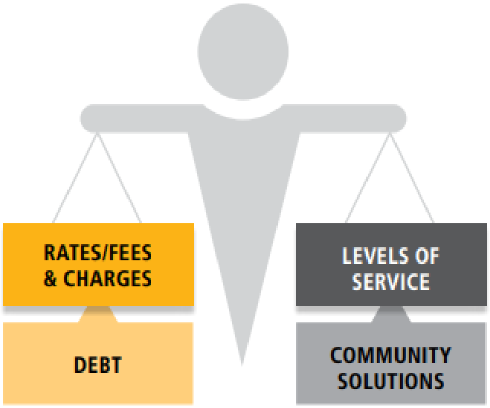
Financial Strategy 2021

Investing in our future



One of the biggest challenges a council faces is balancing its community's ability to pay with the need to maintain infrastructure and deliver services. The COVID-19 pandemic has added to this challenge. Council aims to keep rates and charges affordable for current and future generations. At the same time, Council needs to focus on building its community resilience, supporting economic development and promoting opportunities for growth that ensures the community is sustainable into the future. To ensure that Council will continue with a balanced approach, keeping the two guiding principles of affordability and sustainability at the forefront when developing the financial strategy.

Environmental and national standards are impacting Council's infrastructure projects and heavy investment is required to improve the quality of our services and to meet the higher standards. This is further challenged by the Government's proposed changes to the management of New Zealand three waters. Council has signed a Memorandum of Understanding (MoU) with central government to agree to work together to identify approaches that consider the design of the new entities. This reform programme is outlined in the infrastructure strategy. What does this mean for the funding of water under this Long-term Plan (LTP)? There will not be a significant difference from the previous LTP, as the infrastructure issues and the financial implications will still need to be funded by ratepayers until clear decisions are made.

Going into this Long-term Plan, Central Otago District Council is in a good financial position. CODC holds cash reserves of $13.74 million (June 2020) and while at the time of writing this strategy the council has no external debt, the 2020-21 Annual Plan has signalled Council's intention to move into debt to ensure it meets its intensive capital programme. It is anticipated that this level of debt will increase through the course of this Long-term Plan in order to balance the community's need for new infrastructure and accommodate the growth anticipated for Central Otago.

The desired outcome of this strategy is that Central Otago District Council's asset base and operational expenditure are managed in a cost-effective manner and continue to be funded in a manner that is sustainable for the Council and our communities.

Funding Our Expenditure

Assets Replacement

Investment in the current asset base will continue with replacement of assets funded through depreciation reserves. Council rates for the majority of its depreciation, which is held in reserve to be spent on replacement assets and the payment of borrowings required to fund these assets. All renewals are funded by depreciation reserves. For renewal of assets where depreciation has not been fully funded, it is expected that the unfunded portion of the renewal will be funded by a third party or external debt.

For long-life assets, the renewal programme will fluctuate from year to year. If the reserve is underspent, the reserve will earn interest. At times these reserves may be overspent, in which case any interest cost will be rated for (except for development contribution reserves). Council may also choose to loan or rate-fund replacement assets if there are insufficient depreciation reserves.

Growth Assets

When replacing or putting in new assets, Council will consider whether to build the asset to cater for future growth. This may mean, for example, putting in a larger pipe than is needed for today's use to accommodate additional users in the future. Council will fund the additional capacity through developers' contribution reserves. As part of a subdivision process, developers will contribute to the future growth of infrastructure networks. This money is put in a reserve and used for the growth portion of capital projects.

The Development Contribution Reserve

Typically, building additional capacity for growth in a network precedes the actual growth demand. The growth portion of the capital programme is funded through development contribution reserves. In most instances, these reserves for growth typically run as deficits attracting interest that are in turn funded by developers' contributions.

Asset Increased Levels of Service

The Long-term Plan will respond to increasing environmental and national standards.

While this plan concentrates on asset replacement and growth, there are a number of key projects that will increase the level of service provided by Council. These projects are in addition to the continuation of the Clyde Wastewater project that will see the township move from septic tanks to a new Council service of reticulated wastewater. The first stage of this project is expected to be completed in time for year two of this current Long-term Plan.

1. Completing water treatment upgrades to meet the New Zealand Drinking Water Standards remains a key focus. Within the first three years of this LTP Council expects all of Council-provided water supplies to be fully compliant with the New Zealand Drinking Water Standards.

2. This plan includes investigating more secure water sources at Roxburgh, Ranfurly, Naseby and Patearoa, upgrading wastewater pump station storage volumes, and road flooding improvements such as upgrading culverts.
3. The current water reforms and the receipt of $9.46 million that Central Otago District Council received from Tranche 1 of the Water Stimulus Funding has enabled $5.49 million of projects that were in years 2022 to 2027 of the 2018 LTP to be brought forward. This work is required to be completed by March 2022.
4. Projects to improve water treatment, operational performance, and distribution of water to Bannockburn and Pisa are included in the LTP. These projects include additional capacity to meet future population growth. Hydraulic modelling will be undertaken in 2021 to inform project planning for pipe replacements and reservoir upgrades, which are scheduled for 2027 to 2028.
5. Growth in population, business, tourism and property development is leading to changes in demand for parking and the use of public spaces by motorists, cyclists and pedestrians. For this reason, Council has projects lined up to improve safety, and make these spaces more functional and enjoyable.

Increased level of service for significant capital works is to be primarily funded by loans. To ensure that today's ratepayers do not pay for the building and using of the asset, loan repayment will be rate-funded. Council will rate-fund the depreciation collected on the asset and use these funds to pay the loan principal. This means that the cost of this asset is shared amongst current and future users of the asset. These loans will typically be for no longer than 30 years and funded either internally or externally dependent on the availability of cash reserves. Taking a loan in this instance means that future users of the asset help to pay for it over the asset's lifespan and current ratepayers are not burdened with the full cost. To ensure Council manages the cost of borrowings to mitigate unnecessary costs to the capital programme, Council consulted with the community in the 2020-21 Annual Plan seeking support to join the Local Government Funding Agency (LGFA). With support from the community to join LGFA, Council has joined, and this will help Council manage the cost of borrowings.

In regard to the Clyde Wastewater project, as decided as part of the 2018-28 LTP consultation, all properties connected will pay a connection fee. For stage one this is $10,000 and will be paid either as a one-off payment in full or spread over ten years with a 5% interest charge per annum.

Operational Costs

Funding of operational costs come from a number of sources such as rates, user fees, grants and subsidies. The plan has no significant changes in operational funded levels of service but is impacted by interest rates, population growth and inflation. Where possible and practicable, operational spending is funded through user fees or targeted rates.

Growth and Land Use

Growth in the district

The district has experienced strong growth, particularly around Cromwell and Alexandra. This was anticipated to start slowing in the first year of this LTP. However, analysis shows that growth is expected to average at 1.9% for the first five years and to slow to 1.6% for the final five years. Post COVID-19, the number of applications for resource and building consents has slowed to 90% in the 2020-21 year compared to the previous year. This has been reflected in reduced income across the Long-term Plan.

In Alexandra, Council has released reserve land back to the Crown to enable the land to be sold and developed into residential lots. The Vincent Community Board is currently undertaking a residential subdivision development of its freehold land in Alexandra, which adds sections of a range of different sizes to the market. To assist in meeting demand in Cromwell, the Cromwell Community Board is freeing up land for residential and industrial development. The Board has embarked on a Masterplan project for the wider Cromwell area, to address growth. The plan includes infrastructure planning, transport planning and cover community facility requirements to cater for growth. A spatial framework has been produced that addresses zoning and urban development, which will be implemented through a series of plan changes.

Council is in the process of reviewing its District Plan. This is a critical piece of work that helps us to set the standards for how our district responds to growth in a proactive and sustainable way. The plan review will look at all matters required under the Resource Management Act, with a particular emphasis on ensuring sufficient land is zoned for residential, commercial and industrial purposes for the next 10 to 20 years.

Underspends in years that have fewer costs associated with the District Plan are put into reserve to contribute to future years to help manage the cost of the District Plan.
An assessment of the district's growth to 2050 was undertaken in July 2020. Four scenarios were modelled:

- Low growth
- Medium growth
- High growth
- Business as usual (assuming no impact from COVID-19).

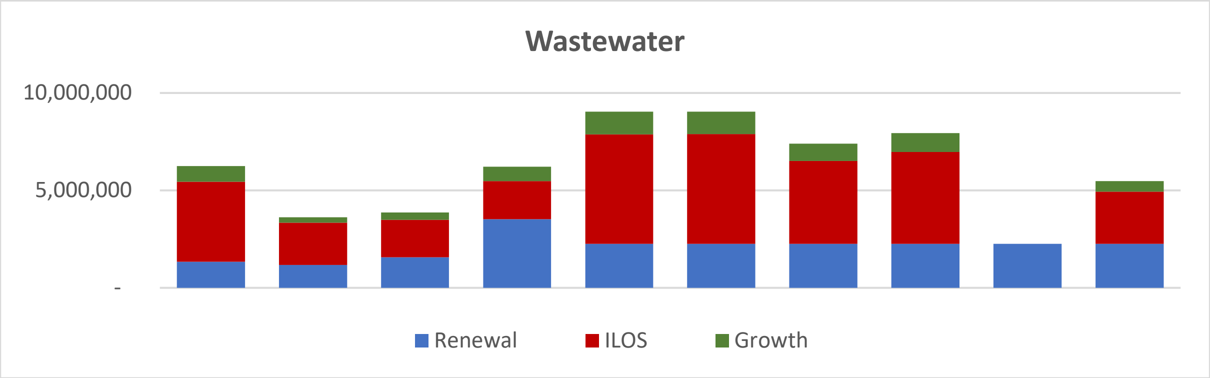
For this Long-term Plan, Council has used the business-as-usual model, which is 1.9% yearly average for the first five years, slowing to 1.6% in the final five years of the plan. This is down on the previous two years, when an average of 2.5% was experienced.

Capital Expenditure

Capital project

The following graphs show the split between growth, changes to levels of service, and renewal or replacement of existing assets. Level of service represents the amount of capital expenditure that is planned as an increase to current levels of service.

The amounts spent on renewals are required to maintain the current levels of service. Renewals are funded by rates through depreciation charges. Expenditure for growth will provide existing levels of service to new ratepayers and is funded by development contributions.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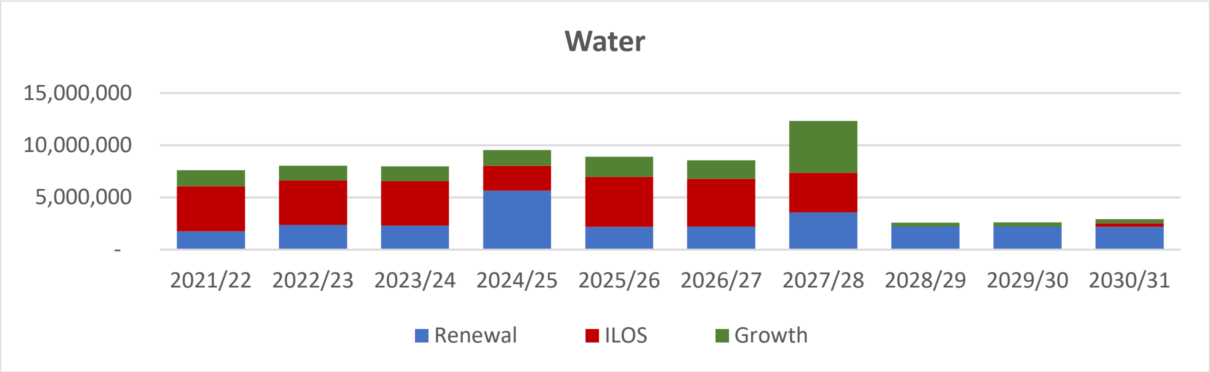
Growth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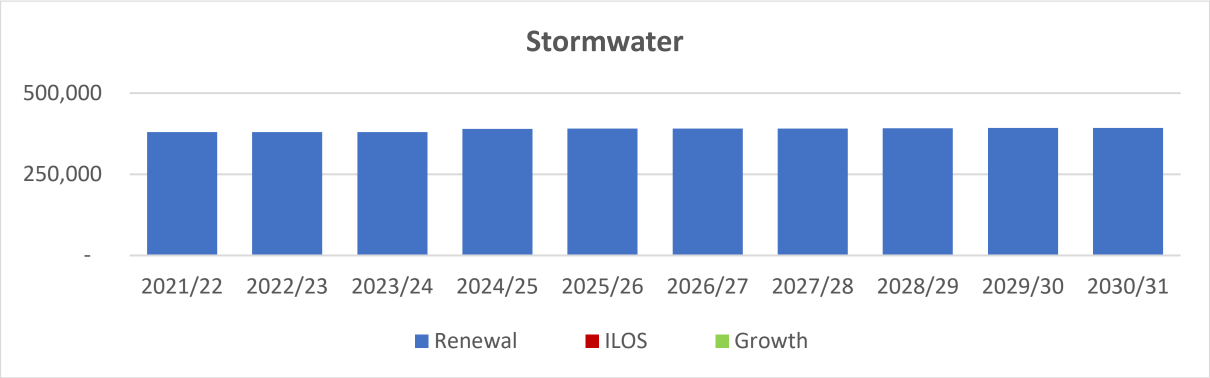
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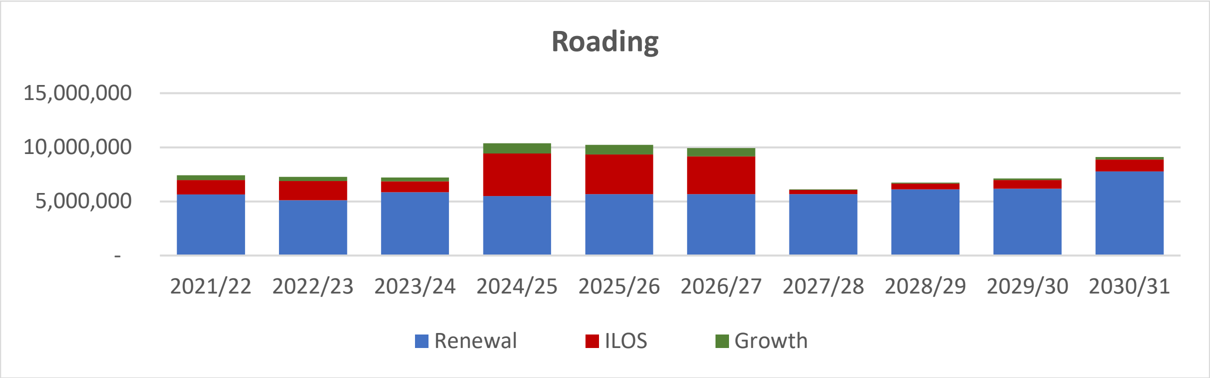
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Growth

Other Factors

Emergency Event

Council continues to build its initial response fund for any costs that are considered a Council essential service or group within the district that has been affected by an “act of God” or an “unplanned event” such as a pandemic, and which is not already covered by insurance. Essential service can include any services Council provides that impact on the four community well-beings (social, economic, environmental and cultural).

Due to the size and geographical distribution of the community, Council consider it unlikely that an event would affect the entire district at any one time, so modelling of Council exposure has taken this into account to determine the share of the funds required. Currently, the Emergency Event Reserve stands at $2.61 million and is projected to reach $4.323 million by Year 10. If an event caused damage that exceeded the balance of the reserve, Council has the borrowing capacity to raise debt for the balance.

Insurance

Council will insure all Council-owned assets with the exception of underground assets and bridges, as underground infrastructure became difficult and expensive to insure following the Christchurch earthquakes. Council adopts the policy of self-funding underground infrastructure. As of year four, Council will revert to setting aside $120,000 each year into the Emergency Event Reserve, which can contribute towards Council’s excess that is not funded by Central Government. This fund covers any non-funded or uninsured expenses incurred in relation to natural disasters (an “act of God”) and unplanned events, including pandemics. In the event of a catastrophic event, Council would loan fund any expenses not covered by Central Government funding and the Emergency Event Reserve.

Debt Security

Council’s Liability Management Policy currently allows Local Authority Bonds (which includes loan funding through LGFA) to be secured by either a general charge over rates or a specific asset of council.

Bridges

There are 179 bridges on the district’s roading network. Seventy-two bridges are expected to reach the end of their economic life within the next 30 years, with a further 30 requiring significant renewal work. A significant number of these bridges are located on low volume roads, and the economic viability of like-for-like replacement of these bridges will need to be reviewed. Further investigation and analysis work is planned for the next three years, before any actual investment will occur.

Council has not previously rate-funded depreciation for bridge renewals, so there are limited reserves set aside for the programme of renewals that will emerge over the next three years. The current projections take into account our current assessment of the increased work required, so ratepayers are being asked to fund the increased depreciation costs that result, as well as the interest cost for the use of money. Council now funds depreciation and maintenance to ensure it’s in a position to continually renew those assets as required.

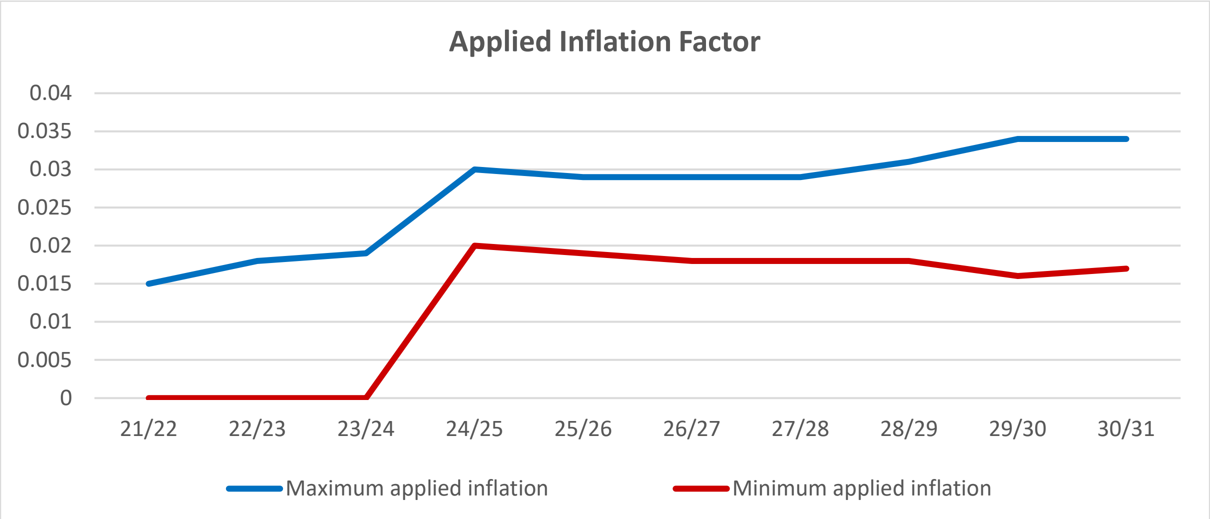
Once a clear work programme is established for the maintenance and renewals of our bridge network, Council can then better consider the funding options available to us. Because bridges are long-life assets, external loan funding may be appropriate. Council has the capacity to borrow further in terms of its limit to total assets. However, Council first needs to assess whether it wants to go down that path or rate-fund the replacements by taking longer to build the self-insurance fund.

Inflation

Inflation reflects erosion in the buying power of money. Each dollar buys fewer goods and services over time. Expenditure forecasts for each activity are input in the dollars of the relevant year for the first three years. This means that planned cost movements or inflation adjustments are expected, the cost movements have been taken into account.

Applying blanket inflation rates over these first three years would then overinflate these costs. If some costs rise due to unplanned inflation, Council may seek alternative measures, such as finding savings where possible or the use of reserves. Alternatively, Council may review its programme of works to ensure it stays within the proposed budget overall.

An inflation factor of zero has been applied to costs for the first three years to reflect that the base figures include known movements in costs for those years. The exceptions to this are depreciation and staff costs, which are inflated from year 1.



During the course of the plan, inflation factors of between 0% (where Council does not apply inflation) and 3.4% have been applied. The difference is reflective of variations in inflation expectations year on year, along with various rates being applied to different costs, for example, water supply inflation factors compared to expected inflation on road construction.

Development Contribution Reserve

In 2007-2008, when development contributions were in their infancy, the estimation of the growth portion of some roading assets was too high. This has left this reserve in a deficit that with interest charges would not recover to a sustainable point. This deficit was remedied by using general reserves and roading depreciation reserves to bring the account back to a sustainable level during years one to three of the 2018-28 LTP.

Impact to Deliver Proposed Levels of Service

Just as the cost of running your household increases every year with inflation, so too does the cost of providing our services. This is because costs like energy, property, labour and construction continue to increase. This in turn affects how much it costs us to deliver services to you. Council has used inflation assumptions, provided by Business and Economic Research Limited (BERL), that are particular to councils. These assumptions underpin this Financial Strategy and are outlined in the financial section.

In planning for the long term, the only certainty is uncertainty. Therefore, creating a plan that accounts for every eventuality would be impossible. So Council bases its forecasting on a set of assumptions and assesses the risks associated with each assumption to determine how to mitigate the consequences and ensure a robust plan that delivers on our promised levels of service.

A positive challenge is that our district is still a desirable place to live for many people. So although Council has a responsibility to provide infrastructure in anticipation of growth, it has the ability to more accurately plan for provision of services in areas where growth is projected to occur.

The review of Council's District Plan will also create a significant opportunity to set the speed of development and growth, and more accurately forecast the demand on levels of service. Council has entered into a number of partnerships that help us deliver our services in a more efficient way. Council has some strong relationships with neighboring councils that its using to the benefit of our communities. One example is our shared library service with Queenstown Lakes District Council.

Financial Prudence Benchmarks

Disclosure Statement

What is the purpose of this statement?

The purpose of this statement is to disclose the Council's planned financial performance in relation to various benchmarks to enable the assessment of whether the Council is prudently managing its revenues, expenses, assets, liabilities and general financial dealings.
The Council is required to include this statement in its LTP in accordance with the Local Government (Financial Reporting and Prudence) Regulations 2014 (the regulations). Refer to the Regulations for more information, including definitions of some of the terms used in this statement.

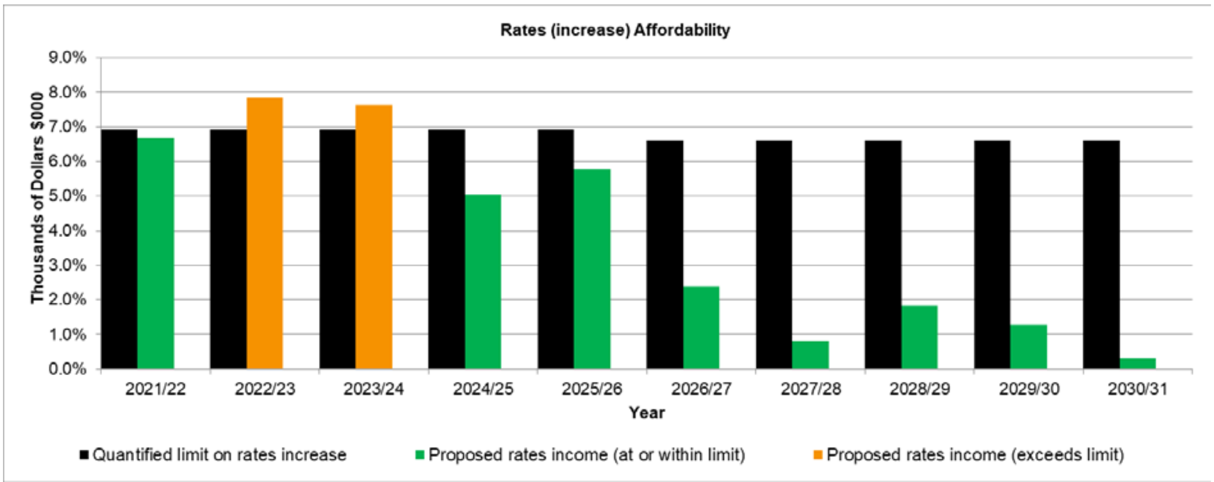
Rates Affordability Benchmark

To maintain an element of affordability, Council has worked towards maintaining a limit on rates increases of 5% per annum for *existing* ratepayers. This does not include the provision for growth currently projected at an average of 1.9% for growth for the first five years decreasing to 1.6% for the final five years.

Anticipated Annual Growth	202021	2021/22	2022/23	2023/24	2024/25	2025/26	2026/27	2027/28	2028/29	2029/30	2028/29
Rating Units	14,084	14,352	14,624	14,902	15,185	15,474	15,721	15,973	16,228	16,488	16,752

This rate cap is an average for the whole district, which means that on an individual basis the combined cap does not apply. These rate increases will go beyond the 10 years, given the level of investment still to occur.

Due to planned rates reduction in 2020-21 as a result of COVID-19, the need to bring some large infrastructure projects forward and to incorporate projects that raise quality standards to meet predicted legislation changes, it is anticipated that Council will slightly exceed the 6.9% cap in years 2 and 3 (7.8% and 7.6% respectively).

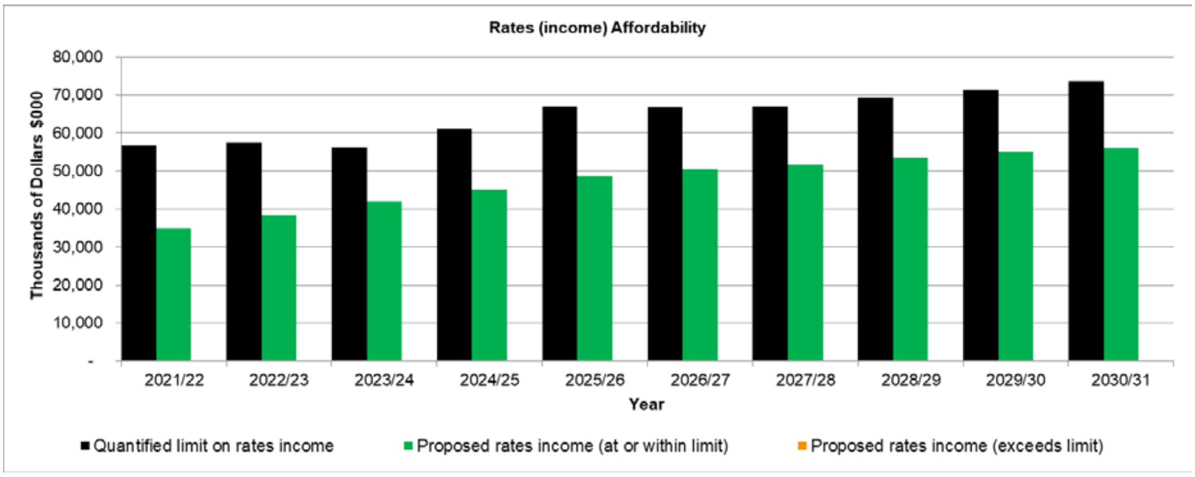


The Council meets the rates affordability benchmark if its planned rates income equals or is less than each quantified limit on rates. Council also sets a rate limit based on total expenditure. This limit has been set at 80% of total revenue and is a measure used across all local authorities. For the 10 years of this plan rates income does not breach this limit.

It is important to remember that this is an average across the district and that rate increases will vary from property to property, with some individual properties seeing increases above this limit, depending on a range of factors such as property valuations and targeted rates assessed on a ward basis.

Rates are the main source of income for councils. Currently Central Otago District Council draws about 60% of our revenue from rates and proposes to limit the rates collected each year to a maximum of 80% of total Council revenue.

Council's strategy is to ensure that both current and future ratepayers pay their fair share of the cost of providing services. This intergenerational equity is achieved through loan funding the increased level of service of long-term assets and drawing rates to pay for the loan over an extended period of time. The loan will be funded by internal or external borrowing depending on availability of funds. This ensures that both current and future users pay for the service.

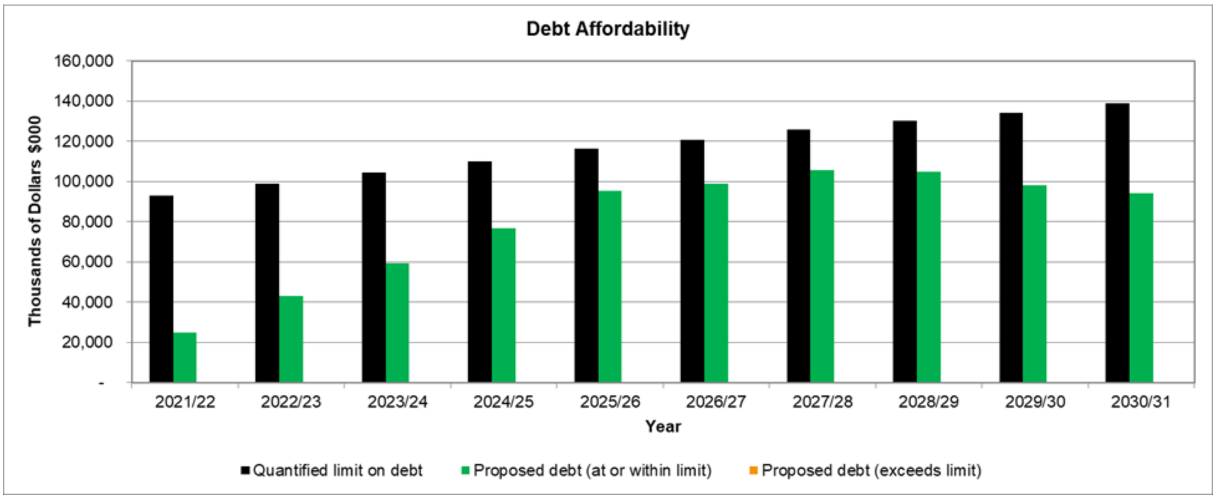


Rates (income) affordability compares the relationship between total revenue and total rates collected. The limit for total rates is set at 80% of total income. This benchmark has been met in each of the 10 years of the plan.

Debt Affordability

The council meets the debt affordability benchmark if its planned borrowing is within each quantified limit on borrowing. The following graph compares the Council's planned debt with a quantified limit on borrowing contained in the financial strategy included in this LTP. The council meets the debt control benchmark if its actual net debt equals or is less than its planned net debt.

The following graph displays the council's proposed net debt as a proportion of planned net debt. In this statement, **net debt** means financial liabilities less financial assets (excluding trade and other receivables).

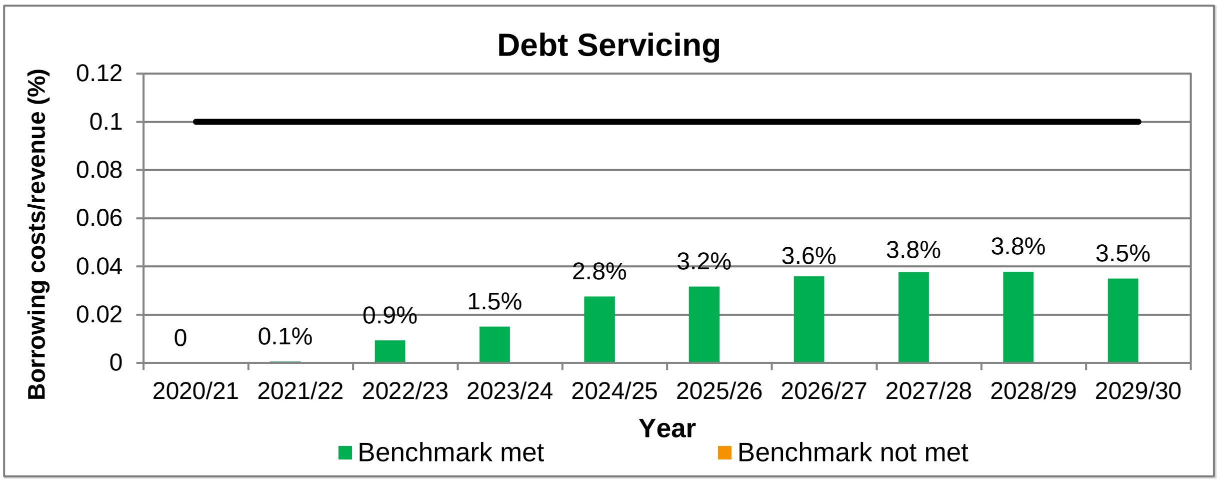


Debt Servicing

A borrowing limit of 10% of total assets has been set to assist in prudently managing borrowing. As the plan has sufficient cash reserves to internally fund any projects that need to be loan funded, debt in this 10-Year Plan will not exceed the 10% of total assets benchmark.

The following graph displays the council's planned borrowing costs as a proportion of planned revenue (excluding development contributions, financial contributions, vested assets, gains on derivative financial instruments, and revaluations of property, plant, or equipment).

Because Statistics New Zealand projects that the Council's population will grow as fast as the national population is projected to grow, it meets the debt servicing benchmark if its planned borrowing costs equal or are less than 10% of its planned revenue.



Investment

Council recognises that as a responsible public authority, any investments that Council holds should be of a relatively low risk. Council also recognise that lower risk generally means lower returns. Council aims to maximise investment income within a prudent level of investment risks. Currently Council has money invested with banks in New Zealand and its aim is to achieve market rates for these investments. Council may also consider other investments in accordance with the Investment Policy. Council's quantified target for returns on financial investments is to achieve a return equivalent to market rates. Council will ensure that all funds are placed in suitable deposit accounts and excess funds will be put on deposit.

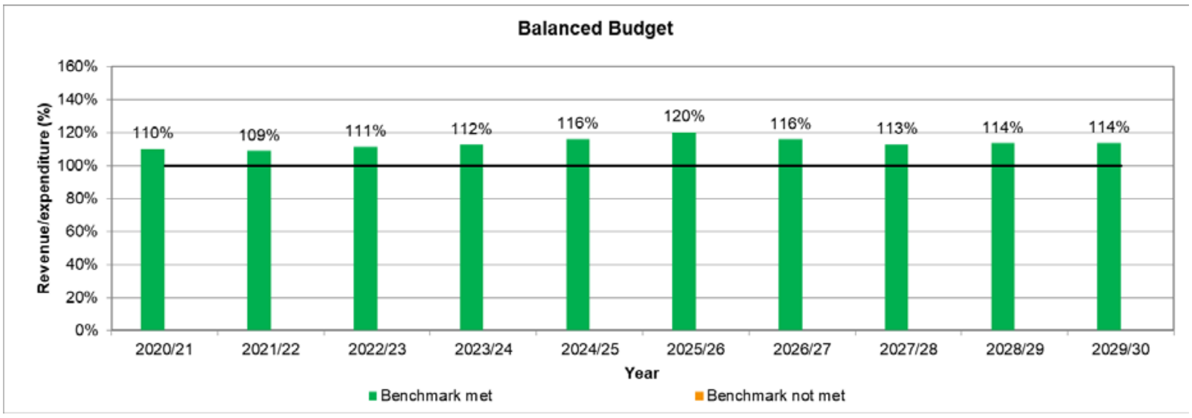
Cash Reserves and Debt

Council currently has reasonable cash reserves. While much of these reserves relate to money set aside for asset replacement, there is a significant amount that has come from Cromwell land sales. In the next 10 years, sale of land is forecast to have a net value of $40 million, which will add to the estimated cash position. The plan reflects the reinvestment of the land proceeds into assets other than cash, such as the planned development for Cromwell.

Significant non-growth expenditure that is not depreciation funded or subsidised will be loan funded. Loans will be set up with repayments (less depreciation) being rated for. The source of these loans are forecast to come out of cash reserves or external borrowings.

Balanced Budget

Council is required to operate a balanced budget, in which operating revenues are set at a level sufficient to meet that year's operating expenses. A balanced budget is achieved when total revenue (less revaluations, developers' contributions and vested assets) is greater than operating expenditure. This plan achieves a balanced budget for each of the 10 years of the plan.



Surpluses can result when:

Rates are raised to repay loans. The rates income appears in the prospective statement of comprehensive revenue, but the repayment is a prospective statement of financial position item.

Income for capital purposes such as development contributions and capital donations appear in the prospective statement of comprehensive revenue. However, the corresponding capital expenditure is a prospective statement of financial position item.

Waka Kotahi New Zealand Transport Agency grants for roading are included in the prospective statement of comprehensive revenue. These are largely used to fund renewal expenditure, which is a prospective statement of financial position item.

Rates have been raised to build the self-insurance fund for emergency events. The rates income appears in the prospective statement of comprehensive revenue, but the reserve fund is a prospective statement of financial position item.

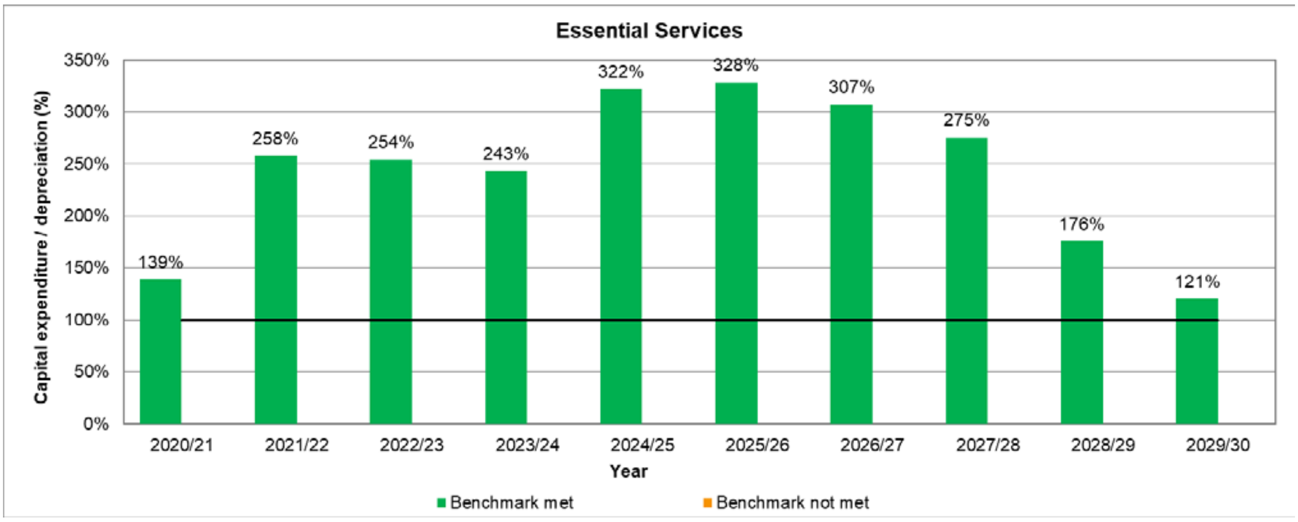
Deficits can result when:

Council's Revenue and Financing Policy indicates that in certain circumstances Council will not fully fund depreciation from rates income, for example, Council does not fully fund depreciation on roading assets. Most roading capital expenditure attracts a government subsidy; therefore, there is no need to fully fund depreciation for the portion that is subsidised.

There are circumstances when fully rate funding depreciation may result in some ratepayers bearing a funding burden that is not entirely fair and equitable. This is where funds for capital project replacement are provided from sources outside Council – for example, where a community has raised funds for a hall. Council would not rate-fund the depreciation on the hall, as any replacement of that facility would be the responsibility of that community.

Essential Services Benchmark

The following graph displays the Council's planned capital expenditure on network services as a proportion of expected depreciation on network services. The Council meets the essential services benchmark if its planned capital expenditure on network services equals or is greater than expected depreciation on network services.



Council's approach will involve maintaining a focus on affordability and the long-term consequences of decision-making. Council needs to balance affordability with suitable investment in our district to ensure progress continues and this remains a great place to live, work and play.