Financial strategy

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The short story

We expect average rates to increase by 5.65% in Year One (2021/22), and debt to increase to a peak of $32 million in 2028/29 (within our set limits). We anticipate that an operating surplus will be made each year during the planning period, reflecting our need to service that debt.

We are conscious of the post-COVID 19 economic environment and aim to keep rates at affordable levels. A key part of this is keeping our levels of services and activities generally to the same level as at present.

We do face two key projects that need funding in the term of this Ten Year Plan:

1) Increasing capacity and mitigating risks associated with town water supply ($9.3 million), and
2) Investing in infrastructure to support the growth of Carterton township to the east ($16.1 million), which will be funded by loans, serviced by financial contributions.

The demand we are facing

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.

Carterton township's population is anticipated to increase, although the Council is not actively promoting growth. In response to the growth pressures the Eastern Growth Area is being planned. 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 steady, but global financial and geopolitical issues continue. 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 from 1.5 percent to 1.2 percent per annum increases and staying at that level for the ten-year period.

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:

- Increasing capacity and mitigating risks associated with the town water supply.
- Servicing growth in residential properties in line with expected growth rates.

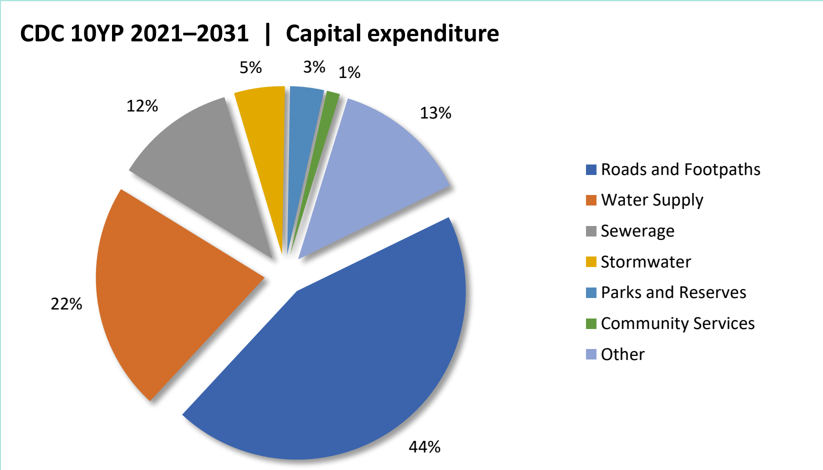
Costs of meeting demand

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 $234 million to $289 million over the ten years of this plan.

The Council will spend just over $80 million on capital expenditure over the next ten years ($6.8 million in 2021/22). The chart below provides a breakdown by major group of activities. The largest share of the capital spend is on transportation ($35.5 million or 44%) followed by water supply ($17.6 million or 22%).

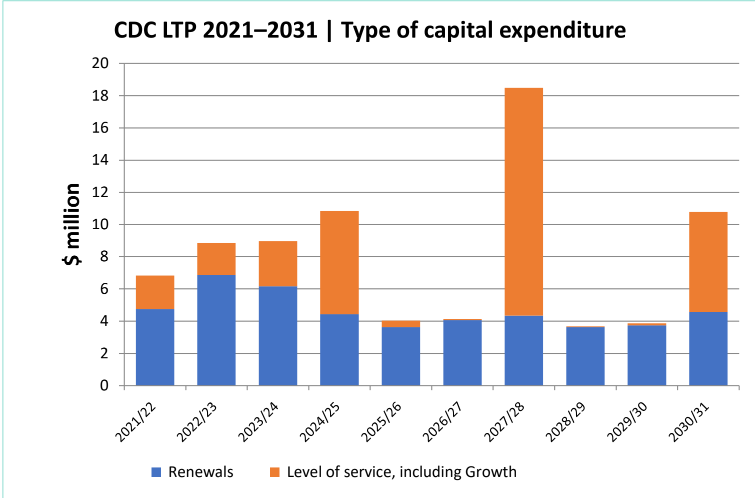


The key capital projects over the ten-year plan are as follows:

- Increasing capacity and mitigating risks associated with town water supply ($9.3 million), and
- Investing in infrastructure (roads, footpaths, services) to support the growth of Carterton township to the east ($16.1 million).

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

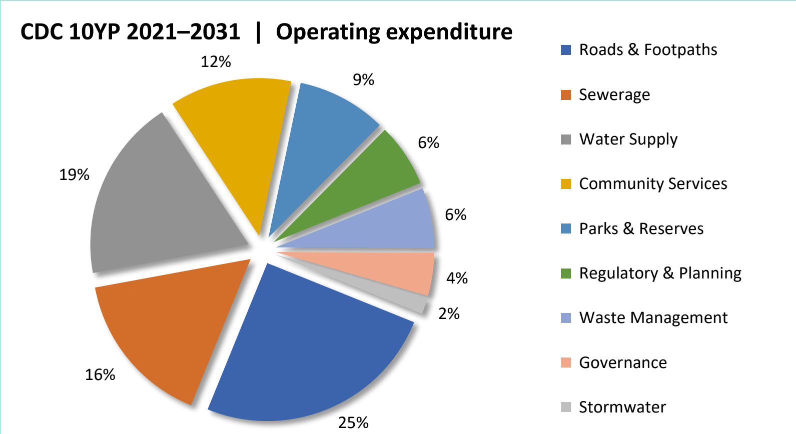
As shown in the chart, there are three peaks in capital expenditure over the ten years. In 2027/28 there is growth expenditure for the additional water supply. In 2024/25, 2027/28 and 2030/31 there is expenditure relating to servicing new residential land in the eastern growth area. In the intermediate years, there is a mix of levels of renewals, service and growth expenditure relating to wastewater developments, smart water meters, water supply resilience, and the additional water supply.

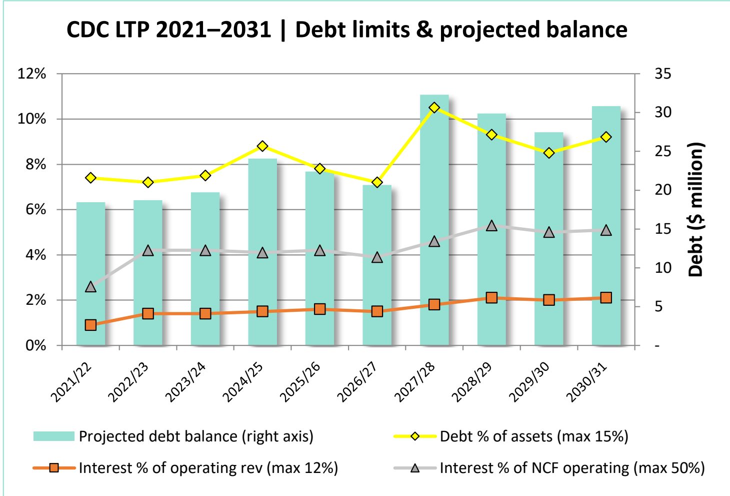


Operating expenditure

Operating expenditure is forecast to increase from $20.0 million (2021/22) to $27.6 million (2030/31) over the next ten years, an increase of nearly 36%, compared with the 31% 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 transportation ($60.1 million or 25%), followed by water supply ($44.8 million or 19%) and wastewater ($38.3 million or 16%).





How we intend to finance our future

Borrowing

The Council has set limits on the level of borrowing. These are set out in its Treasury 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 well within the limits set by the Council.

Rates

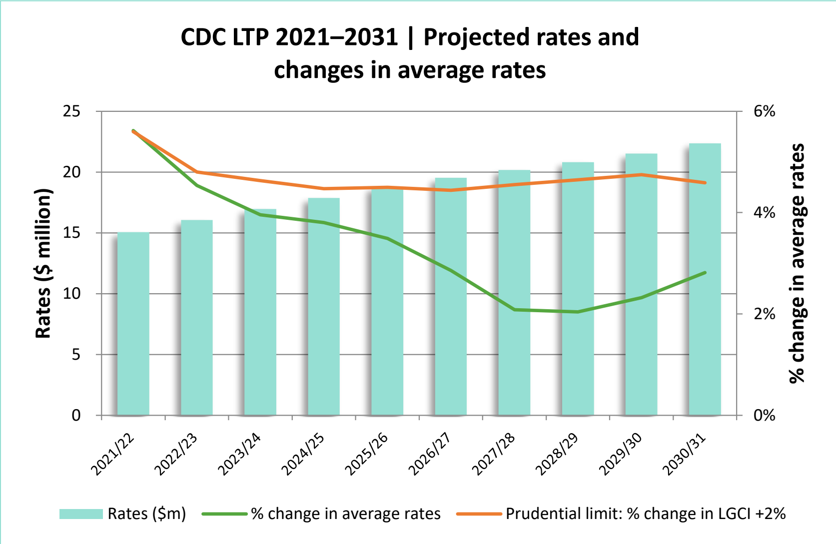
The purpose of local government is to enable democratic local decision-making and to meet its communities' needs for services—now and in the future. These responsibilities often create conflicting views from the community and organisations on what the Council's priorities should be and how much money 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 a prudential policy to limit the increase in average rates in any one year to the increase in the BERL local government cost index plus 2 percent.

The following chart shows the projected rates during the Ten Year Plan (the blue bars) and the percentage increase (the orange line) compared with the limit in rates increases (the grey line).

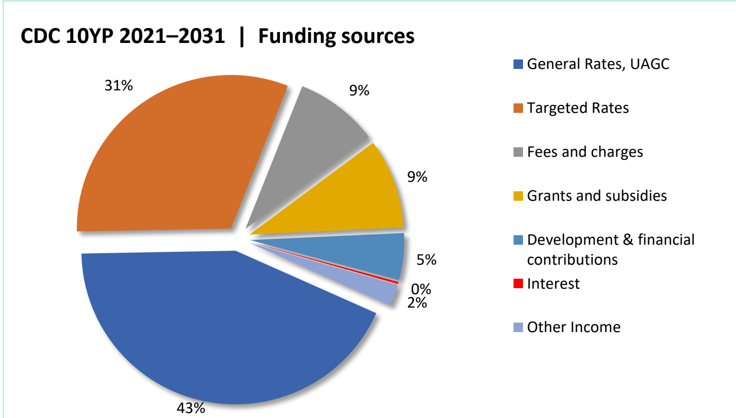


In the 2021/22 financial year, the Council proposes to collect $15.1 million in rate revenue. This is an increase of $1.0 million on the current financial year and equates to an increase of 5.65% in the average rates, after taking into account growth in the rating base.[25]

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. In 2021/22, most of the increased expenditure will impact on urban rates.

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 over two-thirds of its operating revenue from general and targeted 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.



Some of the detail

Inflation

The numbers in this Ten Year Plan incorporate inflation as forecast by economics consulting company BERL.[26] Over the ten years of the Plan, BERL forecasts local government faces inflation increase of 31% in their operating and 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.

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

[26] Business and Economic Research Limited, September 2017. Forecasts of Price Level Change Adjustors–2017 Update: Note to Society of Local Government Managers

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 towards the replacement of relevant infrastructure assets in the future.

In this Ten Year Plan, the Council will fully fund the depreciation expense, except for the following:

- roads and footpaths
- Events Centre building and fitout
- loan-funded capital and renewals expenditure.

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 expansion of the planned sewage treatment capacity and for the additional water supply. 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.

In general, capital expenditure for the renewal of existing assets will be funded from depreciation reserves. However, if insufficient reserve funds are available, the expenditure may be funded by borrowing.

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.

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.

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.

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 to cover:

- the net cost of the activity (expenses less any revenue).
- plus an amount to cover the repayment of loan principal, or to build up reserves for future year expenses (such as the three-yearly elections).
- less any expenses, especially depreciation, that don't need to be funded or the Council has chosen not to fund.

The Section 100 requirement is met, as each year of the Ten Year Plan has a surplus in the Statement of Comprehensive Revenue and Expense.

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.