Manawatū District Council

Financial Strategy

Contents

Type of strategy	Governance
Original strategy date (adopted)	2012
Strategy updated / Reconfirmed	2015, June 2018
Strategy review due	June 2021

Financial Strategy

1. Introduction

1.1.1. The Local Government Act 2002 requires Council to prepare a Financial Strategy as part of its Long Term Plan. This Strategy outlines how the Council intends to manage it finances prudently. This means the Council will act with careful deliberation and will always consider the financial implications of decisions on the community. Council must make adequate and effective provision to meet expenditure needs identified in Annual and Long Term Plans.

2. Why have a strategy?

2.1.1. The Financial Strategy provides a financial framework for making decisions. Simply, it enables Council to assess proposed spending against rates and borrowing requirements over the whole ten years of the Long Term Plan 2018-28. It draws together all of the issues in the Long Term Plan along with the financial consequences and presents these along with the Council's response.

2.1.2. This will:

- Enable the community to readily identify what the financial issues are
- Provide the community with certainty about how expenditure will be met
- The impacts of proposals on levels of services, rates, debts and investment
- Enable the community to predict how the Council intends to manage the financial issues in the future
- Provide guidance to decision makers when considering implications of financial issues on communities now and in the future.

> The Long Term Plan 2018-28 outlines all of the key projects and services Council will provide for the next ten years.

3. What are the financial issues during the next 10 years?

3.1.1. Council's vision is for a "connected, vibrant, thriving Manawatū District - best lifestyle in New Zealand". The services and projects outlined in the Long Term Plan will ensure this vision becomes a reality. The provision of services and projects comes at a cost. Council aims to spend within its means, achieving a balance between meeting the needs of the community with its ability to pay.

3.1.2. Some of the future financial issues Council faces in the future are

- Managing our borrowing levels
- Infrastructure investment
- Rates affordability
- Balancing our budget

- Intergenerational issues

4. Managing our borrowing levels

4.1.1. In year one Council has the capacity to borrow $91 million. Council has taken a conscious step in the Financial Strategy to limit the level of debt to a cap that is $5 million less than the limit. This buffer provides Council with capacity to respond to emergency works caused by natural disasters. By the end of the 2017/18 financial year Council is expected to have borrowed $63 million, which will constrain our borrowing capacity over the next ten years. We are mindful that a single infrastructure project or significant emergency works could use up this remaining borrowing capacity.

4.1.2. Council is proposing to improve its financial resilience by building up reserves. Reserve funds will enable Council to pay debt, undertake repairs to infrastructure in the event of an emergency, and/or respond to unanticipated community requests. The 2018-2028 Long Term Plan proposes to build up reserve funds by $430,000 in 2018/19, $646,000 in 2019/20 and $819,000 in 2020/21 and $1.1 million per annum (on average) in each subsequent year. Reserve funds will be collected via the General Rate.

5. Infrastructure investment

5.1.1. Council owns $670 million in assets including roads, water and wastewater treatment plants, parks, halls and buildings. The costs and impacts of maintaining assets and provision of current levels of services is a driver behind rates increases. Investment in "Three Waters" (drinking water, storm water and waste water) asset renewal is lower than recommended by Asset Management Plans due to Council's debt cap constraints and is a short term cost-saving initiative. Reduced renewal investment increases the risk of network failure and may potentially lead to higher maintenance costs. Assets that do fail will require emergency repair works and may require unplanned funding.

6. Rates afforability

6.1.1. Council uses money collected through rates to fund the provision of services, carry out projects and maintain and replace assets necessary for the District to function to its full potential. Council carefully considers the affordability of the proposed rate requirements both for the Council and ratepayers. When setting rates Council considers:

- the levels of service provided
- intergenerational issues
- other sources of funds
- debt levels
- legislative requirements
- external factors e.g. interest, inflation and changes to external funding
- what our ratepayers can afford

6.1.2. To provide certainty to the community Council sets a rates increase limit. Proposed rates increases for the next ten years have been limited to the Local Government Cost

Index (LGCI) plus three per cent, excluding growth and new levels of service. This is one per cent lower than the previous Financial Strategy in 2015. The LGCI measures the year-on-year price change of goods and services typically used by local authorities.

7. Balancing our Budget

7.1. What is a balanced budget

7.1.1. Council is required to balance its budget by ensuring that operating expenses are covered by operating revenue. There are some permitted exceptions to this requirement; situations where Council is not required to balance its budget. These exceptions have to be stated clearly in the Financial Strategy. The Statement of Comprehensive Revenue and Expense shows a balanced budget for the term of the Long Term Plan. However, this may not always be the case. The main reasons for an unbalanced budget would be:

- not funding depreciation on non-strategic assets
- not funding depreciation on the portion of roading subsidised by the New Zealand Transport Agency (NZTA)
- using revenue for capital purposes
- funding growth-related capital expenditure from development contributions
- funding from prior or future years surpluses

For a copy of the Statement of Comprehensive Revenue and Expense see Long Term Plan 2018-28 - *www.mdc.govt.nz*

7.2. Components of deficits or surpluses

7.2.1. Unfunded depreciation

- Council rates for depreciation to fund the renewal or replacement of assets. There are three activities where Council consider it prudent not to fully fund depreciation. These are roading, halls and recreation centres and parks, reserves and sports grounds.
- Roading is a strategic asset of Council and results in a significant depreciation charge. However, the renewal or replacement of the majority of our roading assets are funded through subsidy from the New Zealand Transport Agency (NZTA). Therefore, it would be double dipping if Council were to fully fund depreciation and also to get a subsidy for the replacement.
- With the exception of the Feilding Civic Centre and the Te Kawau Recreation Centre (both are considered strategic assets) depreciation on halls is not funded as the asset may not be replaced or alternative funding mechanism may be used to fund the replacement. For the same reasons we only fund 50% of the depreciation on parks, reserves and sports grounds.

7.2.2. Revenue for capital purposes

- The operating surplus in the Statement of Comprehensive Revenue and Expense includes revenue to fund capital expenditure. Through the life of the plan this type of revenue includes subsidy from NZTA for roading capital expenditure, grants for community facilities, development contributions received to cover growth related capital expenditure and contributions from ratepayer to fund the connection to Council infrastructures.

7.2.3. To be funded from future development contributions for growth related capital expenditure

- When new land is developed, the developer is charged a contribution fee toward the costs of infrastructure such as water pipes and sewerage pipes, and facilities such as parks and reserves.
- A twenty-year work programme has been developed and development contribution fees have been calculated according to this programme. Often Council is required to put the infrastructure in place to ensure we have the capacity to accommodate growth in advance of the development. In these instances loans are taken out to fund this expenditure. The servicing of these loans (both interest and principal repayments) is to be funded by future development contributions.

7.2.4. Funding from prior or future years surpluses

- There are a small number of circumstances where it is considered prudent to fund operational expenditure from prior or future years' surplus. One example is where a grant is received for solid waste minimisation. This can only be used for a specific purpose and therefore unspent money is set aside and used in future years.

8. Intergenerational Issues

8.1.1. Council manages many different assets. Roads, footpaths, pipes, drains, parks and reserves all require careful management to provide services to the community now and in the future.

8.1.2. Some assets are useful for a long time and provide service to more than one generation. For example, pipes and bridges often have an estimated life of 60 to 100 years. When making financial decisions about how to fund assets, Council takes into account how today's decision will impact on current and future generations. Council considers that it is fair to expect those people who benefit from the service should pay for it. This principle assists Council to decide how to fund the costs of replacing existing assets and to build new assets. For example, long life assets may be partly funded by a loan. Loans spread the cost of the asset across current and future generations.

9. Expected Changes in the District

9.1.1. The population of the district is growing. Pressure is mounting for development to cater for the growing population. A number of changes are accounted for during our future financial planning period.

9.1.2. The population of the Manawatū District has grown at an average rate of 1.3 per cent a year over the last 10 years. Population growth has been particularly strong between 2014 to 2017, with the annual average rate of growth of 1.7 per cent. Future population growth is forecast to average 1.3 per cent a year from 2018 to 2023 declining to 1.1 per cent growth a year to 2028.

9.1.3. The number of households in the district are expected to increase at a different rate than population increases. Household growth for 2018/19 year is forecast to grow by 1.6 per cent. During 2018-28 period household growth is expected to increase by between 1.3 per cent to 1.6 per cent per annum.

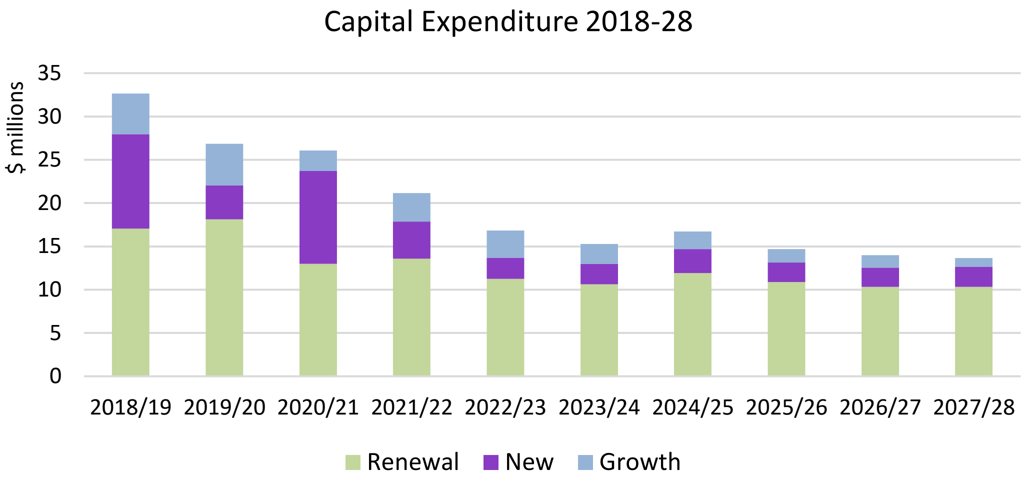
9.1.4. In June 2017, our population was 30,300. During the 10-year life of this long-term plan Manawatū District Council forecasting indicates that the population is likely to increase to 34,715 (June 2028).

9.1.5. The Council does not expect any significant impact to current ratepayers on the costs of providing current activities from the forecast growth. Additional costs to provide network services, including water, waste water and storm water, to cater for this growth will be recovered through development contributions. The costs of meeting higher standards have been more significant than the impact of forecast growth over the last 10 years.

9.1.6. One of the major changes in the forecasted population is the increase in older people. This is a similar trend nationally. This will have an impact on the type of services delivered by the Council and the way services are delivered.

10. Capital expenditure

The graph below shows the amount of capital expenditure required to maintain existing levels of service and meet any additional demand on Council's infrastructure.



10.1.1. Roading expenditure is a significant component of capital expenditure. In 2018/19 Council plans to spend $9.7 million on the roading network. This figure fluctuates over the 2018-28 period. The spikes in this expenditure throughout the 10 years accommodate significant projects such as the Mangaweka Bridge replacement in 2019/20.

10.1.2. Work is planned to extend our services to cater for the expansion of the Feilding Township.

10.1.3. Council believes the resources made available in the Long Term Plan give us the ability to meet levels of service requirements.

11. Managing our borrowing levels

For a copy of the Liability Management Policy see www.mdc.govt.nz

11.1. **Borrowing Terms**

11.1.1. The term of borrowings is to be the lesser of the estimated useful life of the asset or 30 years. While a 30-year ceiling does not fully address all our the intergenerational issues, it provides a suitable timeframe to repay debts. The loan repayments are offset by lower maintenance requirements for newer assets.

11.1.2. Loan principal is to be repaid over the life of the loan by either regular principal repayments throughout the life of the loan or a contribution to a loan redemption fund.

11.2. **Liability Management Policy Limits**

11.2.1. The borrowing limit ratios established in the Liability Management Policy are:

- Net interest must not exceed 20 percent of total revenue
- Net interest must not exceed 25 percent of annual rates revenue
- Net debt must not exceed 175 percent of total revenue
- Available financial accommodation must not be less than 110 percent of external indebtedness

11.2.2. This provides Council the capacity to borrow $91 million at the start of the 2018-28 Long Term Plan (June 2018). The Council's balance sheet can prudently sustain this level of debt. However, Council does not wish to impose this high level of debt for two primary reasons:

- The debt servicing charges will result in rates affordability issues for ratepayers, and
- To ensure borrowing facilities are available for unexpected circumstances such as a natural disaster.

11.3. Debt limits for planning purposes

11.3.1. Council's planned estimated debt limit is $86 million by the end of 2018/19. This figure gradually increases over the remaining years of the 2018-28 Long Term Plan reaching $117 million in 2028/29. Inflation is the main reason the debt limit is increasing over the life of the plan.

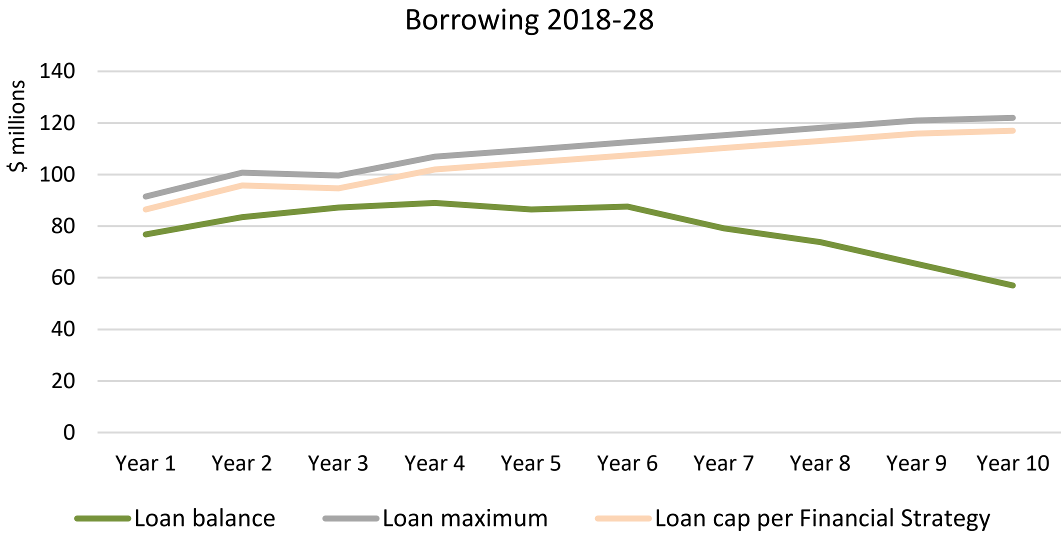
The estimated debt limit for the Financial Strategy and planning purposes is reached by:

1. calculating each of the borrowing limit ratios in the Liability Management Policy;
2. choosing the ratio that results in the lowest limit;
3. subtracting $5 million from this result to provide borrowing capacity in the event that the unexpected occurs.

The estimate assumes interest rates will not rise significantly. This level of debt enables Council to fund the capital spending programme in the 2018-28 Long Term Plan. Debt levels will be reviewed every three years during Long Term Plan development or periodically as risk profiles, revenue and asset levels change.

11.3.2. During the 10 years of the Long Term Plan, Council comes close to the cap in 2020/21 as it funds significant capital expenditure to enable growth and new compliance requirements. In 2021/22 the reduction of capital expenditure and loan repayments have enabled debt levels to stabilise. The debt cap is a maximum limit and Council is not planning on operating near the limit in the long term.

11.3.3. The graph below shows Council's proposed debt over the next 10 years, together with the maximum planned debt allowed according to the Financial Strategy. The maximum debt allowed in the Financial Strategy is based on whichever limit in the Liability Management Policy yields the lowest debt, less a $5 million emergency buffer. In this case the lowest debt limit not exceeding 175% of revenue.



12. How will Council meet its financial requirements?

12.1. **Rates**

Rates are a property tax set annually by Council. Rates are one source of revenue the Council uses to fund projects and operating services.

12.1.1. Council considers the affordability of the proposed rate requirements both for the Council and ratepayers. When setting rates Council considers:

- the levels of service provided
- intergenerational issues
- other sources of funds
- debt levels
- legislative requirements
- external factors e.g. interest, inflation and changes to external funding
- what our ratepayers can afford

12.2. **Rates Increases**

12.2.1. The Council has decided on the following limit for rate increases:

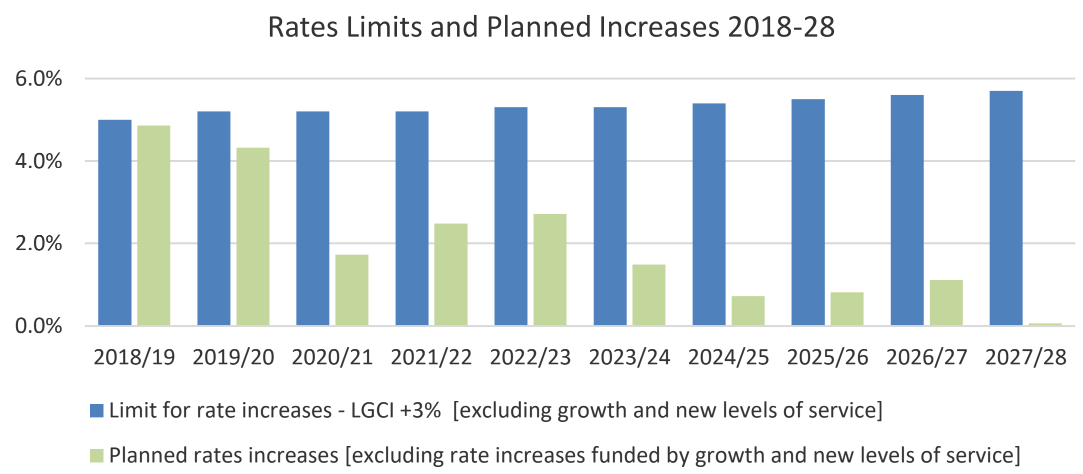
Rates increases: Rates increases are based on the previous year's total rates revenue multiplied by LGCI +3 per cent (excluding increases that are the result of new levels of service and increases absorbed by forecasted household growth). Rate increases do not include rates levied through water by meter charges as these are volume related and are outside the control of Council.

12.3. Rates Percentage Increases 2018-28

12.3.1. The graph below indicates total rates increases against set limits over the ten years 2018-28. The most significant rise is forecast in 2018/19 at 4.9 per cent with the lowest in 2027/28 at 0.1 per cent. Over the next ten years, the average total rates increase per annum is 2.0 per cent. Smaller increases beyond 2021/22 are likely to rise when reviewed as part of the three-yearly Long Term Plan process.

12.3.2. The percentage increases reflect Council's total rate revenue increases for existing ratepayers receiving a similar level of service as the prior year. They do not reflect individual rates rises. The change in rates on individual properties will be different from the average increase. The rates for individual properties are dependent on valuation changes, the mix of rate charges and the combination of services provided. The rates and the percentage increases below exclude increases in growth, new levels of service and water by meter.

12.3.3. Added to these increases is rates revenue received as a result of new rateable properties (growth in the number of households in the district) and new levels of service. For the 2018/19 year Council is forecasting the number of properties in the district to grow by 1.6 per cent. In addition to that Himatangi Beach, Tangimoana, Halcombe and Cheltenham are receiving a new level of service for stormwater. These residents will be rated for stormwater services for the first time, amounting to an additional 0.2 per cent of rates revenue.



What are CPI and LGCI?

The Council recognises rates need to remain affordable. In other industries the Consumer Price Index (CPI) is often used to determine affordability. However, the CPI is only marginally useful for Councils as they face a different mix of cost pressures compared to households. Council's costs pressures include roading and pipeline costs that are influenced by commodity prices and the availability of specialist people. This issue has been recognised by Local Government New Zealand who commissioned Business and Economic Research Limited (BERL) to develop a cost index. The cost index is called the Local Government Cost Index (LGCI).

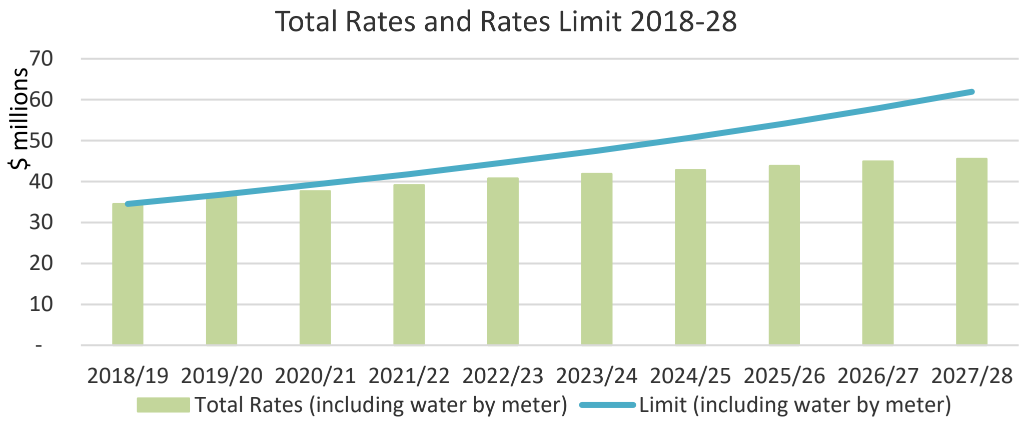
Council has decided to use the LGCI, which examines the main cost drivers for local government activity and measures their annual changes. This has created a local government cost index to parallel the household CPI. The LGCI is updated yearly and does not always grow faster than the CPI. In one out of the last seven years it has had a lower annual increase.

13. Rates limits

13.1.1. The graph below shows the rates revenue and rates limits for the next 10 years. Rates limits include the upper limit of rates increases plus rates generated from new levels of service, plus forecast growth in households, plus rates generated by water by meter. Water users include extraordinary users as defined in Council's Water Supply Bylaw 2015 and ratepayers who opt for volumetric charging.

13.1.2. Total rates commence at $34.3 million for the 2018/19 year and increases to $45.3 million over the next 10 years.

13.1.3. The growth in the rating base can also affect the rates limits. Additional properties result in more rates to cover the additional costs of providing services. Household growth forecasts are used as an estimate of the future growth in the number of properties.



13.1.4. The base rates level is the budgeted 2017/18 rates income being rates revenue (net of GST) of $32.3m, which includes rates penalties and water by meter.

What does Council consider when making financial management decisions?

The following principles assist Council to make prudent financial decisions.

14. Borrowing

14.1. **Governing Policy**

> For a copy of the Liability Management Policy go to www.mdc.govt.nz

14.1.1. Council utilises external borrowing to fund the acquisition of assets. Council's Liability Management Policy governs the borrowing mechanisms and current limits.

14.1.2. Internal borrowing is a mechanism available to manage both the level of funds available and external debt.

14.1.3. This facility enables an activity to borrow from the Council treasury function as opposed to borrowing externally, with an appropriate interest rate charged.

14.1.4. Utilising internal borrowing enables Council to manage its cash/investment portfolio to take advantage of the moving margins between interest rate receivable and interest rates payable. Internal borrowing is used when external borrowing costs are higher than allowed investment returns

14.2. **Security for Borrowing**

14.2.1. Many of Council's assets are not readily saleable so are less attractive as security items. Council will secure borrowings by a charge over our rating revenue either directly or through a debenture trust deed.

14.2.2. Council will not secure other assets unless circumstances show it to be appropriate (e.g. leased assets).

15. Investments

For a copy of the Investment Policy go to *www.mdc.govt.nz*

15.1. **Governing Policy**

15.1.1. Council is a risk-averse entity. Council will not undertake transactions where the level of return or benefit is dependent on an unacceptable level of risk. The Investment Policy expressly forbids any form of purely speculative activity.

15.1.2. Adequate liquid funds are to be kept to allow all expected payments to be made on the due date. Investment levels should ensure adequate funds are maintained so special funds and reserves are backed by suitable investments.

15.2. **Objectives for holding and managing investments:**

15.2.1. Equity investments

- Shares are held for strategic purposes that allow other activities within Council. Shares are not purchased solely for investment purposes
- While Council receives a dividend from these investments, the benefits of holding these shares are not always related to the dividend. Consequently, the target on these investments is a nil return
- The performance of these investments is reviewed regularly to ensure strategic and economic objectives are being met.

15.2.2. Treasury Investments

- Treasury investments include cash investments such as government stock, local government stock, bank bonds, debentures, and bank deposits.
- These are held:
    - To ensure Council's specific reserves (separate, special and loan redemption funds) are backed up by realisable cash assets except where Council approves otherwise

- To manage Council's cash position in a manner that maximises interest returns and minimises operational cash deficits and the associated costs incurred
- To maximise interest returns from surplus funds.

- For these investments, Council expects an average market return.

15.2.3. Community Loans

- The main objective of providing loans to community organisations is social, economic, cultural and environmental benefits provided to the District.
- While a market return is received from a number of these investments, others provide no return. Council individually approves this type of investment, with community benefits and the targeted return is addressed at that time. The targeted return on these investments (taken as a group) is nil.

16. Expenditure Classifications

16.1.1. To assist in identifying the reason for expenditure and finding the most appropriate funding source, Council has four expenditure classifications. Classification reflects good practice and new legislative requirements for financial reporting.

Type of Expenditure	Description
Operational expenditure	Operating expenditure is the day-to-day costs associated with providing a service. It includes expenditure not linked to an asset. It includes work required to keep an asset operating at the required level.
Capital – renewal expenditure	Renewal work is expenditure required to replace or refurbish an existing asset that will bring the asset back to the original service potential. For example, replacing an ageing water pipe with another pipe to provide the same water capacity and pressure.
Capital - new works to improve the service level	In meeting desired Council outcomes and working to achieve its vision, Council may invest in additional facilities and/or upgrade existing assets. There will be changing service level requirements because of new technology, changing legislative requirements and resource consent requirements.
Capital - new works to accommodate growth	Capital expenditure to accommodate growth in resident population and business activity.

17. Funding Mechanisms

17.1.1. Council has a number of funding mechanisms available. Council's Revenue and Financing Policy details the funding mechanisms used for each activity. In summary, how an activity is funded is determined by:

- contributions to community outcomes

- who causes the costs to be incurred
- who receives the benefit
- when the benefit is likely to be enjoyed

17.1.2. Funding mechanisms include, but are not limited to those detailed in the table below.

	Operating Expenditure	Renewal Expenditure	New Works	Growth Works
User pays fees and charges				
Subsidies and grants				
Interest and dividends				
Rates (including Targeted Rates)				
Capital contributions				
Development contributions				
Funding from prior or future years' funds				
Loan funding				

Key

primary source of funding if available

secondary source on a case-by-case basis

funding will be considered if necessary on a case-by-case basis

main source of revenue is from the New Zealand Transport Agency for roading

depreciation is charged through rates and is used to fund the renewal of assets

Targeted rates are used to fund activities where the benefit is enjoyed by a specific group in the community. Where targeted rates are used to fund an activity, any over or under spending in any one year is separately accounted for and not used to offset other activities.

For example the targeted rates collected to fund the activity e.g. solid waste can only be used for solid waste. These funds cannot be used to fund any other activity.

18. Depreciation

18.1.1. Most assets lose their value over time (in other words, they depreciate), and must be replaced once the end of their useful life is reached. Depreciation is a method of allocating the cost of an asset over its useful life. For example, as a bridge ages and comes to the end of its useful life it is worth less than when new.

18.1.2. Depreciation represents the charge to the current ratepayers for the use of the asset during each year. If operating costs, including depreciation, are not covered by operating revenues, it can be argued the current users of the service are not paying for the benefits they are receiving. Depreciation will be charged on all assets by allocating the cost/or valuation of the asset over the estimated remaining useful life of the asset.

18.1.3. Assets are regularly revalued (operational assets at least every three years and infrastructural assets annually) with the depreciation expense based on the revalued amount. This ensures the amount of depreciation reflects current market values.

18.1.4. As depreciation is a charge for the use of the asset by current users, Council has elected not to create individual depreciation reserves.

18.1.5. There are some assets depreciated in the financial statements, but their depreciation is not included in the calculation of rates. This includes local halls (except for Te Kawau and Feilding Civic Centre) and approximately 50 per cent of parks and reserves assets. If these assets were replaced, Council would work with the relevant communities to determine the most appropriate funding mechanism.

18.1.6. The proportion of depreciation on roading assets funded by the New Zealand Transport Agency (NZTA) subsidy is also removed from the rating calculation. Currently Council receives 53 per cent of the maintenance and renewal expenses on the majority of roading assets. Including this in our rating calculation would be funding the expense twice.

19.Significant land use changes

19.1.1. Council is currently undertaking a review of the Manawatū District Plan. One of the initial parts of the review has involved consideration of urban growth requirements for Feilding. A total of four residential growth precincts and one industrial growth precinct were identified in the Feilding Urban Growth Framework Plan, which Council adopted in 2013. To date residential growth precincts One, Two and Three and the industrial growth precinct (Precinct 5) from the 2013 Framework Plan have been through the public plan change process under the Resource Management Act 1991. The new residential areas are located to the west of Feilding and detailed structure plans have been prepared to guide land development. The combined total household yield of the three residential precincts is 1,860 new residential lots, at minimum lot sizes between 800m2 and 2000m2 Some areas have been identified as deferred residential zoning, meaning that these areas will remain rural and be rezoned to full residential, at a later date as demand requires. In 2017 the industrial landbank at Kawakawa Road was extended by a further 16ha to meet long term demand for industrial land in Feilding. A Structure Plan has been developed for this land (Kawakawa Industrial Park) and has been incorporated with the District Plan.

19.1.2. Research and analysis is being undertaken on the residential growth area which is located around Pharazyn Street/Reids Line (Precinct Four). This future residential area will provide a total yield of 1,778 residential lots and an additional 29ha of open space for future amenity and recreational land use. A Plan Change to rezone this land from rural to residential is being formulated and is scheduled to be publicly notified in 2018.

20. Maintaining Levels of Service

20.1.1. Throughout the life of the Long Term Plan Council expects to maintain existing levels of service and meet additional demand as a result of growth. Council considers it has adequate planned income to fund these expected levels of service. There are some significant factors that may affect our ability to maintain the existing levels of service including:

- Increasing standards for drinking water, wastewater and stormwater compliance (set by central government and Horizons Regional Council)
- Legislation changes requiring new levels of service
- Costs increasing faster than CPI for a number of our key activities due to rising commodity prices
- Compliance costs in the environmental and regulatory group of activities (set by central government)
- Retaining and attracting skilled staff
- Continuing to deliver savings through efficiencies, partnerships and collaboration.

20.1.2. Planned capital expenditure is provided on Page 8.