.2	31.1	32.1

You will find more information about rates in the Community and Rates sections of the 2015/25 Long Term Plan.