

## Financial strategy

This section of the Long Term Plan outlines Council's financial strategy for the next ten years. The Council must, under the Local Government Act 2002, manage its revenues, expenses and assets, liabilities, investments and general financial dealings prudently. It must manage in a manner that sustainably promotes the community's current and future interests.

The Financial Strategy demonstrates how Council will:

- Provide for growth in its region and manage changes in land use
- Ensure that the level of rates and borrowing are financially sustainable and are kept within pre-set limits
- Be accountable for maintaining the assets that it owns on behalf of the community
- Fund network infrastructure and maintain levels of service
- Obtain pre-set returns on financial investments and equity securities
- Give securities on borrowing.

In preparing the Long Term Plan and this Financial Strategy, Council considered the balance of:

- Service levels, the costs of these services and the money required to achieve those levels of service
- Priorities for expenditure across all activities
- Setting rates and charges across the full ten year period of this Long Term Plan and how to minimise these while achieving the targeted levels of service
- The level of debt that current and future ratepayers would need to fund
- The level of growth that is expected in the next twenty years and beyond.
- Overall, Council considers this Long Term Plan to be financially sustainable and will provide the most important services to residents, businesses and visitors.

## ***Strategic direction of Council***

Council's vision and community outcomes are set out in a separate document. The 'Council Activities' section also includes information on the contribution that Council activities make towards achieving the Community Outcomes.

## ***Factors that influence how we fund our activities***

- Nelson City Council covers a relatively compact urban area and a small rural area. This means that the funding of services is largely done by a general rate across the city rather than through rates targeted at separate communities
- There are factors outside Council's control that have an impact on how we fund our activities. For example, changes in road and transport funding provided by Central Government affect what projects the Council carries out
- The cost of goods and services that Council provides increases at a higher rate than the Consumer Price Index. For example roading costs are dependent on oil based products

- Many residents have low incomes and rates affordability is an important focus for many households. Council looked for every opportunity to reduce costs while not setting back Nelson's progress.
- Council aims to have costs and fees that are an appropriate reflection of the balance of individual benefit versus public good

The consequences of these factors are:

- It is not financially sustainable for Council to provide all the services and activities wanted by the community at the same time. Therefore Council has to prioritise its work programme
- Council spent the last 12 months reviewing its work programme and services to prioritise the needs of the community
- Costs to maintain and deliver Council services will continue to increase in the foreseeable future, mainly due to inflation, increased expenditure on environmental programmes, increased depreciation, and a large capital expenditure spend, which leads to increased operational expenditure
- Some projects and levels of service that are of a lower priority, but were included in the previous Long Term Plan 2012 – 2022 have been delayed or removed.

### ***Providing for existing levels of service and meeting additional demand***

Council assessed the funding requirements to meet the levels of service set out in the activity section of this Long Term Plan and considers that the capital and operating expenditure is sufficient to achieve the planned levels of service.

However, to keep rate increases and debt levels to a minimum, Council has removed or delayed a number of planned projects over the next 10 years. Details of these are set out in the 'Council Activities' section and the section on what is not included.

Activities that will have an increase in levels of service over the ten years of this Long Term Plan include improvements stormwater and flood protection and protection of biodiversity through the Nelson Nature project

Major capital expenditure planned to maintain or increase levels of service includes the majority of projects in the following Council activities:

- Transport projects
- Water supply
- Wastewater
- Stormwater
- Flood protection
- Seismic strengthening of Council facilities.

Major operating expenditure changes to maintain or improve levels of service include: Nelson Nature.

Lower levels of service: A review of levels of service is proposed in the first three years of the Long Term Plan which may reveal some areas where reduced levels of service will offer useful savings or efficiencies without impacting on the key outcomes Council seeks



to achieve. This is part of Council's continuous improvement approach and will include development of robust business cases for all projects.

### ***Growth and changes in population***

The number of people in Nelson and where they choose to live, and the growth in economic activity, directly affect the demand for land for development, infrastructure and the other services the Council provides. This growth underpins our land use planning, infrastructure developments, where and when new services or facilities are required and how much things will cost. An increased number of ratepayers also helps to spread costs and collectively we can afford a greater range of facilities and services.

The assumptions section describes Council's population estimates based on Statistics New Zealand population projections. This Long Term Plan is based on a population of 49,740 in 2015 and then almost 53,320 in 2025. This is an increase of more than 10% over the 10 year period of this plan. Approximately half of the growth will be in Stoke.

Council takes a generally conservative approach in applying population growth estimates in its infrastructure planning, using a mid-range estimate and continually updating and revising as new data is available.

The cost of the City's growth is funded through collecting development contributions and financial contributions, primarily from the development of subdivisions. Information on the amount expected to be collected from these sources is set out in the draft Development Contributions Policy, which is available as a separate document.

### ***Summary by activity of growth component of capital projects***

<b>Activity</b>	<b>\$ per HUD (exc GST)</b>
Stormwater	3,570
Wastewater	4,290
Water Supply	2,960
Transportation	970
<b>Grand Total</b>	<b>11,790</b>

### ***Land use changes***

Although some of the increase in population can be met from improved and more intensive use of land already zoned for residential and business use, there is a requirement to provide further land for houses and businesses. A change in land zoning requires a change to the Nelson Resource Management Plan (NRMP) using processes set out in the Resource Management Act 1991.

The Council has been processing a number of re-zoning plan changes over the past five years. The most significant changes in use of land over the next twenty years are expected to be:

- Residential development between Nelson and Richmond around the Champion Rd area

- Development of land in the Ngawhatu and Marsden valleys east of Stoke for residential use
- To provide for this growth, Council has included projects with a growth component totalling \$25.7 million over ten years (excluding NZ Transport Agency grants).

### ***Balancing the budget***

The Council is required under the Local Government Act 2002 to ensure each year's projected operating revenues are set at a level sufficient to meet that year's projected operating expenses. The Council may set projected operating revenues at a different level from that required, if the Council resolves it is financially prudent to so do.

In assessing a financially prudent position, consideration is to be given to:

- The estimated expenses of achieving and maintaining the predicted levels of service provision set out in the Long Term Plan. This includes the estimated expenses associated with maintaining the service capacity and integrity of the assets throughout their useful life
- The projected revenue available to fund the estimated expenses associated with maintaining the service capacity and integrity of assets throughout their useful life
- The equitable allocation of responsibility for funding the provision and maintenance of assets and facilities throughout their useful life
- The funding and financial policies and this Financial Strategy.

During the development of this Long Term Plan, Council considered how to balance its current existing asset renewal programme, the recovery programme associated with damage caused by the extreme weather events in December 2011 and April 2013, and providing for growth.

### ***Overall summary of 10 year financial performance***

As part of the process of developing this Long Term Plan, Council considered the key issues and what could be done about them. Council looked at what to do to meet expected population growth, to enhance the environment, and to meet the community's social and cultural needs. Council then prioritised the potential activities and projects.

The financial information in this Long Term Plan reflects the activities and projects the Council identified as priorities, and is planning to deliver over the next ten years, while keeping within its limits for rates increases and borrowing.

Council is forecasting capital expenditure of \$383 million, of which \$130 million would be for renewals, and operating expenditure of \$1,089 million over the 10 years of this Long Term Plan. Council's total income, after inflation, would increase from \$102 million in 2013/14 to \$137 million in 2024/25, Year 10.

### ***Rates***

Council had to weigh up requests for more and improved services with keeping rates and charges affordable.

Average rates increases in the first three years (including growth) are 3.6%, 3.4% and 2.8%, respectively. Over the following seven years the rates increases (including growth)

will average 2.4%. This increase includes an assumption of 1% growth in the rating base per year.

The rates rises are greater than the predicted rate of inflation in some years, reflecting:

- Additional money set aside for the Disaster Recovery Fund
- Cost increases faced by Council, particularly for insurance and construction, which are projected to increase at a higher rate than the Consumer Price Index
- Depreciation and interest payments – an increased capital expenditure programme will mean that there will be a corresponding increase in depreciation and interest charges.
- Reductions in Government funding for services, where Council has decided to maintain service levels
- Increased costs from Government e.g. Initial Earthquake Prone Assessments.

TOTAL RATES AND DEBT

	Annual Plan 2014/15 (\$000)	Budget 2015/16 (\$000)	Long-term Plan 2016/17 (\$000)	Long-term Plan 2017/18 (\$000)	Long-term Plan 2018/19 (\$000)	Long-term Plan 2019/20 (\$000)	Long-term Plan 2020/21 (\$000)	Long-term Plan 2021/22 (\$000)	Long-term Plan 2022/23 (\$000)	Long-term Plan 2023/24 (\$000)	Long-term Plan 2024/25 (\$000)
General Rates	39,105	41,003	43,174	45,089	46,106	47,684	48,497	50,143	51,705	53,381	55,292
Targeted Rates (Water, stormwater, wastewater)	23,359	24,379	25,121	25,858	27,270	28,130	29,514	30,729	32,222	33,543	35,379
Total Rates	62,464	65,382	68,295	70,947	73,376	75,814	78,011	80,872	83,927	86,924	90,671
Total Net Debt	111,989	118,939	133,826	142,391	147,285	153,361	151,048	155,462	155,949	157,003	151,928

		1	2	3	4	5	6	7	8	9	10
Net Debt		118,776	133,615	142,161	147,076	153,227	150,952	155,561	156,198	157,508	152,662
Debt/Revenue Ratio		123.6%	134.3%	138.1%	137.7%	139.0%	135.1%	134.0%	130.3%	124.9%	117.3%
Rates		3.6%	3.4%	2.8%	2.4%	2.2%	1.6%	2.4%	2.6%	2.5%	3.3%
Rates Cap		4.2%	4.5%	4.5%	4.6%	4.8%	4.9%	5.0%	5.2%	5.4%	5.5%

While the Council will continue to consider affordability issues when setting rate levels each year, it is required by the Local Government Act to 2002 include a statement on quantified limits on rates and rates increases. Council will limit the increase in the Council’s ‘Total Rate Requirement’<sup>1</sup> to no more than the forecast<sup>2</sup> percentage increase of the local government cost index (LGCI) plus 2% in each of the 10 years, including an assumption of a 1% rating base growth per year. Using the LGCI rather than Consumer Price Index (CPI) is considered to be more realistic as LGCI reflects the realities of higher local government costs - the cost of doing Council business.

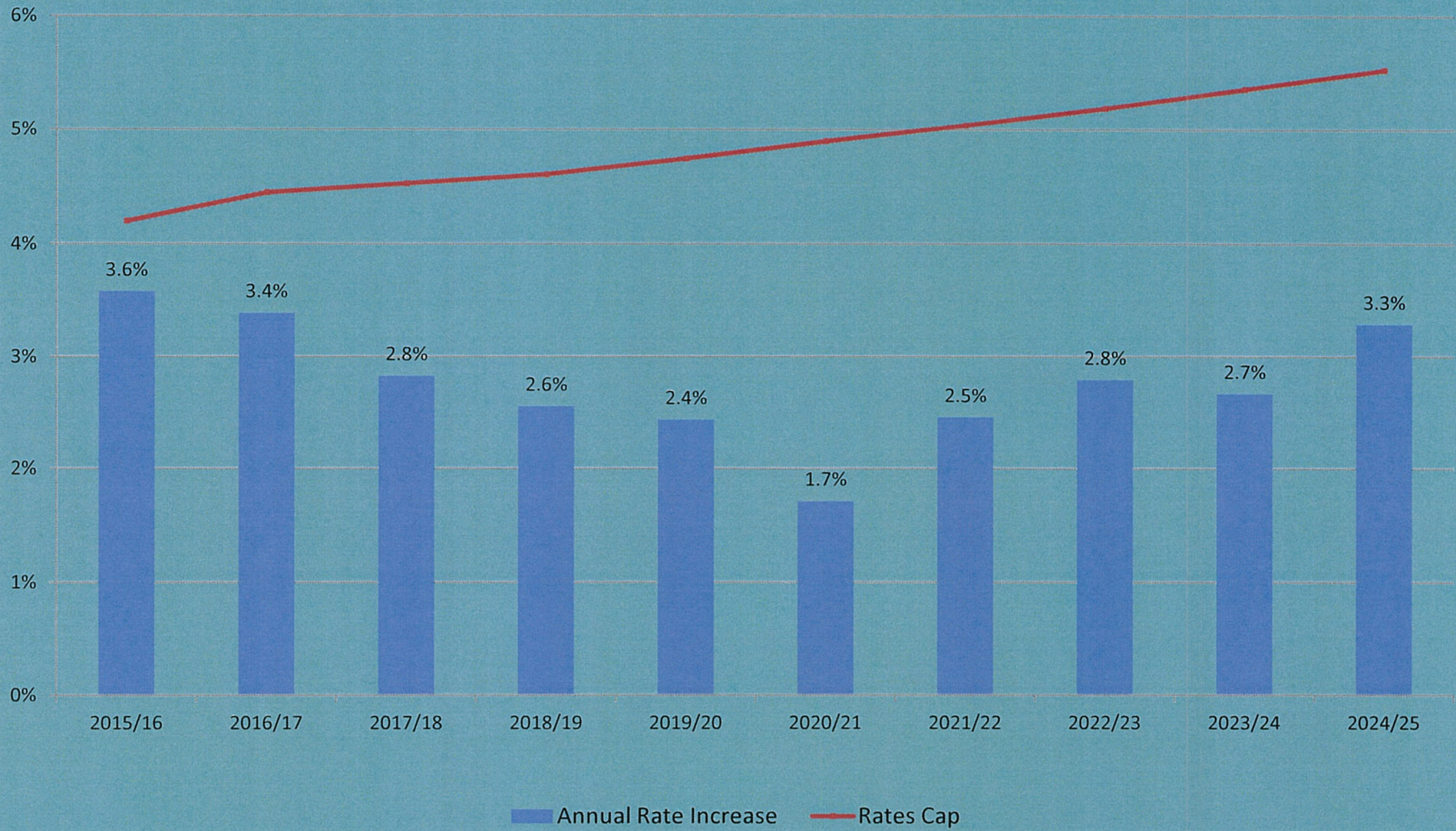
From time to time, Council will need to increase the level of service that it is providing to meet, for example, community needs. Individual properties may experience smaller or larger increases depending on movements in property values, the services received and location. Council has set a limit of \$93 million per year for the Total Rate Requirement over the 10 years of this Long Term Plan.

<sup>1</sup> The ‘Total Rate Requirement’ includes both general and targeted rates such as water, wastewater, stormwater and flood protection.

<sup>2</sup> As provided by Business and Economic Research Limited (BERL).



## Annual Rates Increase versus Rates Cap

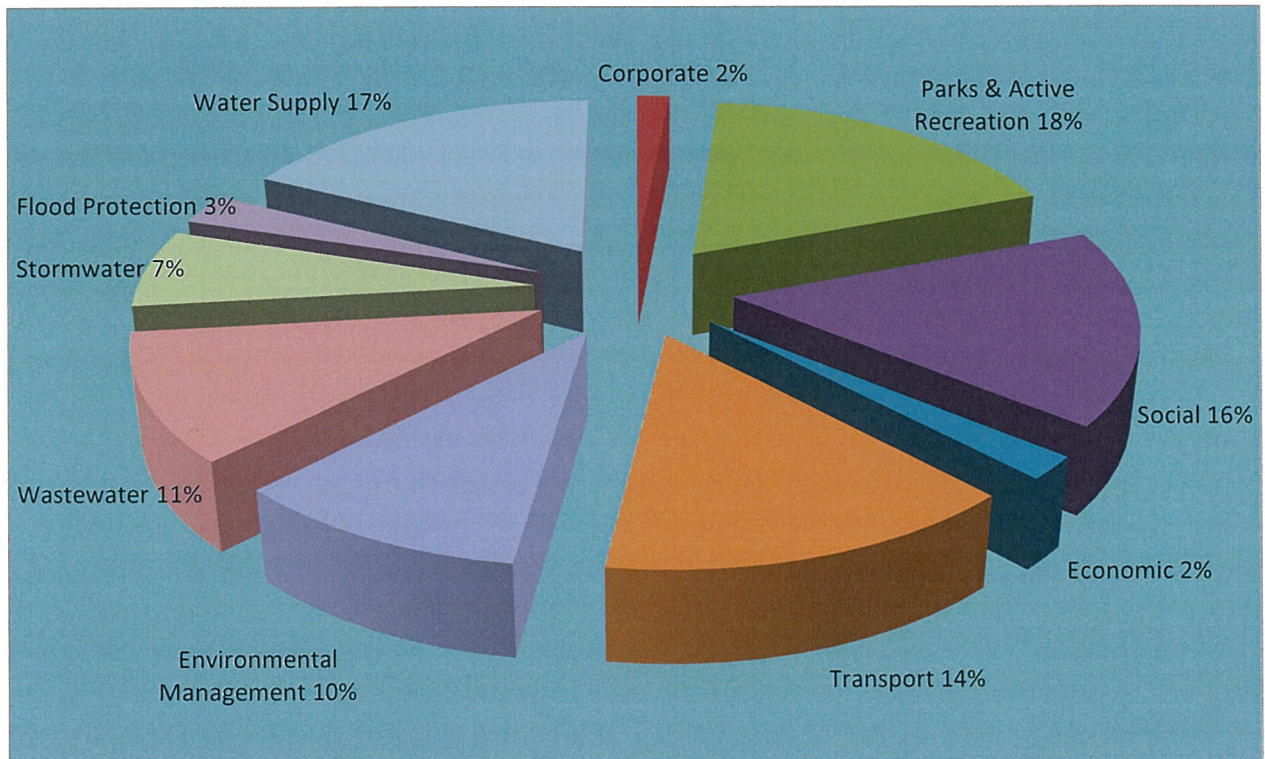




### ***Where the money will go***

The following diagram shows the Council services provided and the proportion of rates to be spent on these services over the next 10 years. See the individual activity sections to see what services are provided under each activity.

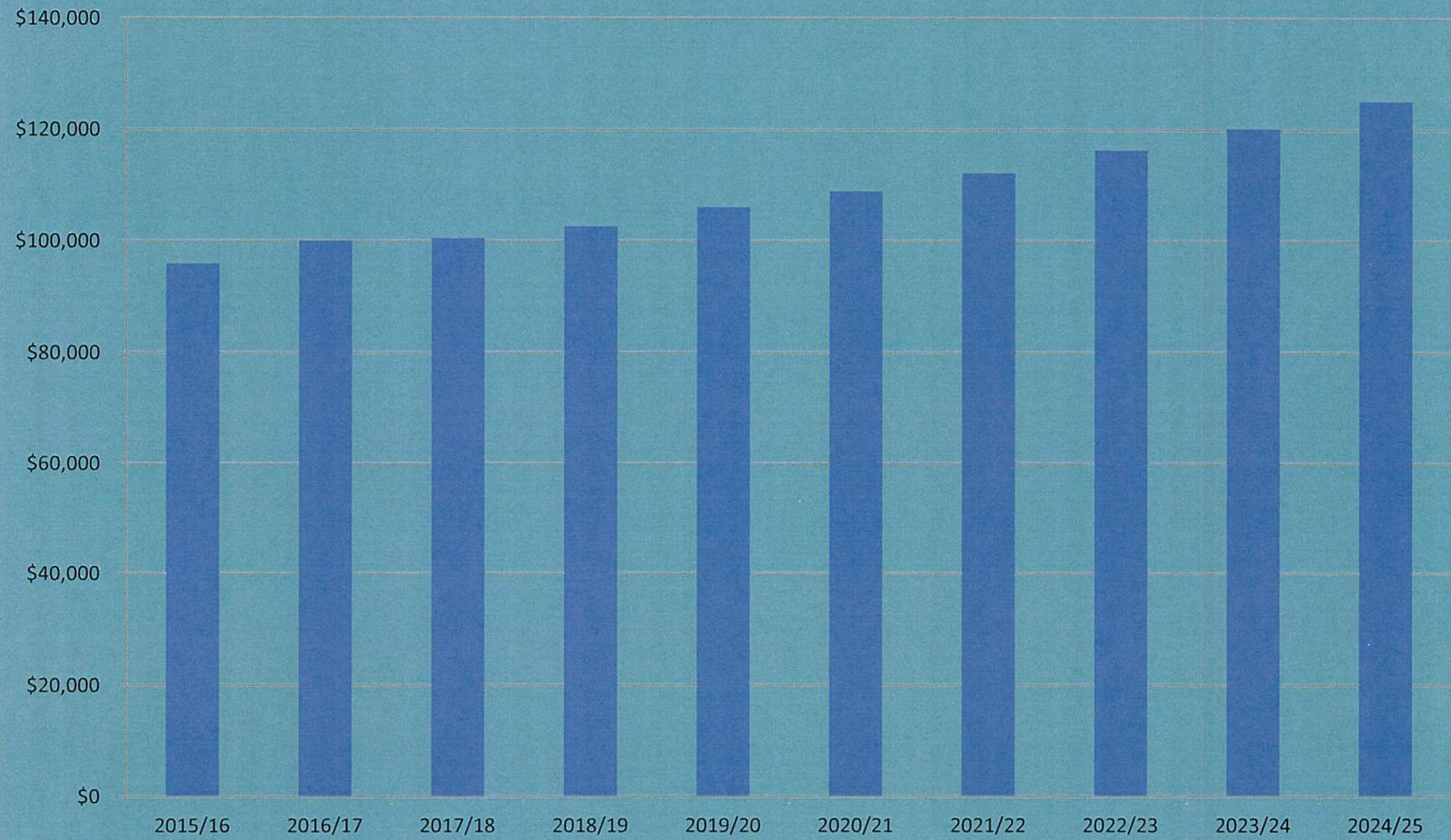
### **TEN YEAR EXPENDITURE BY ACTIVITY**



Total operating expenditure is budgeted to increase from \$92 million in 2014/15 to \$124 million in 2024/25, a 35% increase including inflation over the 10 years of the Plan.



## Annual Inflated Expenditure (000s)





## ***Funding expenditure***

Council funds operating expenditure from the following sources:

- Council levies targeted rates or fees and charges on the basis of direct user pays for the benefit received, however in some cases targeted rates are levied as a proxy for direct user pays
- Where the Council is providing services that are part of national programmes or the Government provides subsidies to the Council to provide certain services then Council will claim for these Government grants/subsidies
- Other sources of funding include interest and dividends received, and other operating revenue such as rent received
- A general rate where there is a deemed general benefit across the city.

Each activity uses different sources of funding depending on the services it delivers. All operating costs are funded with the exception of depreciation on the NZ Transport Agency share of subsidised transport projects and some other minor assets.

Council may choose to not fully fund operating expenditure in any particular year if the deficit can be funded by operating surpluses in the immediately previous or later years. An operating deficit will only be budgeted where it would be beneficial to avoid large fluctuations in rates, fees or charges.

## ***Managing risks from natural hazards***

As a result of recent extreme weather events in December 2011 and April 2013, Council intends to increase its Emergency Fund to \$7.3 million over the next 10 years. There is a risk that future disaster recovery costs during the next 10 years could be higher than anticipated. Should this occur, Council might need to reconsider the amount put aside on an annual basis. It is important to note that even with the reserve built up to the desired level, Council will continue to hold appropriate levels of insurance for assets.

## ***Use of borrowing***

Capital expenditure is funded in the following priority order:

1. Financial Contributions and Development Contributions, if a growth project
2. Grants and subsidies, for example from NZ Transport Agency, Tasman District Council, or community groups
3. Depreciation
4. Loans.

Because the level of borrowing is planned to increase, the management of interest costs is very important.

The Council Treasury Policy includes the Investment and Liability Management Policies. These are published separately and are available on request. The Council has determined maximum amounts and limits of debt.



The borrowing limits table shows a comparison of the limits in the policy compared with those set in this Long Term Plan. The policy limits were determined in association with the Council's bankers and Treasury Adviser. The table also shows that Council is operating within the guidelines contained in the Treasury Policy.

BORROWING LIMITS

	Annual Plan 2014/15	Budget 2015/16	Long-term Plan 2016/17	Long-term Plan 2017/18	Long-term Plan 2018/19	Long-term Plan 2019/20	Long-term Plan 2020/21	Long-term Plan 2021/22	Long-term Plan 2022/23	Long-term Plan 2023/24	Long-term Plan 2024/25
	(\$000)	(\$000)	(\$000)	(\$000)	(\$000)	(\$000)	(\$000)	(\$000)	(\$000)	(\$000)	(\$000)
Net Debt	111,989	118,939	133,826	142,391	147,285	153,361	151,048	155,462	155,949	157,003	151,928
	%	%	%	%	%	%	%	%	%	%	%
Net external debt not to exceed 20% of equity	9.1%	8.8%	9.7%	10.1%	10.1%	10.2%	9.8%	9.8%	9.4%	9.2%	8.6%
Net external debt not to exceed 150% of total revenue	112.3%	123.6%	134.3%	138.1%	137.7%	139.0%	135.1%	134.0%	130.3%	124.9%	117.3%
Net interest expense on external debt as a % of total revenue to be less than 15%	5.1%	5.9%	7.1%	7.4%	7.5%	7.6%	7.8%	7.6%	7.7%	7.5%	7.5%
Net interest expense on external debt as a % of total rates income to be less than 20%	8.1%	8.6%	10.4%	10.7%	10.9%	11.0%	11.2%	10.9%	10.9%	10.8%	10.8%



In 2012 after consultation, the Council became a "Guaranteeing Local Authority" in the Local Government Funding Agency (LGFA). Access to the LGFA means the Council is able to achieve a lower cost of borrowing, and therefore funding. The upper limit to be able to borrow through LGFA would require Council to contain its interest to rates revenue ratio under 25%.

To fund the capital works programme in this Long Term Plan, the amount of borrowing would peak at \$157 million during 2023/2024. The borrowing programme is within the three limits imposed under the Liability Management Policy, which is available on request.

Although interest rates are currently low, Council has budgeted for the average interest rate paid on its loans to increase over the 10 years of this Long Term Plan within a range between 5.15% and 5.45%.

Base interest rate assumptions use the most recent Reserve Bank of New Zealand 90 day bank bill rate forecasts (from the June 2014 Monetary Policy Statement) and long term historical 90 day bank bill averages. Council's all-up interest rate cost includes the current fixed rate borrower swap hedge portfolio and assumptions regarding future credit margins. In addition to obtaining lower rates for borrowing through the Local Government Funding Agency, Council manages the cost and risk of borrowing through its Liability Management Policy, which requires a spread of terms for loans so that they do not have their interest rates reviewed at the same time, when interest rates may be high.

## Annual Debt versus Debt Cap (000s)





## **Investments**

The Council has a portfolio of investments comprising:

- Equity investments
- Asset investments
- Associated organisations.

The full Investment Policy is published separately and available on request. It contains information on the reasons for holding these investments.

Council's main investments are shareholding Council Controlled Trading Organisations, commercial property and forestry investments. A list of these investments and the targets for returns on these investments is set out below.

It is acknowledged that in cash terms the investments of Port Nelson Ltd, Nelson Airport Ltd, Nelson Tasman Tourism Ltd and the New Zealand Insurance Corporation will be less than Council's overall objective of receiving a return equal to or greater over time than the average costs of Council borrowing. While the cash returns are lower, Council expects to meet its policy once future realisable capital growth is included.

INVESTMENT	TARGET RETURN
Port Nelson Limited	6% on average shareholder funds
Nelson Airport Limited	5% on opening shareholders funds
Nelmac Limited	7% on closing shareholders funds
Tourism Nelson Tasman Limited	No return on shareholders funds
New Zealand Local Government Insurance Corp	No return on shareholders funds

Council also has approximately 650 hectares of forestry which generate a commercial return, while providing recreational opportunities.

## **Securities for borrowing**

Council's external borrowings and interest-rate risk management instruments will generally be secured by way of a charge over rates and rates revenue offered through a Debenture Trust Deed. Under a Debenture Trust Deed, Council's borrowing is secured by a floating charge over all Council rates levied under the Rating Act. The security offered by Council ranks equally or '*pari passu*' with other lenders, which means on equal terms in all respects, at the same rate, or proportionately.

From time to time, with Council and Trustee approval, security may be offered by providing a charge over one or more of Council's assets.

Physical assets will be charged only where:

- There is a direct relationship between the debt and the purchase or construction of the asset that it funds, for example an operating lease or project finance
- Council considers a charge over physical assets to be appropriate
- Any pledging of physical assets must comply with the terms and conditions contained within the Debenture Trust Deed.