Financial strategy

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.

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 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.

Borrowing

Security on borrowing

The Council provides lenders with security on its borrowings through a debenture trust deed. This gives lenders a charge over Council's rates income. In the unlikely event of Council defaulting on a loan, the lender has the ability to ensure a rate is set to recover the outstanding amount owed. This security is attractive to lenders and helps ensure Council can obtain ongoing support for its debt programme and reduces the interest rate required by lenders.

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

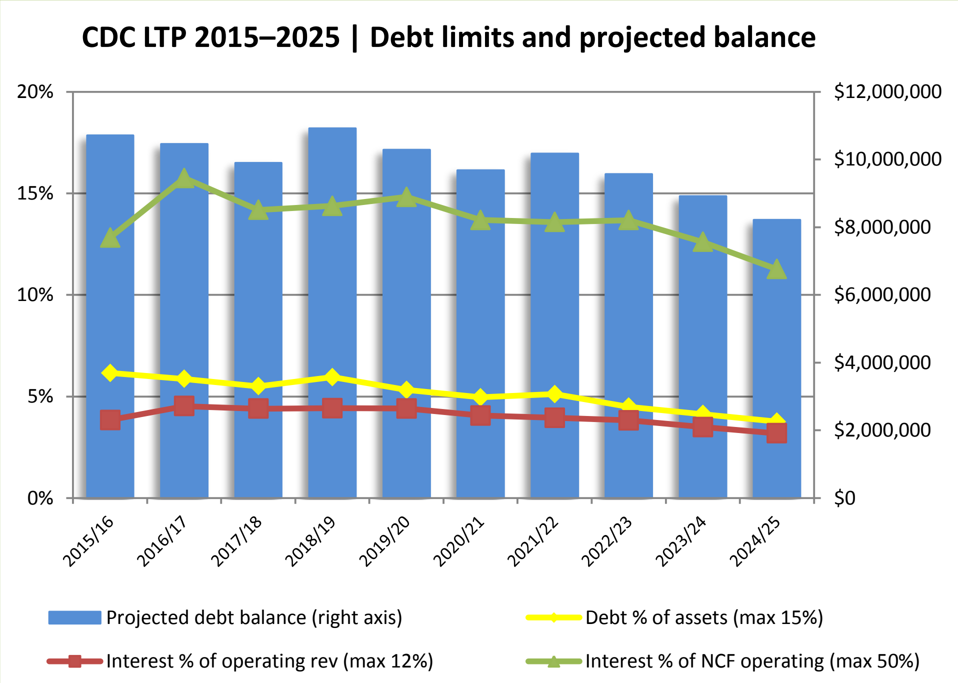
Security may also be offered over specific assets with prior Council approval. The Council will offer security on infrastructure assets only where special rating provisions apply. It intends to continue to secure its borrowing in the current manner.

Borrowing limits

The Council has set limits on the level of borrowing. These are set out in its liability management policy. All three of the following conditions must be met:

- total debt as a percentage of total assets will not exceed 15 percent
- in any financial year, gross interest paid on term debt will not exceed 12 percent of gross operating revenue
- in any financial year, gross interest expense will not exceed 50 percent net cash inflow from operating activities.

These measures over the next ten years are shown in the following chart. All are within the limits set by the Council.



Financial investments and equity securities

An investment is an asset held by Council that provides service potential or future economic benefit to Council. Investments include property, ownership in Council related trading entities and financial assets. A financial asset is any asset that is cash or the contractual right to receive cash including financial investment instruments.

Council holds financial investments sufficient to match reserve accounts created by Council resolution and as a result of short-term cash flow surpluses. The Council recognises that as a responsible public authority, any investments that it does hold should be of a relatively low risk. It further recognises that lower risk generally means lower returns. Council aims to maximise investment income within a prudent level of investment risks. Council currently has money invested with banks in New Zealand. Council aims to achieve market rates for these investments.

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 no excess funds will remain not on deposit for more than 90 days, in line with the Council's investment policy.

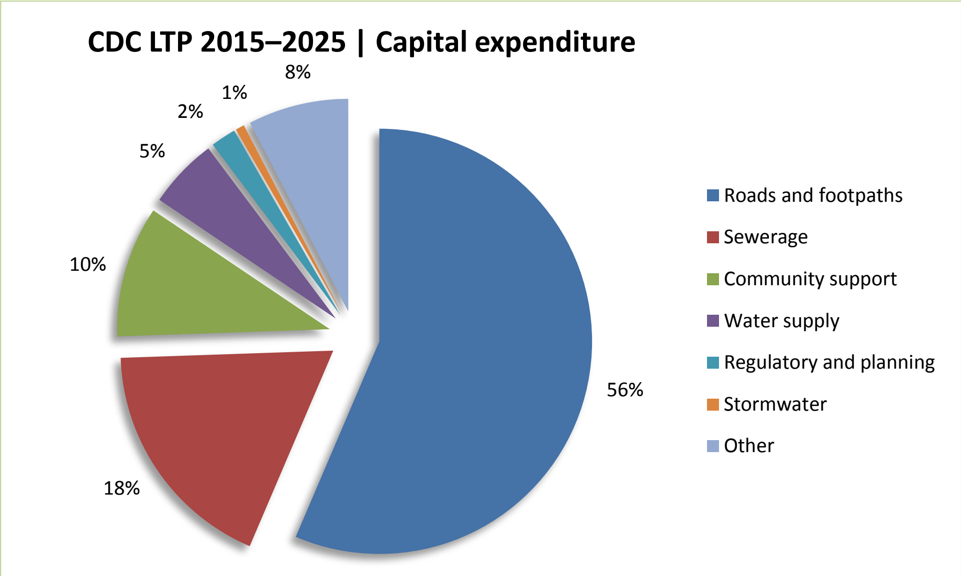
The Council has three small shareholdings with NZ Local Government Insurance Corporation (Civic Insurance), Airtel Ltd, and Farmlands. These investments are required to enable the Council to utilise specific services. With the exception of the above three shareholdings, the Council will not acquire equity investments. Council's target for returns on these equity investments is that access to the organisation's services continues.

Capital expenditure

Capital expenditure is for purchasing, building, replacing, or developing the district's assets, such as roads, parks, sewerage, and buildings. For each major infrastructure network (water, sewerage, stormwater, and roads) asset management plans are in place. These are key planning tools for the maintenance, renewal, and development of assets.

The assets managed by the Council are forecast to grow from $172 million to $219 million over the ten years of this plan.

The Council will spend $31.8 million on capital expenditure over the next ten years, of which $4.4 million is budgeted for 2015/16. The chart below provides a breakdown by major group of activities. The majority of the capital spend is on roads and footpaths ($18.0 million or 56 percent) followed by sewerage ($5.7 million or 18 percent).



The key capital projects over the ten-year plan are as follows.

Sewerage reticulation

The programme of accelerated sewer mains renewals will continue over the next three years. This will cost about $850,000, over and above the usual end-of-life renewals during that period. It will be funded from extra borrowing.

Sewage treatment

The capacity of the sewage treatment facilities will be expanded in line with the resource consent conditions and to create additional headroom to meet ongoing and peak demand. This development work at Daleton Farm will cost $2.0 million over the next ten years and includes more land-based storage of treated effluent, expansion of the wetlands, another irrigator to discharge to land, and eventually discharge to water directly to Waiohine, bypassing Mangatārere.

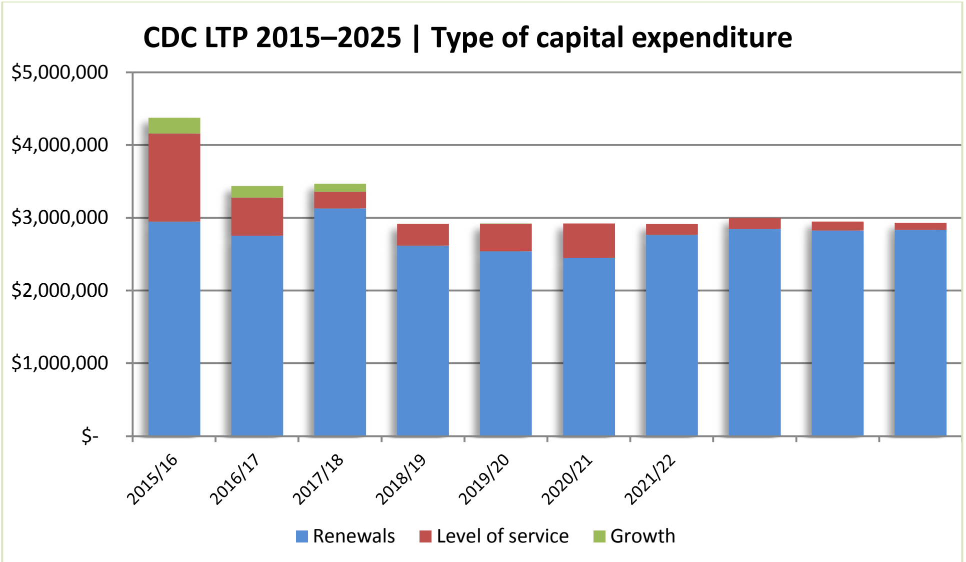
Town centre

The next stage of CBD re-vitalisation is to enhance Broadway as the link between the Railway Station and High Street. The $500,000 upgrade will include further landscaping along the length of Broadway from the Railway Station to Masson Street, undergrounding of some services, and improved aesthetics for walking and the visual approach to our town centre. A concept plan is being prepared and work is expected to begin late 2015.

Consent renewals

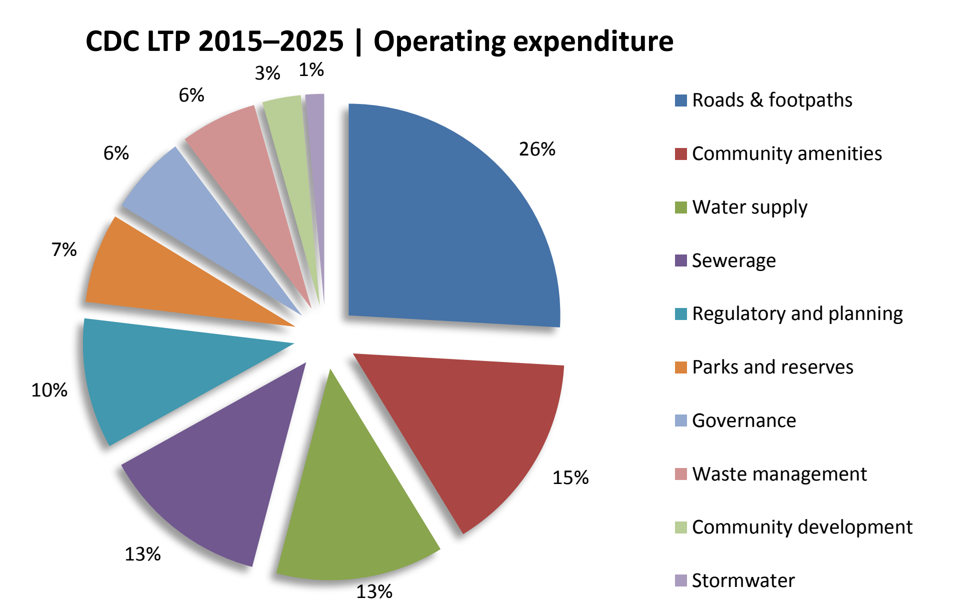
During the ten years there are a number of important resource consent renewals. The Council estimates it will need to invest significant sums in these renewal processes—the consenting process for water supply in 2015/16, $200,000 for a range of consents for the development work related to the sewage treatment facilities, and $250,000 for sewage treatment and disposal in 2017.

The chart below breaks down capital expenditure between renewal of existing assets, responding to or anticipating growth in demand, and improving levels of service.



Operating expenditure

Operating expenditure is forecast to increase from $13.2 million to $16.3 million over the next ten years, an increase of 23 percent, compared with the 34 percent BERL forecast for local government inflation over the same time period. The following chart shows the split between groups of activities.



The greatest operating expenditure over the next ten years is on roads and footpaths ($39.1 million), community amenities (such as the library, information centre, and other activities at the Events Centre, swimming pool, public toilets, and the cemetery—$23.2 million[2]), and water supply ($19.4 million).

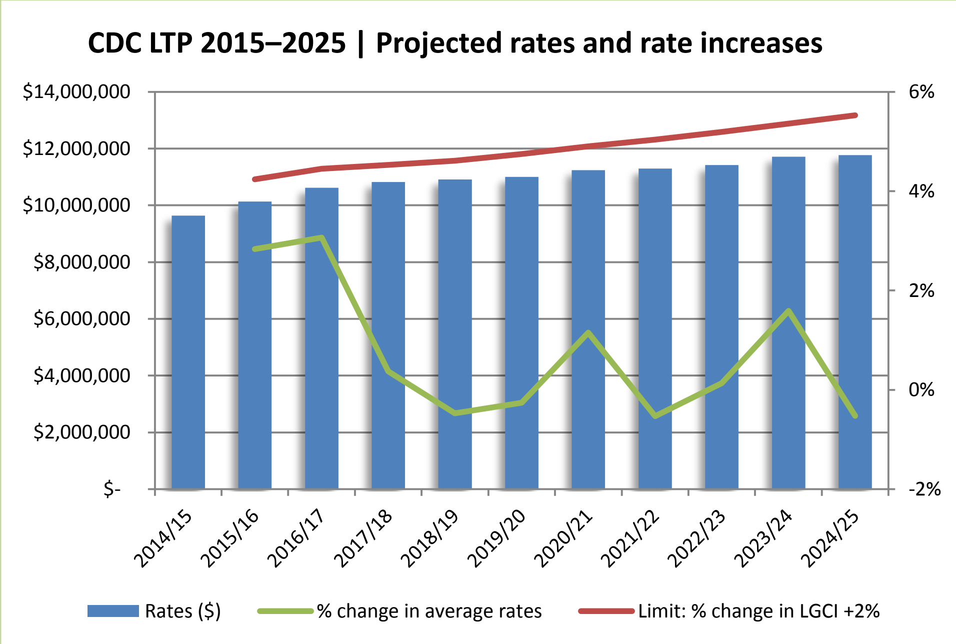
Rates

The purpose of local government is to enable democratic local decision-making and to meet its communities' needs for services—now and in the future. These responsibilities often create conflicting views from the community and organisations on what the Council's priorities should be and how much money is spent.

Affordability is a concern for most ratepayers, whilst many feel that the Council should be doing more to accommodate the needs of a changing community. While grappling with this balancing act, the Council has taken into account as far as practicable the requirements of the current community without compromising future generations.

Rates limit

The Council has decided to limit the increase in average rates in any one year to the increase in the BERL local government cost index plus 2 percent.[3] The following chart shows the projected rates during the Long Term Plan and the percentage increase compared with the limit in rates increases.



[2] This includes the proposed non-cash 'cost' of gifting the housing for the elderly properties of $1.6 million in 2015.

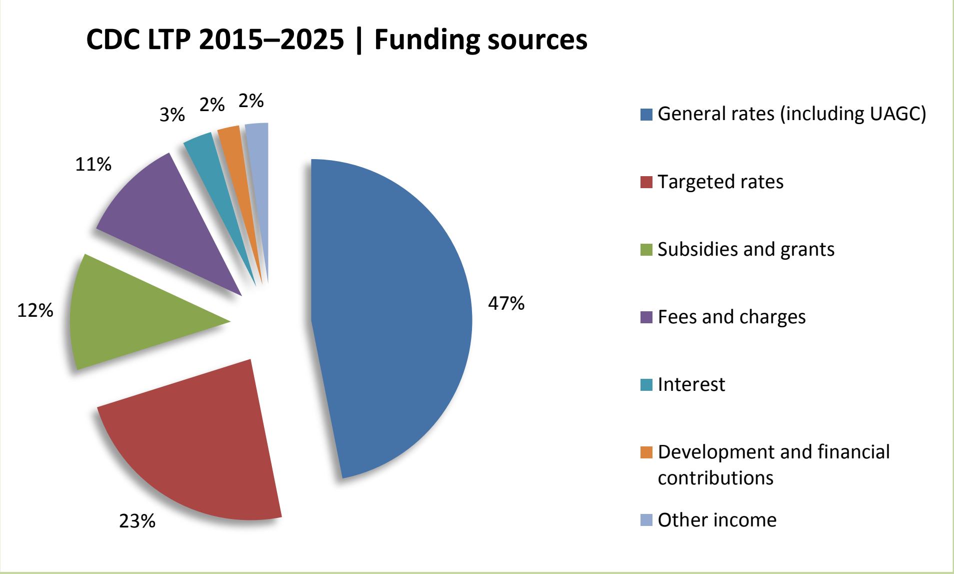
[3] For example, for the rates limit in 2015/16 the BERL LGCI is forecast to increase by 2.24% to June 2016.

The Council proposes to collect $10.1 million in rate revenue in the 2015/16 financial year. This is an increase of $492,000 on the current financial year and equates to an increase of 2.8 percent in the average rates, after taking into account growth in the rating base.[4]

Actual rates each year for individual properties will vary depending upon the targeted rates that are applicable, the differential rating category, and the valuation of each property.

Other funding sources

The graph below shows how the Council will fund the services and projects it will deliver to the community over the next ten years. Currently, the Council draws about two-thirds of its operating revenue from rates because it does not have alternative revenue streams, such as significant financial investment funds or investments in corporate enterprises, and has taken a fairly low risk approach to borrowing.



[4] The average rates is the total forecast rates divided by the total number of forecast rateable properties.

Policies

The Council has a range of funding and financial policies that affect the Long Term Plan. The full policies can be found in appendix A.

Revenue and financing policy

The revenue and financing policy summarises how activities undertaken by the Council are funded. The aim is to achieve the fairest funding mix for the community as a whole.

The Council has reviewed its revenue and financing policy to meet requirements under the Local Government Act.

The full policy can be found in appendix A.

Investment policy

The investment policy sets out the Council's policy in respect to investments. It includes the Council's general objectives of holding investments and for holding equity.

The Council gives preference to conservative investment policies and avoids speculative investments. The Council accepts that lower risk generally means lower returns on investment.

The Council has reviewed its investment policy and expanded the financial institutions at which it invests to include non-bank deposit-takers, with more detailed requirements about the institutions.

The full policy can be found in appendix A.

Remission of rates policy

The remission of rates policy specifies the circumstances under which rates will be considered for remission.

The Council has reviewed its remission of rates policy and has extended the period during which an application can be made for remission of penalties, and extended the relief available to owners of sub-divided rating units.

The full policy can be found in appendix A.

Significance and engagement policy

The significance and engagement policy explains how the Council will determine the degree of significance of particular issues, proposals, assets, decisions, and activities.

It lets both the Council and the community understand when the community can expect to be engaged in the Council's decision-making processes, and to know how this engagement is likely to take place.

The significance and engagement policy is a new requirement under the Local Government Act and was approved by the Council in November 2014.

The full policy can be found in appendix A.