Consultation 2017/18
Support Papers

Financial strategy
Balancing the budget
(from 2015–2025 Long Term Plan)

Financial strategy

This financial strategy explains how the Carterton District Council will manage its finances over the next ten years. It sets out the general approach and principles to be followed, and it provides a guide against which proposals for funding and expenditure can be assessed.

In preparing this ten-year plan to meet the reasonable needs of our community, the Council applied the following principles:

- be fair to our ratepayers and customers
- maintain service delivery and if required meet increasing demand
- balance the budget
- be good stewards of our assets and infrastructure, and of our funds
- spread the cost of assets across their useful lives.

Being fair to our ratepayers and customers means that our activities are cost-effective and necessary for the community's current and future needs. It means that we allocate rates and charges to those who benefit and to those who have a negative impact on (or exacerbate) our community well-being. It means that we spread costs across today’s and tomorrow’s users (intergenerational equity) to match when benefits arise. And it means being aware of not excessively burdening today's users with the impact of yesterday's users not having contributed enough.

We plan well. We have good asset management systems. Asset management plans are renewed regularly, and inform a 30-year infrastructure strategy. Every three years we prepare a ten-year plan. Every year we prepare a detailed annual plan. We consult the community on what is proposed. And at the end of every year we report back to the community on how well we have done against the plans.

Levels of service and demand

Our levels of service and activities are driven by our plans and strategies. These are described in more detail in the sections for each group of activities.

Although property numbers in Carterton township is anticipated to increase, the Council is not promoting or encouraging growth. It is a priority to retain the ‘character’ of Carterton—friendly, caring, vibrant, connected, and engaged—which unmanaged growth could put at risk.

The economic climate is underperforming, global financial and geopolitical issues continue, and the central government in New Zealand continues its programme of austerity. Consequently, the Council has allowed for growth in the rating base to be lower in the next decade than it has in the past, falling over the next five years to 1.0 percent per annum increase and staying at that level for the rest of the ten-year period. When the economic environment improves, pressure on rates should reduce because rates will be more widely allocated across a larger rating base.

For most of our activities this modest growth will not impact our levels of service. The financial numbers in this ten-year plan are largely based on maintaining business as usual. In other words, the Council is planning to continue with its current range of activities and generally to the same level of service as at present.

There are significant exceptions to this, where Council wishes to address issues of capacity and quality:

- an accelerated programme of sewer mains renewals—more than just end-of-life renewals, and beyond depreciation funding—through extra borrowing
- continued expansion of the sewage treatment capacity, in line with expected consent conditions and to create additional headroom to meet ongoing and peak demand
- further development of the town centre.

As well as the above, this plan identifies several reviews of activities that the Council intends to undertake.

Balancing the budget

Under Section 100 of the Local Government Act 2002, the Council is required to ensure that it raises sufficient revenue to cover its projected operating expenses unless it considers it prudent not to do so.

The rates are set at a level to produce a desired surplus. Generally that surplus would be zero, ie a balanced budget. But in some years and in some activities, a surplus is needed to cover the repayment of loan principal, or to build up reserves for future year expenses (such as the three-yearly elections). And in other years and other activities, a deficit is planned because not all expenses, especially depreciation, needs to or should be funded.

Over the ten years of the plan, the budget is balanced (ie there is no loss) in every year except year one due to the gifting of the Pensioner Housing to the Carter Society.

Inflation

The numbers in this LTP incorporate inflation as forecast by economics consulting company BERL.[1] Over the ten years of the Plan, BERL forecasts local government faces inflation rates of 34 percent in their operating costs and 37 percent in their capital costs.

Depreciation

Depreciation is calculated on an annual basis to fund the renewal of assets over time. It is a major expense. It represents over a quarter of total operating expenditure.

Charging depreciation each year spreads the cost of an asset over its useful life. Generally, depreciation is funded by income (including rates) in the same year that the depreciation is incurred. Funding of depreciation results in an increase in the Council's cash balance over the ten-year period of the Plan, held in depreciation reserves. These cash funds will earn interest and will provide funding for the replacement of relevant infrastructure assets in the future.

In this Long Term Plan, the Council will fully fund the depreciation expense, except for the following:

- roads and footpaths
- Events Centre building and fitout
- ~~loan-funded infrastructure development, such as the accelerated programme of sewerage renewals and treatment capacity.~~
- *all loan-funded capital and renewals expenditure* [proposed amendment]

This recognises that either we do not need to build up the full amount of funds for future replacement, or it would not be fair on the current generation of ratepayers.

Some of the capital construction of roads and footpaths is funded from subsidies received from the New Zealand Transport Agency, and the capital construction of other assets was partly-funded from external funding. Therefore, we do not need to build up the full amount of replacement funds.

We need to borrow to fund other capital expenditure, including the Events Centre final fitout, the planned accelerated programme of sewerage renewals, and expansion of the sewage treatment capacity. This is because insufficient funds have

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[1] *Forecasts of Price Level Change Adjustors – 2014 Update*: Note to Society of Local Government Manager, Business and Economic Research Limited, October 2014 (amended)

built up in the past in depreciation reserves. Either it is a new asset, or rates have not covered the cost of depreciation over the full life of the asset.

In these cases, the Council considers it would be unfair for the current generation of ratepayers to pay both the loan repayment (to fund the existing asset) and the depreciation (to fund its replacement). During the terms of the loans, rates will fund the principal repayment and interest expense, after which rates will fully fund the annual depreciation expense. At the end of the asset life, there will be some depreciation reserves built up to contribute to the replacement cost.

Reserve funds

Some financial reserves operate to hold funds generated in one year and applied in another. The main sources of funds are depreciation, the setting aside of surpluses, and asset sales. The reserves are used to accumulate depreciation, to smooth income between years (for example, elections are every three years and some funds are set aside in the two intervening years), for emergency or contingency funds, or to set aside some funding for special projects. Draw down is mainly for funding asset renewals.

Our policies allow for the internal borrowing from cash reserves, for which a market-based interest rate is charged.