FINANCIAL STRATEGY

Financial Strategy 2018

Investing in our future

One of the biggest challenges a council faces is balancing its community's ability to pay, with the need to maintain infrastructure and deliver services. At Central Otago District Council we aim to keep rates and charges affordable for current and future generations. At the same time we need to focus on building our community resilience and promoting opportunities for growth that ensure our community is sustainable into the future. Environmental and national standards are impacting Council's infrastructure projects and heavy investment is required to improve the quality of our services and to meet the higher standards. To ensure that we continue with a balanced approach, we keep the two guiding principles of affordability and sustainability at the forefront of how we develop our financial strategy.

Going into this 10-Year Plan the Central Otago District Council is in a good financial position. CODC holds cash reserves of $25 million (February 2018) and has no external debt. To ensure reserves are used for their intended purpose, this plan does not use its reserves to pay for operating or capital expenditure, although some interest from reserves is used to offset rates. Council's assets are well managed with a clear replacement and growth programme planned over the next 30 years, as outlined in the Infrastructure Strategy.

A key challenge for the Council over the next 10 years is the investment we will need to make in infrastructure. This expenditure will need to accommodate both renewals and growth, and also the increases in environmental and health standards, while meeting community expectations on levels of service.

The desired outcome of this strategy is that Central Otago District Council's asset base and operational expenditure are managed in a cost-effective way, and continue to be funded in a manner that is sustainable for the Council and our communities.

FUNDING OUR EXPENDITURE

Assets Replacement

Investment in our current asset base will continue with replacement of assets funded through depreciation reserves. Council rates for the majority of its depreciation, which is held in reserve to be spent on replacement assets. All renewals are funded by depreciation reserves. For renewal of assets where depreciation has not been fully funded, it is expected that the unfunded portion of the renewal will be funded by a third party.

With long life assets the renewal programme will fluctuate from year to year. If the reserve is underspent, the reserve will earn interest. At times these reserves may be overspent, in which case any interest cost will be rated for (except for development contribution reserves). Council may also choose to loan or rate-fund replacement assets if there is insufficient depreciation reserves.

Growth Assets

When replacing or putting in new assets Council will consider whether to build the asset to cater for future growth. This may mean, for example, putting in a larger pipe than is needed for today's use to accommodate additional users in the future. Council will fund the additional capacity through developers' contribution reserves. As part of a subdivision process developers will contribute to the future growth of infrastructure networks. This money is put in a reserve and used for the growth portion of capital projects.

The Development Contribution Reserve

Typically building additional capacity for growth in a network precedes the actual growth demand. The growth portion of the capital programme is funded through development contribution reserves. In most instances these reserves for growth typically run as deficits attracting interest that are in turn funded by developers' contributions.

Asset Increased Levels of Service

The 10-Year Plan will respond to increasing environmental and national standards.

While this plan concentrates on asset replacement and growth there are a number of key projects that will increase the level of service provided by Council. These projects are in addition to increased treatment of Omakau water supply that is planned for 2017/18.

- The Clyde Wastewater project will see the township move from septic tanks to a new Council service of reticulated wastewater.
- The plan also includes a higher level of water treatment to Alexandra's water supply with significant investment to the Lake Dunstan water scheme. These projects are in response to increasing environmental and health standards.
- Increased water treatment is planned for Clyde, Ranfurly and Patearoa.
- A new reservoir and rising main to connect Pisa to a single water supply at Cromwell, will provide a higher level of water treatment for Pisa residents.
- An ongoing programme to increase road safety.

Increased level of service for significant capital works is to be primarily funded by loan. To ensure that today's ratepayers do not pay for the building and using of the asset, loan repayment will be rate-funded less the depreciation collected on the asset. These loans will be for 20 years and funded either internally or externally dependent on the availability of cash reserves. Taking a loan in this instance means that future users of the asset help to pay for it over the asset's lifespan and current ratepayers are not burdened with the full cost.

Operational Costs
Funding of operational costs come from a number of sources such as rates, user fees, grants and subsidies. The plan has no significant changes in operational funded levels of service but is impacted by interest rates, population growth and inflation. Where possible and practicable operating spending is funded through user fees or targeted rates.

GROWTH AND LAND USE

Growth in the district
The district is experiencing strong growth particularly around Cromwell and Alexandra. Council's planning and building control staff are processing unprecedented numbers of applications for resource and building consents and also receiving plan change requests and enquiries for rezoning of land.

In Alexandra, Council has released reserve land back to the Crown to enable development, and the Vincent Community Board will be undertaking a subdivision development of its freehold land. To assist in meeting demand in Cromwell, the Cromwell Community Board is freeing up land for residential and industrial development. The Board is also embarking on a Master Plan project for the wider Cromwell area, to address growth. The plan will include infrastructure planning, transport planning and cover community facility requirements to cater for growth, and produce a spatial framework that addresses zoning and urban development.

Council is in the process of reviewing its District Plan. This is a critical piece of work that helps us to set the standards for how our district responds to growth in a proactive and sustainable way. The plan review will look at all matters required under the Resource Management Act, with a particular emphasis on ensuring sufficient land is zoned for residential, commercial and industrial purposes for the next 10 to 20 years. The budget makes an allowance of $106,000 each year. Underspends in years that have fewer costs associated with the district plan are put into reserve to pay for years where costs that exceed the $106,000 allowance.

An assessment of the district's growth was undertaken by consultants in May 2017, which produced a report CODC Growth Projections to 2048. The report included four scenarios:

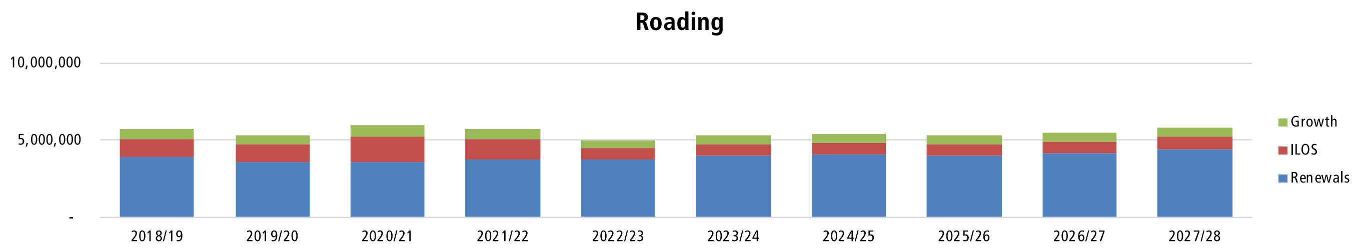
- Low Growth
- Medium Growth
- High Growth
- Modified Growth

For this 10-Year Plan Council has used the medium growth projection, which is 0.8%pa for the 10 years of the plan.

CAPITAL EXPENDITURE

Capital project
The following graphs show the split between growth, changes to levels of service, and renewal or replacement of existing assets. Level of service represents the amount of capital expenditure that is planned as an increase to current levels of service.

The amounts spent on renewals are required to maintain the current levels of service. Renewals are funded by rates through depreciation charges. Expenditure for growth will provide existing levels of service to new ratepayers and is funded by development contributions.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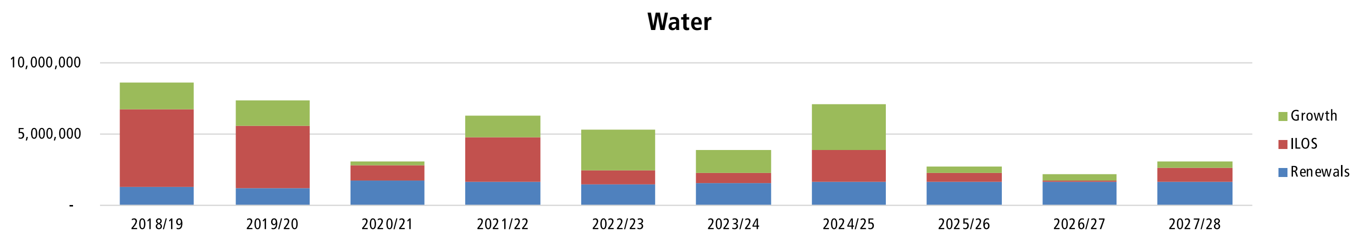
Growth
ILOS
Renewals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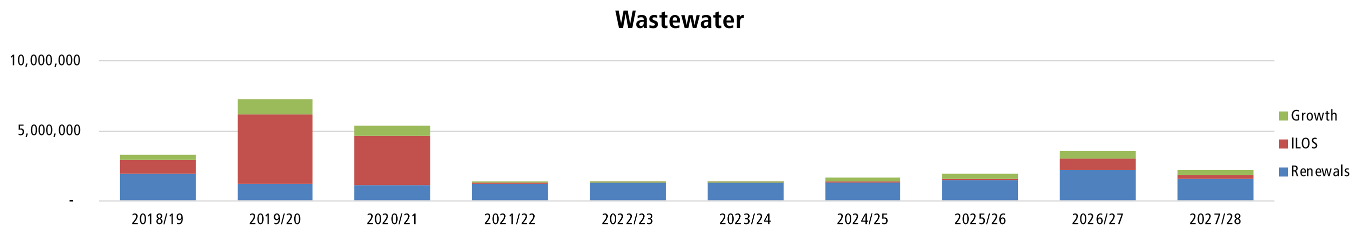
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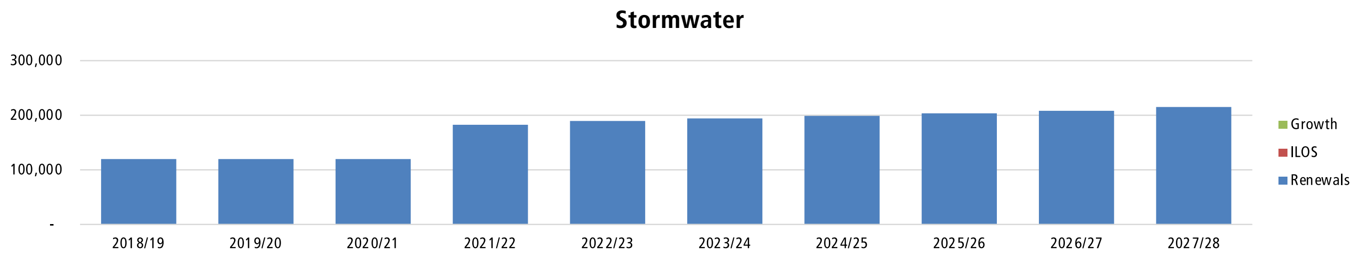
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Growth
ILOS
Renewals

OTHER FACTORS

Disaster recovery
Council continues to build its initial response fund for any natural disaster to provide for our underground assets that are not covered by insurance and any unsubsidised costs in relation to natural disasters.

Due to the size and spread of our communities we consider it unlikely a disaster would affect the entire district at any one time, so our modelling of our exposure has taken this into account to determine our share of the funds required. Currently the disaster recovery reserve stands at $2 million and is projected to reach $4.7 million by Year 10. If an event caused damage that exceeded the balance of the reserve, Council has the borrowing capacity to raise debt for the balance.

Insurance
Council will insure all Council-owned assets with the exception of our underground assets. After the Christchurch earthquake, underground infrastructure became increasingly difficult and expensive to insure. Council adopts the policy of self-funding underground infrastructure. Currently Council sets aside $120,000 each year into a disaster recovery fund. This fund covers any non-funded or uninsured expenses incurred in relation to natural disasters. In the event of a catastrophic event, Council would loan fund any expenses not covered by the disaster recovery fund.

Debt Security
Council's Liability Management Policy currently allows Local Authority Bonds to be secured by either a general charge over rates or a specific asset of council. This 10-year plan projects sufficient cash reserves to remove the need for external borrowing.

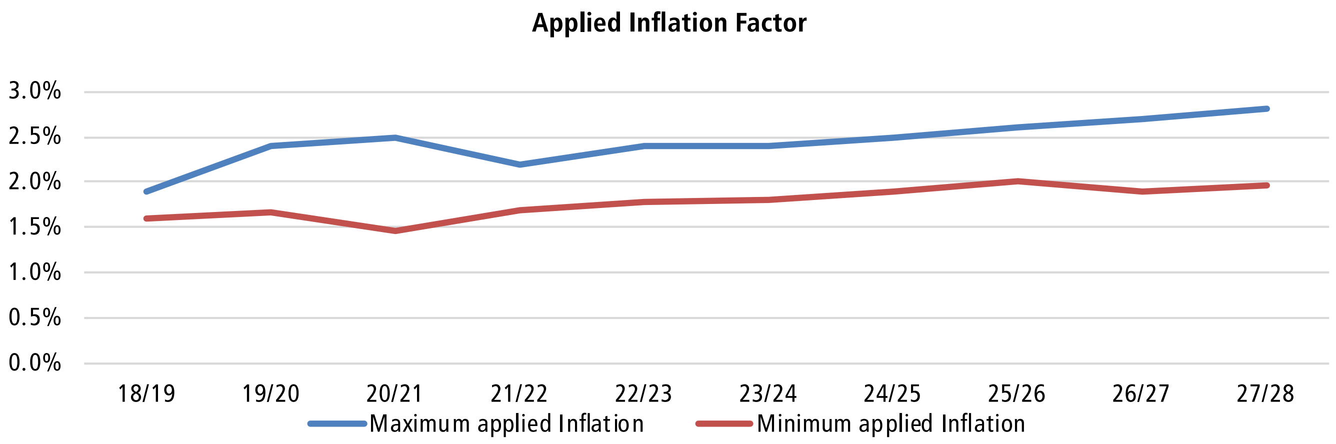
Bridges
There are 175 bridges on the district's roading network. Thirty-five bridges are expected to reach the end of their economic life within the next 30 years, with a further 30 requiring significant renewals work. A significant number of these bridges are located on low volume roads, and the economic viability of like for like replacement of these bridges will need to be reviewed. Further investigation and analysis work is planned for the next three years before any actual investment will occur.

Council has not previously rate-funded depreciation for bridge renewals, so there is no money set aside for the programme of renewals that will emerge over the next three years. The current projections take into account our current assessment of the increased work required, so ratepayers are being asked to fund the increased depreciation costs that result as well as the interest cost for the use of the money. We have started to fund depreciation and maintenance to ensure we are in a position to continually renew those assets as required.

Once a clear work programme is established for the maintenance and renewals of our bridge network we can then better consider the funding options available to us. Because bridges are long life assets, external loan funding may be appropriate. Council has the capacity to borrow further in terms of its limit to total assets, however we first need to assess whether we want to go down that path or rate-fund the replacements by taking longer to build the self-insurance fund.

Inflation
Inflation reflects erosion in the buying power of money. Each dollar buys less and less goods and services over time. Expenditure forecasts for each activity are input in the dollars of the relevant year for the first three years. This means where planned cost movements or inflation adjustments are expected, the cost movements have been taken into account. Applying blanket inflation rates over these first three years would then overinflate these costs. If some costs rise due to unplanned inflation the additional cost will be covered by net operation savings. If net operational savings were not achievable this would add 0.45% rates. The additional rates would not lead to a breach to the Rates (income) affordability or Rates (increase) affordability benchmarks.

An inflation factor of zero has been applied to costs for the first three years to reflect that the base figures include known movements in costs for those years. The exceptions to this are depreciation, asset values and staff costs, which are inflated from Year 1.



During the course of the plan inflation factors of between 1.5% and 2.8% have been applied. The difference is reflective of both variations in inflation expectations year on year along with various rates being applied to different costs, for example, water supply inflation factors compared to expected inflation on road construction.

Development Contribution Reserve
In 2007-2008, when development contributions were in their infancy, the estimation of the growth portion of some roading assets was too high. This has left this reserve in a deficit that with interest charges will not recover to a sustainable point. This plan will remedy this situation by using general reserves and roading depreciation reserves to bring the account back to a sustainable level. The effect of this will be a reduction in interest earned on the general reserve, with minimal effect on rates over the life of the plan.

IMPACT TO DELIVER PROPOSED LEVELS OF SERVICE

Just as the cost of running your household increases every year with inflation, so too does the cost of providing our services. This is because costs like energy, property, labour and construction continue to increase. This in turn affects how much it costs us to deliver services to you. We have used inflation assumptions, provided by BERL, that are particular to councils and our assumptions that underpin this Financial Strategy are outlined in the financial section.

In planning for the long term the only certainty is uncertainty. However, creating a plan that accounts for every eventuality would be impossible. So we base our forecasting on a set of assumptions we assess the risks associated with each assumption to determine how to mitigate the consequences and ensure a robust plan that delivers on our promised levels of service.

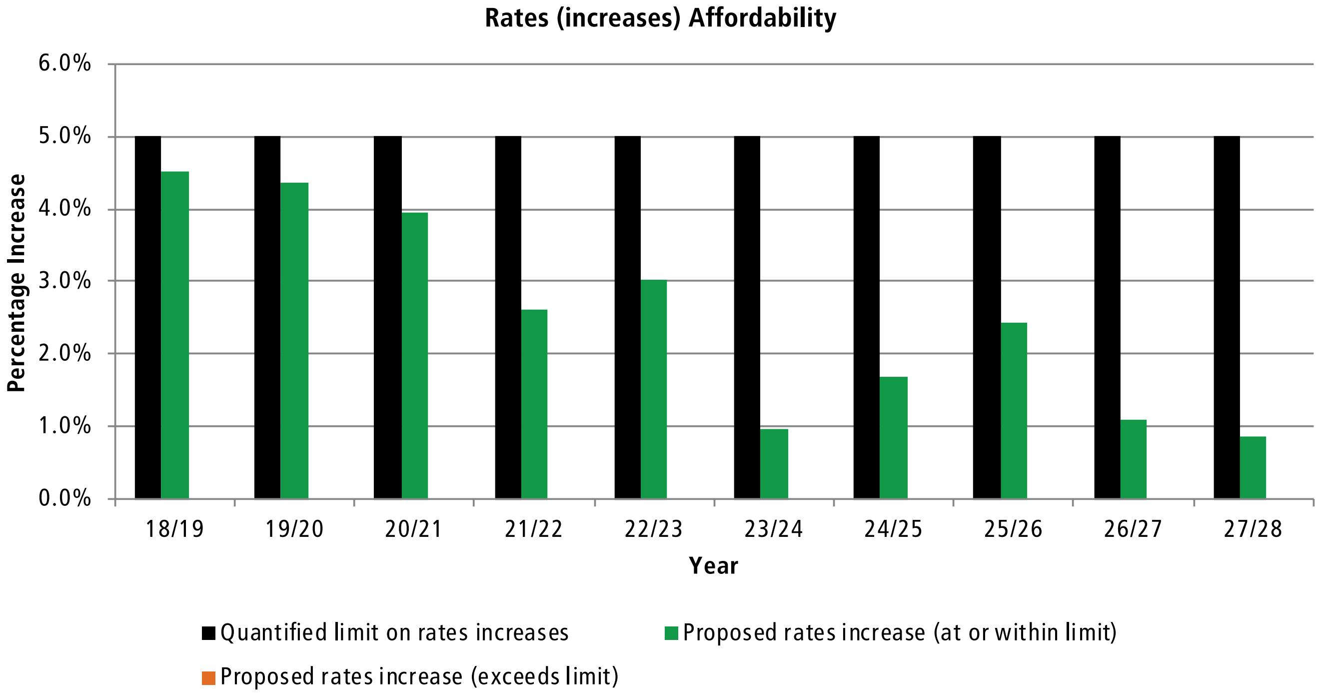
A positive challenge is that our district is still a desirable place to live for many people. So although we have a responsibility to provide infrastructure in anticipation of growth, we have the ability to more accurately plan for provision of services in areas where growth is projected to occur.

The review of Council’s District Plan in 2018 will also create a significant opportunity to set the speed of development and growth, and more accurately forecast the demand on levels of service.

We have entered into a number of partnerships that help us deliver our services in a more efficient way. We have some strong relationships with neighboring councils that we are using to the benefit of our communities. One example is our shared library service with Queenstown Lakes District Council. Strong links with local organisations and community groups in the district mean our parks team can work with the likes of Rotary and Lions to deliver improvement projects in local reserves spaces, where local solutions allow the ratepayer’s dollar to go further. We have also shed some operational responsibilities and associated expenses in the past year with the formation of Fire and Emergency New Zealand (FENZ) encompassing the rural fire authority and Otago Regional Council centralising the emergency management functions (CDEM) for the Otago region.

To maintain an element of affordability Council has worked towards maintaining a limit on rates increases of 5% per annum for existing ratepayers. This rate cap is an average for the whole district, which means that on an individual basis the 5% cap does not apply. Due to the need to bring some large infrastructure projects forward and to incorporate projects that raise quality standards to meet predicted legislation changes, it is anticipated that Council will be close to this limit in 2019/20 and 20/21.

With consideration given to all of the above, the proposed rates increases in this 10-Year Plan are after an assumed 0.8% annual growth in rateable properties. These rates increases will go beyond the 10 years given the level of investment still to occur.

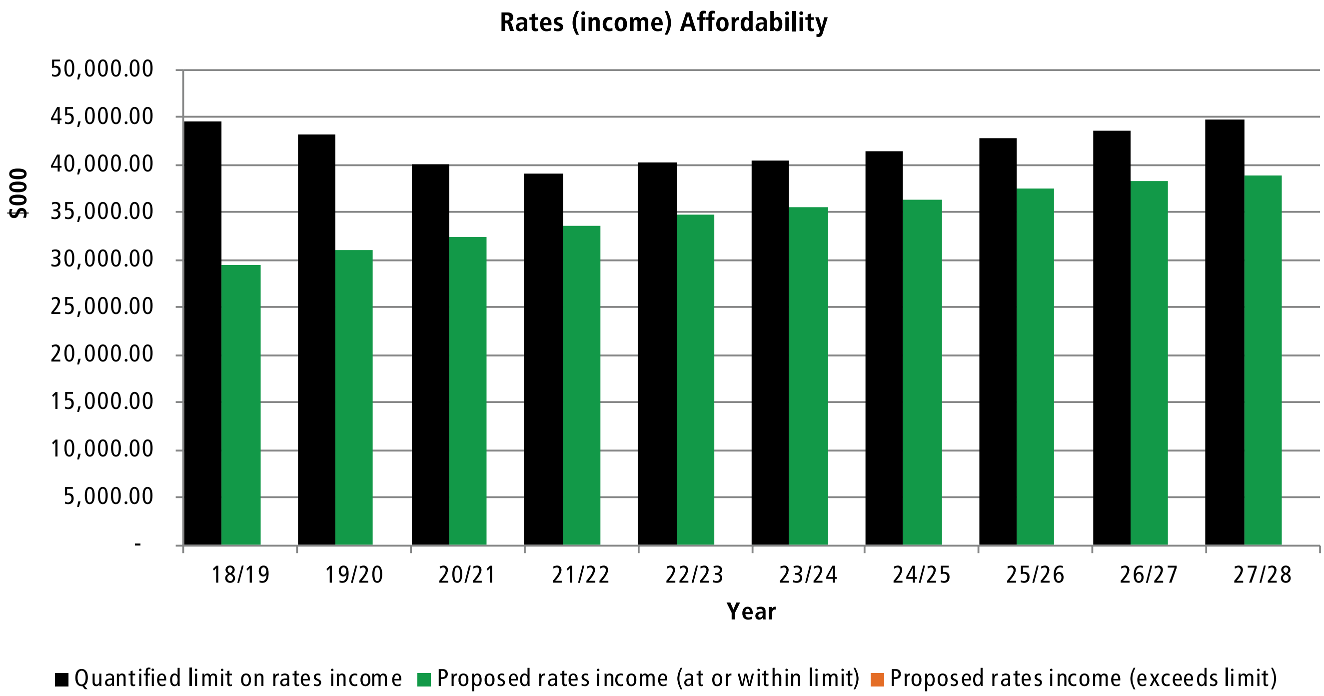


Council also sets a rate limit based on total expenditure. This limit has been set at 80% of total revenue and is a measure used across all local authorities. For the 10 years of this plan rates income does not breach this limit.

It is important to remember this is an average across the district and that rate increases will vary from property to property, with some individual properties seeing increases above this limit, depending on a range of factors such as property valuations and targeted rates assessed on a ward basis.

Rates are the main source of income for councils. Currently Central Otago District Council draws about 70% of our revenue from rates and propose to limit the rates collected each year to a maximum of 80% of total Council revenue.

Council's strategy is to ensure that both current and future ratepayers pay their fair share of the cost of providing services. This intergenerational equity is achieved through loan funding the increased level of service of long-term assets and drawing rates to pay for the loan over an extended period of time. The loan will be funded by internal or external borrowing depending on availability of funds. This ensures that both current and future users pay for the service.

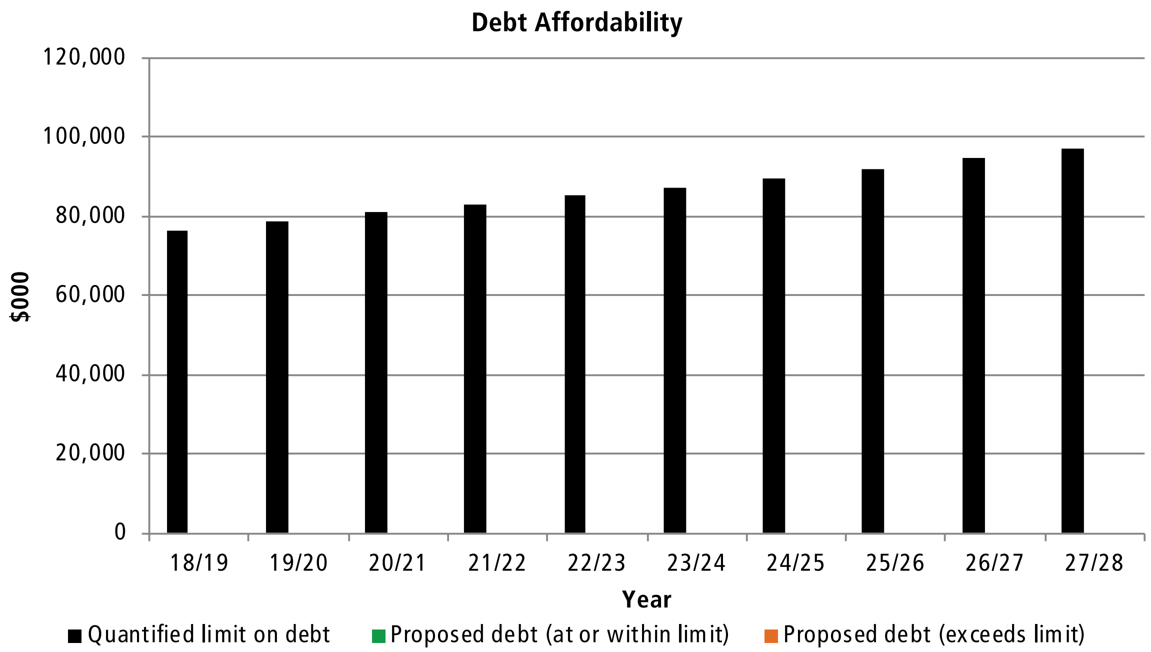


Rates (income) affordability compares the relationship between total revenue and total rates collected. The limit for total rates is set at 80% of total income. This benchmark has been met in each of the 10 years of the plan.

Anticipated Annual Growth 0.80%											
Year	2017/18	2018/19	2019/20	2020/21	2021/22	2022/23	2023/24	2024/25	2025/26	2026/27	2027/28
Rating Units	13,622	13,735	13,845	13,956	14,068	14,181	14,294	14,408	14,523	14,639	14,756

Debt affordability

The council meets the debt affordability benchmark if its planned borrowing is within each quantified limit on borrowing. The following graph compares the Council's planned debt with a quantified limit on borrowing contained in the financial strategy included in this long-term plan. The quantified limit is 10% of the total value of assets.



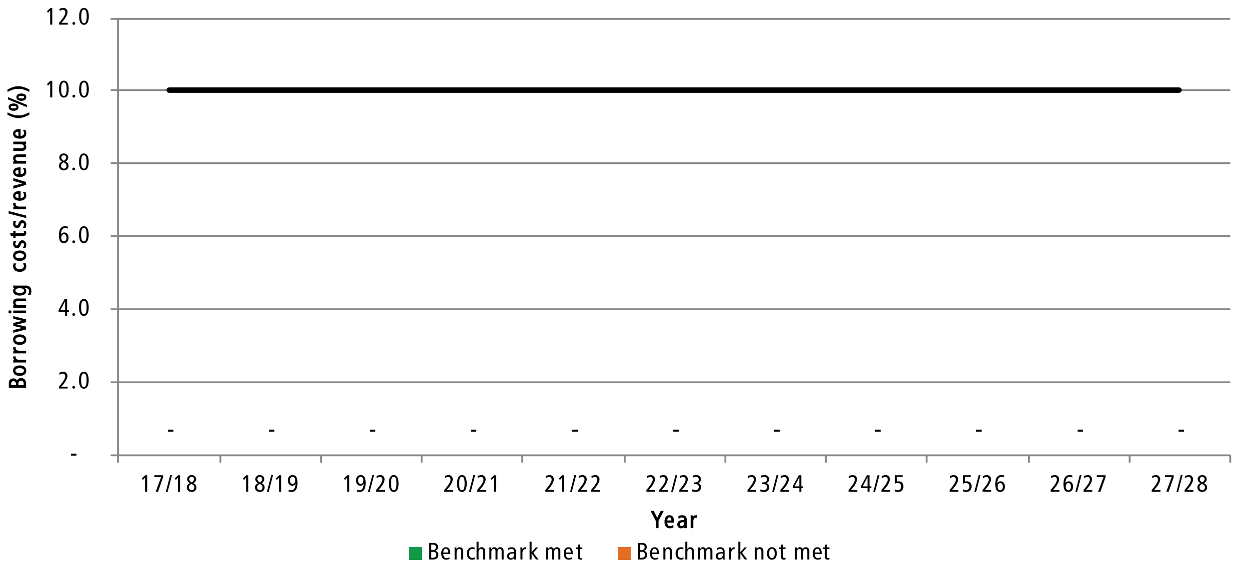
Debt Servicing

A borrowing limit of 10% of total assets has been set to assist in prudently managing borrowing. As the plan has sufficient cash reserves to internally fund any projects that need to be loan funded, debt in this 10-Year Plan will not exceed the 10% of total assets benchmark.

The following graph displays the council's planned borrowing costs as a proportion of planned revenue (excluding development contributions, financial contributions, vested assets, gains on derivative financial instruments, and revaluations of property, plant, or equipment). Council does not plan to borrow externally within the next ten years.

Because Statistics New Zealand projects the council's population will grow as fast as the national population is projected to grow, it meets the debt servicing benchmark if its planned borrowing costs equal or are less than 10% of its planned revenue.

Debt servicing benchmark



Investment

We recognise that as a responsible public authority, any investments that we hold should be of a relatively low risk. We further recognise that lower risk generally means lower returns. Council aims to maximise investment income within a prudent level of investment risks. Currently we have money invested with banks in New Zealand and we aim to achieve market rates for these investments. We may also consider other investments in accordance with the Investment Policy. Our quantified target for returns on financial investments is to achieve a return equivalent to market rates. We will ensure that all funds are placed in suitable deposit accounts and excess funds will be put on deposit.

Cash Reserves and Debt

Council currently has high cash reserves. While much of these reserves relate to money set aside for asset replacement there is a significant amount that has come from Cromwell land sales. In the next 10 years sale of land is forecast to be $15 million, which will add to the estimated cash position. The plan reflects the lack of certainty around reinvestment of the land proceeds into assets other than cash. This has resulted in an ending cash position in the plan of $48 million. Any loan raised for capital expenditure will utilise these cash reserves by way of internal borrowing where possible.

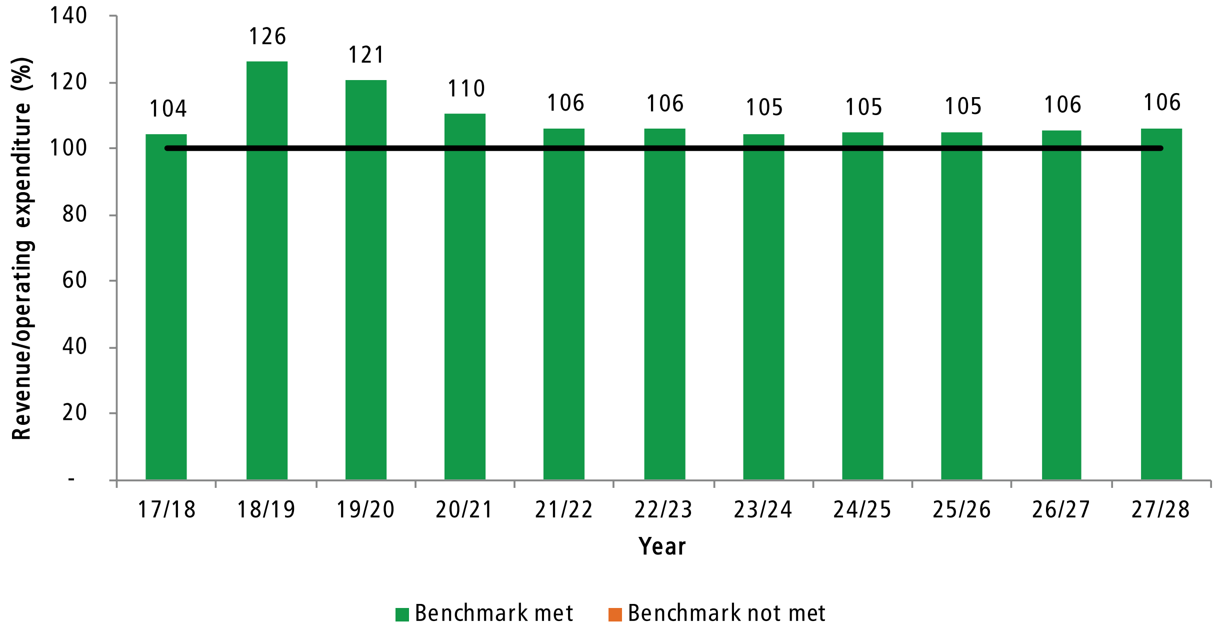
Significant non-growth expenditure that is not depreciation funded or subsidised will be loan funded. Loans will be set up with repayments (less depreciation) being rated for. The source of these loans are forecast to come out of cash reserves.

	2018/19	2019/20	2020/21	2021/22	2022/23	2023/24	2024/25	2025/26	2026/27	2027/28
Forecast Cash Balance ***$ Millions***	9.2	8.4	10.4	12.6	16.8	22.5	24.8	32.3	39.1	46.5

Balanced Budget

Council is required to operate a balanced budget whereby operating revenues are set at a level sufficient to meet that year's operating expenses. A balanced budget is achieved when total revenue (less revaluations, developers' contributions and vested assets) is greater than operating expenditure. This plan achieves a balanced budget for each of the 10 years of the plan.

Balanced budget benchmark



Surpluses can result when:

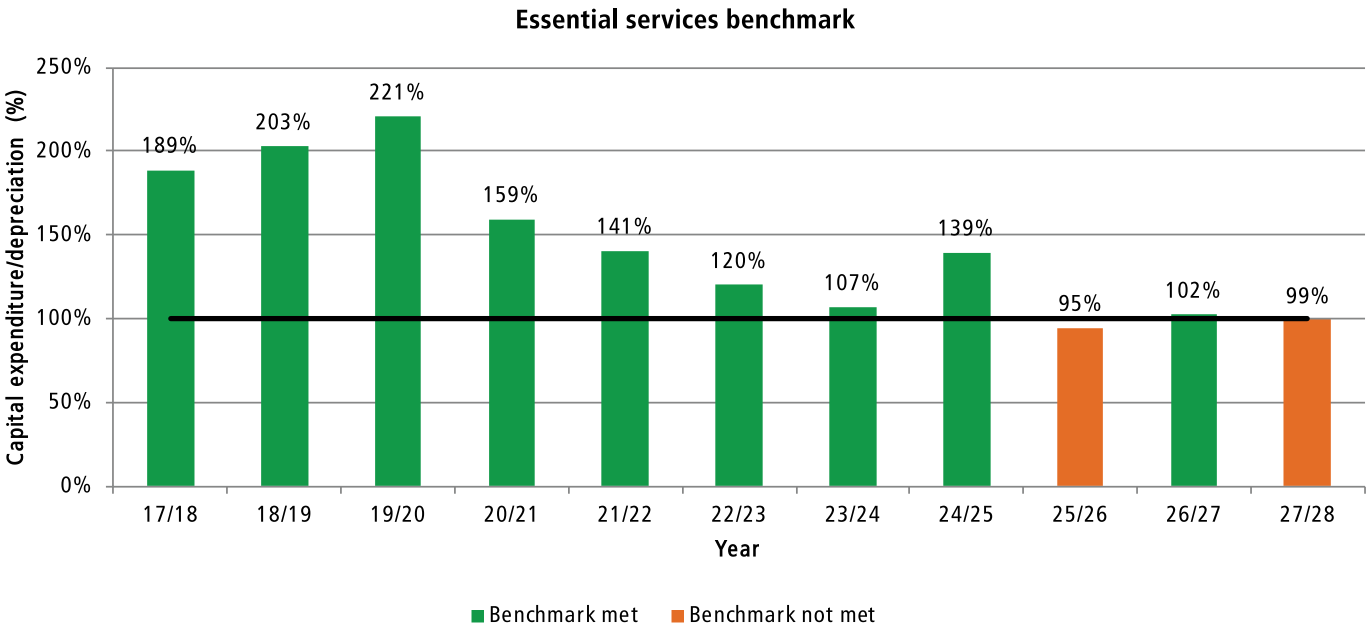
- Rates are raised to repay loans. The rates income appears in the prospective statement of comprehensive revenue but the repayment is a prospective statement of financial position item.
- Income for capital purposes such as development contributions and capital donations appear in the prospective statement of comprehensive revenue, however the corresponding capital expenditure is a prospective statement of financial position item.
- NZTA grants for roading are included in the prospective statement of comprehensive revenue. These are largely used to fund renewal expenditure, which is a prospective statement of financial position item.
- Rates have been raised to build the self-insurance fund for underground assets. The rates income appears in the prospective statement of comprehensive revenue, but the reserve fund is a prospective statement of financial position item.
- Rates have been raised to repay the deficits in the roading development contribution fund, which are included in the prospective statement of comprehensive revenue. However the development contribution fund is a prospective statement of financial position item.

Deficits can result when:

- Council’s Revenue and Financing Policy indicates that in certain circumstances we will not fully fund depreciation from rates income, for example, Council does not fully fund depreciation on roading assets. Most roading capital expenditure attracts a government subsidy; therefore there is no need to fully fund depreciation for the portion that is subsidised.
- There are circumstances whereby fully rate funding depreciation may result in some ratepayers bearing a funding burden that is not entirely fair and equitable. This is where funds for capital project replacement are provided from sources outside Council – for example, where a community has raised funds for a hall. Council would not rate-fund the depreciation on the hall, as any replacement of that facility would be the responsibility of that community.

Essential Services Benchmark

The following graph displays the council’s planned capital expenditure on network services as a proportion of expected depreciation on network services. The council meets the essential services benchmark if its planned capital expenditure on network services equals or is greater than expected depreciation on network services.



Council's approach will involve maintaining a focus on affordability and the long-term consequences of decision-making. We need to balance affordability with suitable investment in our district to ensure progress continues and this remains a great place to live, work and play.

Financial Prudence Benchmarks

Disclosure Statement

What is the purpose of this statement?

The purpose of this statement is to disclose the Council's planned financial performance in relation to various benchmarks to enable the assessment to whether the Council is prudently managing its revenues, expenses, assets, liabilities and general financial dealings.

The Council is required to include this statement in its long-term plan in accordance with the Local Government (Financial Reporting and Prudence) Regulations 2014 (The regulations). Refer to the regulations for more information, including definitions of some of the terms used in this statement.