FINANCIAL STRATEGY 2021-31

Te Rautaki Ahumoni 2021-31

Introduction

The Financial Strategy supports the delivery of Council activities and services to address rates affordability and ensure that the Council remains in a long-term stable financial position. The Financial Strategy is central to the development of the Council's Long Term Plan.

This strategy focuses on balanced investment in priority areas to support the district's development and communities' aspirations, while also ensuring that our long term financial position is strong, prudent and fair in addressing the many challenges we are facing.

Objectives

The Financial Strategy will continue to place the long-term financial sustainability and affordability of rates at the forefront of the 2021-31 Long Term Plan.

The objectives of this Financial Strategy are to continue to achieve the right balance between ensuring resources are available to sustainably invest in and manage assets and services, while at the same time:

- maintain rates at an affordable level
- control our expenditure
- manage financial risk, and
- ensure inter-generational equity.

Planning for the long term

The Long Term Plan 2021-31 has a particular focus, in the first three years, on key initiatives to ensure that we:

- Plan for, and adequately respond to, sustainable growth management
- Improve asset management and planning for three waters services (including growth-related)
- Mitigate and adapt to current and/or expected climate change effects
- Prepare for local government sector reform of water-related services

Initiatives to support this include the development of a Future Development Strategy (FDS) and Regional Spatial Plan, a district-wide rates review and implementation of an organisational capacity and capability review.

Strategy context

COVID-19

The emergence of COVID-19 has had a profound effect on the world, and the Whakatāne District and our communities are no exception. As with other emergency events, the Council will need to respond appropriately to any future outbreaks of COVID-19, which will impact the Level of service we are able to provide. For the purposes of budgeting and planning our work over the next 10 years, we've made the assumption that there will be no further major resurgences of COVID-19 (i.e. which would impact our work plan or services).

Funding and resourcing pressures facing our district include:

- Time-bound opportunities to leverage significant central government co-funding opportunities.
- Interest rates are at historic lows. The New Zealand economy has thus far come through COVID-19 more strongly than had initially been expected and as a result, there are signs of inflationary pressures. General commentary from both the Reserve Bank and commercial banks are forecasting interest rate increases over the coming years.
- Limitations on available funding tools and levers.
- Inflation, cost increases and service procurement challenges.

Key strategic and financial considerations

- Since 2013, the Whakatāne District's population has grown at an average rate of approximately 1.6 percent per annum. As at 30 June 2020, the Whakatāne District population is estimated to be 38,200.
- There is insufficient land zoned at present to cope with expected growth.
- Council needs to invest in new and upgraded infrastructure to service anticipated growth projections for the district.
- The need to upgrade the district's three waters infrastructure and services provides the biggest challenge to the Council's long-term financial strategy. This is currently estimated to cost $153 million over the LTP period.
- The Council manages $760 million of community assets (Total assets as at 1 July 2020).
- Operating expenditure is averaged at $90 million per annum over the LTP period.
- The Whakatāne District Council employs approximately 313 full-time equivalent staff, making it one of the larger employers in the Eastern Bay of Plenty.
- In order to fund existing Council services and priority projects, including renewal of existing assets and new capital expenditure, $374 million is planned to be invested over 2021-31. Grants and subsidies will be used to reduce the impact of this investment, and Council's rates and debt levels will need to increase.
- The Council has smoothed the planned growth in total rates required from the district over the first three years, and intends to manage its expenditure within this plan. It is important to note, however, that the rates increase for a particular property will be different each year.

Balancing affordability and growth

The district's population trend over the past two decades has been a static / reducing population. This trend has dramatically reversed in the past seven years with significant lifts in property values, and consistent annual increases in the district's population.

While the Council has most of the infrastructure necessary to service a stable population base, pressure for new and improved assets and services has come from population growth.

In particular, new investment in water supply and wastewater (sewage) treatment, and improvements to the quality of water and wastewater outfalls is required over the 2021-31 LTP period. Furthermore, renewal of wastewater consents in 2026 will likely result in pressure to improve the standards of wastewater treatment and discharge outfalls.

The assumption for the development of the Long Term Plan is that the population of the district will continue to grow at a rate exceeding projections in our previous LTP 2018-28.

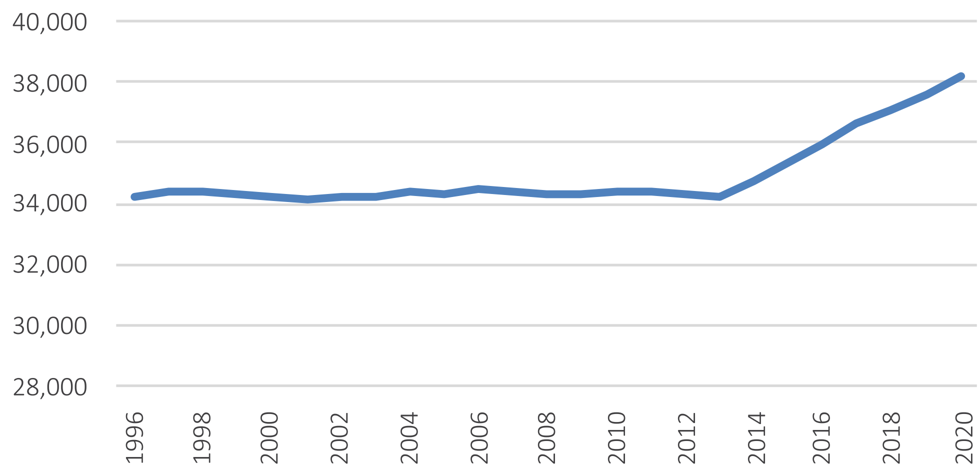
Our growth assumption is based on Statistics NZ's 2013 'high' population scenario, with a conservative 15 percent buffer added in line with actual population growth experienced in recent years. This assumption falls roughly in the middle of the 'medium' and 'high' scenario forecasts from Statistics NZ based on the 2018 census.

From a rating base perspective, an assumption of an increase of 120 Housing Equivalent Units (HEUs) per annum has been used for the development of the Financial Strategy. This figure is based on a mixture of recent trend data and population projections and is considered a conservative approach to rating. This will ensure that the Council is adequately and responsibly planning for the additional costs associated with supporting increased population and development.

Development Contributions are also paid on completion of new properties to pay for associated new or improved infrastructure.

Council is also currently developing a Future Development Strategy (FDS), and Regional Spatial Plan with partners, to guide decisions on the sustainable management of growth within the district.

Actual district population 1996-2020



Maintaining existing assets

The Council manages $760 million of assets (total assets as at 1 July 2020) on behalf of our communities. These assets are critical to servicing our district and supporting community wellbeing.

The Council ensures robust Asset Management Plans are in place for our core infrastructure activities so they are well maintained, have a long-term prioritised programme of works and that the 'whole of life' costs are balanced and shared across multiple planning periods.

Environmental standards continue to increase regarding the quality of water that we discharge around the district. Higher standards are required in the term of the Long Term Plan 2021-31 for three waters (water, stormwater and wastewater) as many of the assets are either nearing the end of their life or require capacity upgrades to manage growth. A significant amount of work is required, including upgrades to our wastewater treatment plants, to meet modern standards and gain consents from Bay of Plenty Regional Council.

In July 2020, central government initiated the Three Waters Reform Programme to review local government three waters service delivery arrangements. One of the possible outcomes of this reform is that the management and operation of the three water assets may move to another agency. The outcomes of this reform are not included in this Long Term Plan, as there are currently a number of uncertainties around the final outcome. Council's Long Term Plan 2024-34 will include any associated planning and investment requirements.

Financial implications of natural hazards and events

Natural disasters can result in significant costs for the initial response effort, clean-up, and capital works programme required to rebuild damaged assets. Planning for the financial impact of such events is difficult. Depending on the scale of an event, this could require the reprioritisation of projects and budgets and unbudgeted spending. Council's options for meeting the cost of natural hazards and events damage includes pre-funding (increasing reserves) or post-funding (increasing debt).

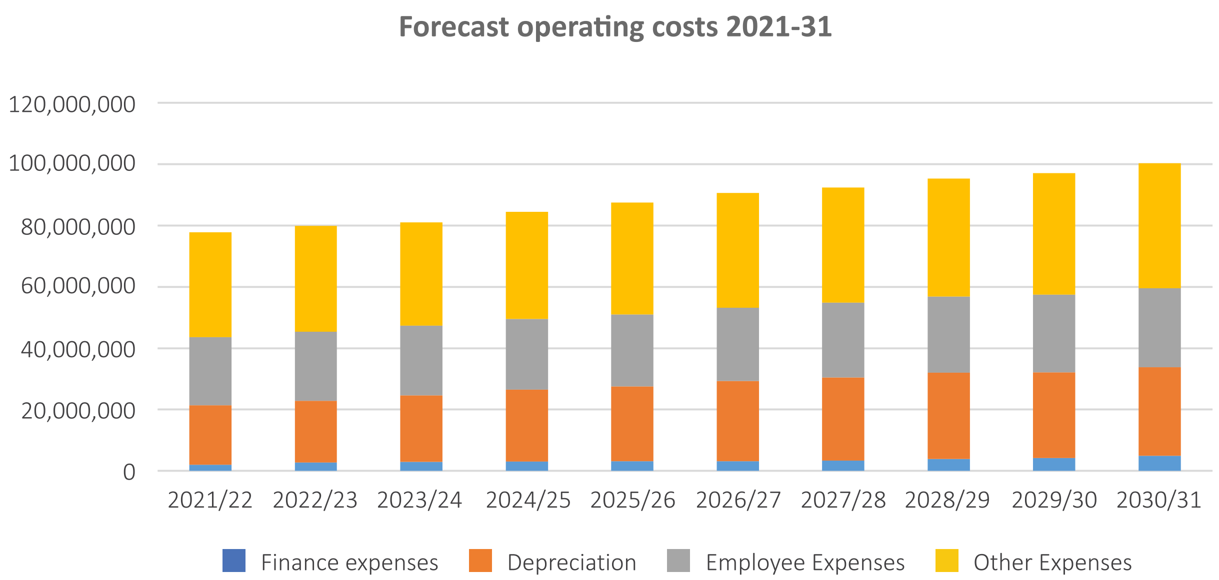
The Council will initially attempt to meet any costs from within existing budgets and where available, from insurances and external subsidies. The LTP also includes two reserve funds to help meet the cost of responding to natural hazard damage, the Roading Storm Damage Reserve and the Disaster Recovery Reserve. Council is also planning to implement a number of initiatives in this Long Term Plan to support our Climate Change Strategy, including investment to support Council's target of being carbon neutral by 2030, and development of a Climate Change Risk Assessment and Adaptation project. The Long Term Plan also includes an increase in the costs of insurance due to increased risks.

Expenditure

OPERATING EXPENDITURE

Operating expenditure primarily pays for Council's day-to-day costs of delivering services and maintaining existing assets. The majority of our operating expenditure is related to the four core network infrastructure activities which include transport connections, water supply, stormwater drainage, and sewage treatment and disposal.

The Council's total operating expenditure is set to increase from $78 million in 2022 to $103 million in 2031 equating to a 33% increase across the LTP period. The four largest areas of investment are in recreation and community services, transport connections, three waters and corporate and district (including building and consents). These four activities make up 75 percent of our operating expenditure.



CAPITAL EXPENDITURE

Capital expenditure pays for buying or building new assets, renewing an existing asset or improving an existing asset to deliver a better service.

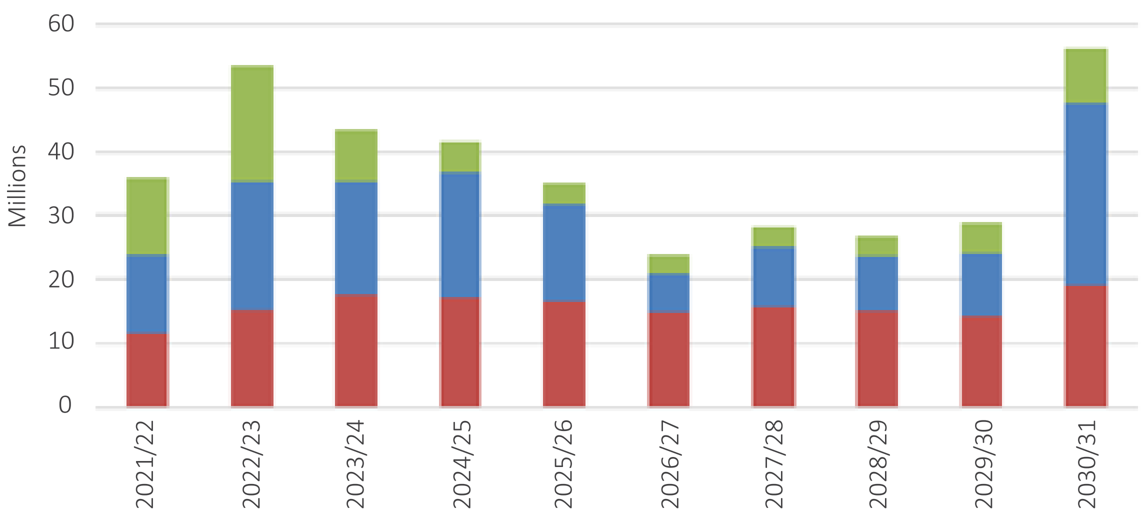
Growth projections show approximately an additional 1,200 households will be required over the Long Term Plan 10 year period. Investing in better service levels for infrastructure is essential to any growing community; however, Council must balance these improvements with our communities ability to pay. The Council's total capital expenditure is planned to range from $23.8 million to $56.3 million per year over the 10 year planning period. Total capital expenditure over this period is planned to be $374 million.

The majority of Council's capital expenditure is related to core network infrastructure (transport connections, water supply, stormwater drainage and sewage treatment and disposal). Over the life of the LTP, these account for 78 percent of our capital expenditure.

The transitional nature of this LTP has a significant portion of Council's capital expenditure for renewals, including the replacement of assets that have reached the end of their lifespans. The renewal of network infrastructure, including transport connections, stormwater drainage, water supply, and sewage treatment and disposal, accounts for 33 percent of our planned capital expenditure. Other renewals (of non-network infrastructure such as halls, public toilets, playgrounds etc.) account for a further 12 percent.

Council assets have very long lives. Council's strategy is to ensure that both current and future ratepayers pay their fair share of the cost of providing assets and services. Intergenerational equity is achieved through loan funding, long-term assets and drawing rates to pay for the loan over an extended period. Depreciation assists in intergenerational equity by ensuring that a cost is recognised for the consumption of the assets. Depreciation reserves are set aside annually to meet the costs of renewing an asset as it nears the end of its lifespan.

Capital expenditure by level of service 2021-31



Borrowing and debt

The Council has a healthy balance sheet and is in a stable financial position. Our portfolio of activities and services includes managing $760 million worth of community assets, compared to total liabilities of $106 million. Careful consideration has been given to prioritising and scheduling only necessary capital projects.

Through this Long Term Plan, the Council has increased its debt limit (applying to external debt) being less than 175 percent of total revenue (previously the cap was 150 percent). The increase will provide Council with the necessary funding for our capital investment plan, as well as ensuring there is a sufficient headroom in our debt limit to cope with unexpected and natural disaster events.

Total borrowing at 30 June 2020 was $72 million of external borrowing through the banks. Increased investment to manage asset renewals, improved levels of service, and development of new assets over the period of the LTP, will result in Council needing to increase debt levels. Council also anticipates as projected debt rises, managing the cost of debt will become increasingly important. Over the first three years of the Long Term Plan, Council will consider obtaining a formal credit rating with an external credit agency, such as Standard & Poors or Fitch. One benefit of a formal credit rating is the ability to access debt at a lower cost through our funding partners, but this needs to be considered against the cost of maintaining the credit rating.

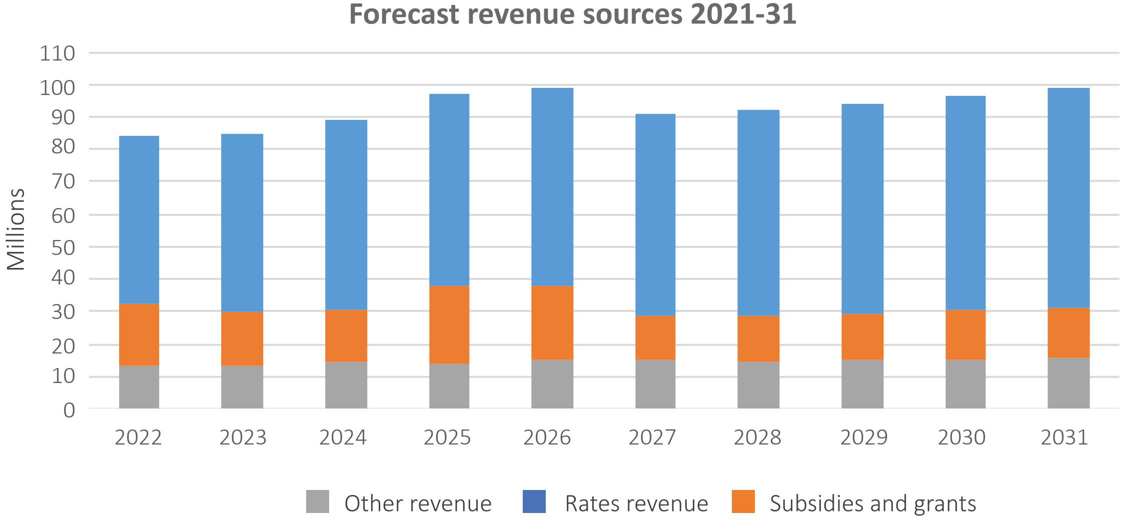
Council's strategy is to ensure that both current and future ratepayers pay their fair share of the cost of providing services, referred to as intergenerational equity. Council achieves this through loan funding for long-term assets and drawing rates to pay for the loan over an extended period. Depreciation also assists in intergenerational equity by ensuring that a cost is recognised for the consumption of the assets.

Policy on securities for borrowing

To borrow money, the Council has to offer lenders security. Like most councils, we secure our debt against our rates income, rather than against physical assets like land or buildings. This means that lenders can make us increase rates to repay debt under certain circumstances. Using this form of security helps to keep the interest rates on our debt low. Council uses financial derivatives to arrange interest rate risk. These derivatives, known as swaps, reduce variability in interest costs, allowing Council to better manage cash-flow. The Council's full policy on security for borrowing, the Liability Management Policy, is available at **whakatane.govt.nz/policies-and-bylaws**

Revenue

Rates provide the majority of revenue required to pay for the services and facilities delivered by the Council. This typically accounts for 65-70 percent of our revenue each year, with the balance coming from other sources. Other sources include subsidies, grants, financial assistance rates and government partnerships, and fees and charges.



Rates setting

The Council has smoothed the planned growth in total rates required from the district over the first three years of this LTP, and intends to manage its expenditure within this plan. After smoothing, the resulting per annum total rates rise for the first three years of the LTP will be 6.93 percent. Rates increases for the remaining seven years will continue to be calculated annually. This has the effect of reducing the rates increase for year one (2021/22).

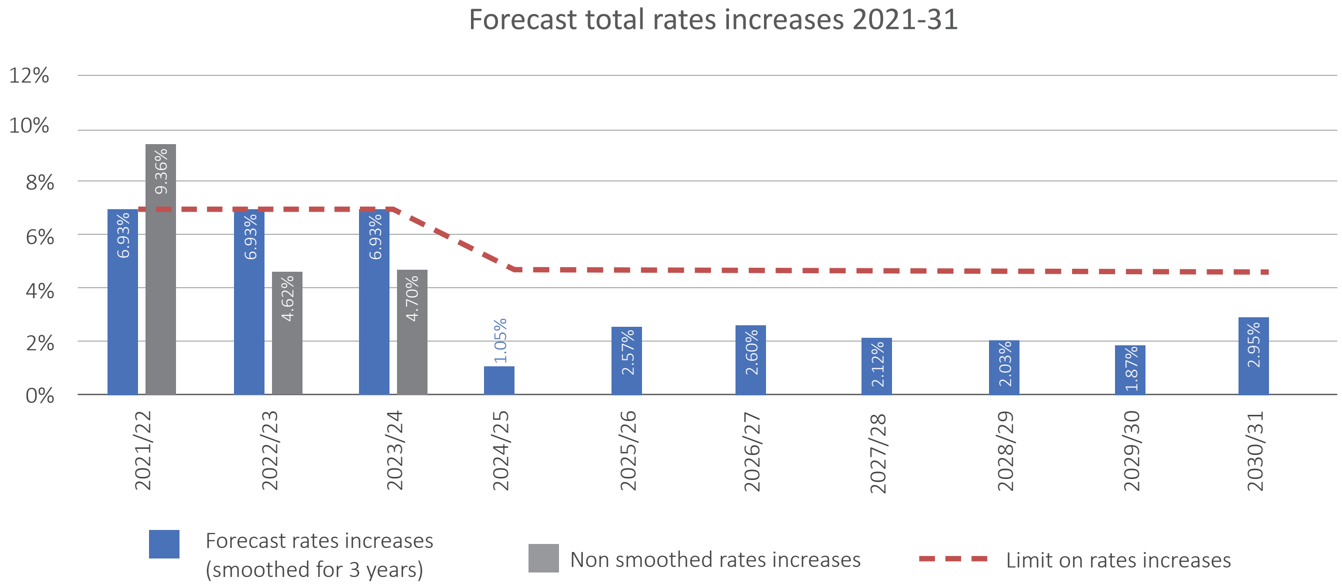
We intend to increase the total rates take by the same amount – 6.93 percent- each year for the first three years. It's important to note that the increase will vary for individual households and properties each year, although the increases will be more predictable.

Due to the transitional aspect of this LTP, Council can only adequately predict the first three years at this point. A full review of the LTP will be undertaken during the next three years, including a rates review and overall financial strategy to ensure the LTP adequately plans for growth. Council will monitor this set rates method over the LTP to ensure services are not adversely affected.

Limits on rates

As the Council has smoothed rates for the first three years of the Long Term Plan, the Council's intent will be to manage within the smoothed total rates increase figure of 6.93 percent per annum for those three years. For years four to 10 of the LTP, we will retain our existing limit on rates of inflation (based on the Local Government Cost Index or LGCI) plus two percent.

It should be noted that the limit applies to the total rates increase across the district, with actual rates increases varying from property to property.



What is LGCI?

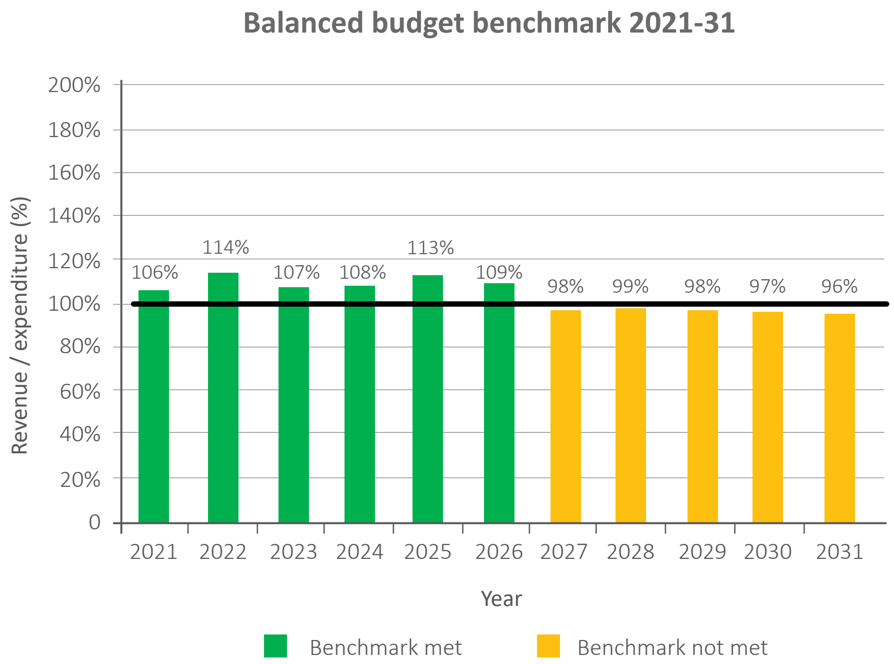
The LGCI, or Local Government Cost Index, is a measure of inflation, as it relates to costs specifically affecting the Local Government sector. LGCI inflation figures are produced for the local government sector by Business and Economic Research Limited (BERL). The forecast limits for rates increases (at LGCI + 2%) are based on the LGCI forecast at the time this Financial Strategy was written. As annual updates are made to LGCI, the limits will be adjusted accordingly.

Operating a balanced budget

The LTP forecast is for a surplus during the first five years of the plan, and the budget is balanced in each of these initial years. This surplus includes subsidies for capital projects undertaken by Council, and is utilised to fund asset purchases and/or debt repayments. The forecast for years five to 10 (2027-2031) of the LTP does not quite meet the balanced budget threshold. In total across all 10 years of the LTP, Council has planned for a balanced budget.

The small deficits in the later years of the LTP is principally due to the Matatā wastewater project which is forecast to be completed in 2026. As there is currently no rating scheme for Matatā wastewater, the proposed operating costs (from 2026 onwards) have been reserve funded. As Matatā wastewater assets will be built and commissioned later in the LTP, no renewals are planned, and no depreciation has been funded for these assets over the remaining term of the LTP. A full rates review alongside the 2024-34 LTP will provide an opportunity to consider the need for a rating scheme for Matatā wastewater to address this future deficit.

Elements of the Financial Strategy that support a balanced budget approach over the 10 years includes proposals to increase debt levels, obtaining a credit rating for the Council and introducing standardised rate increase for the first three years of the LTP.



Financial investments disclosure

Under the legislation, our Financial Strategy must disclose any objectives for holding and managing investments and equity securities.

Council holds financial investments, such as term deposits, to manage its cash flow to finance expenditure on operations. As per Council's Investment Policy, these investments are not significant.

The Council holds these funds to:

- Invest surplus cash and working capital funds.
- Invest proceeds from the sale of assets.
- Invest funds allocated for approved future expenditure to implement strategic initiatives or to support inter generational allocations.
- Invest amounts allocated to accumulated surplus, Council created and restricted reserves such as renewal reserves, operational reserves, development contributions and the harbour fund.

The Council has an Investment Policy in place, setting out its approach to managing any investments.

Significant assumptions

The Council has made a number of forecasting assumptions in preparing the 2021-31 LTP. These are outlined in the *Our Assumptions for this Long Term Plan* chapter of this document, beginning on page 127