FINANCIAL STRATEGY

Council is required to adopt a financial strategy as part of its long-term planning. The purpose of the financial strategy is to:

- Facilitate prudent financial management by Council, by providing a guide against which to consider proposals for funding and expenditure.
- Provide a context for consulting on Council's proposals for funding and expenditure, by making their overall effects on services, rates, debt and investments transparent.

One of the purposes of the long-term planning and financial policy development is to provide "predictability and certainty about funding sources and levels of funding".

Council is required to set its operating revenues to cover its projected operating costs unless it is prudent to do otherwise. The test of whether operating revenues are set to cover operating costs is whether the Statement of Comprehensive Revenue and Expense has a balance before Asset Revaluations of greater than zero. The financial projections show that Council has met this requirement.

Council is also required to manage its revenues, expenses, assets, liabilities, investments and general dealings prudently and in a manner that promotes the current and future interests of our community. This requires a wider view, and a longer term view of the costs and services Council provides.

In developing this plan, Council has considered the following;

- The estimated expenses of maintaining levels of service contained within the 10-year plan, including the estimated expenses associated with service capacity and the integrity of assets throughout the useful life.
- The estimated revenue available to fund the expenses outlined above.
- A fair allocation of responsibility for funding the maintenance of assets throughout the useful life.

The objective of the financial strategy is to ensure that debt, revenue and expenditure (Operating and Capital) are managed in a way that ensures service levels are able to be maintained in a financially sustainable way.

Significant factors impacting on the Financial Strategy

Population

Population change and the number of rateable properties are not significant factors for the financial strategy. Population and the number of properties is expected to have a low level of increase at 0.3% per annum. Council has noticed the upturn in Taranaki's regional growth which appears to be flowing through most of the provincial areas.

Current assets have the capacity to cope with the moderate growth being experienced. It would take consistent growth of 2-3% for a considerable number of years before this would change. If it were to change the Council and the community would have enough time to develop policies and a new financial strategy to cope with that growth.

Financial Overview

- Council manages an asset base of $334 million; these assets are mainly essential network assets of Roads, Water supplies, Sewage disposal systems and Stormwater networks. The holding value of those assets is $288.8 million. These assets have very long lives of up to 120 years, and the replacement value of the infrastructure assets is $346.1 million.
- Council does not face major challenges with infrastructure maintenance as the major services are less than half way through their lives. However, a number of transport bridges are nearing the end of their useful lives and will require replacement over the next 30 years. As an NZTA subsidised activity this will reduce the impact of the cost of renewal.
- Debt levels are moderate for a Council of our size.
- Rates levels are comparable to similar sized districts with comparable services.
- The major challenge for financial sustainability is the level of rates increases required over the 10 years of the plan and the variability of the increases between activities. This variability means that for many years of the plan the different ratepaying groups will see rates rises which vary significantly from the level of the total rates rise.
- Capital expenditure over the period of the plan is $87.1 million. This expenditure includes a major item for the pool complex. At $15m this is a major component of the 2020/21 financial year spike in capital expenditure.
- To fund the capital expenditure Council's net debt will rise by $19 million from the opening year, peaking in Year 7 (2024/25) of the plan, with the debt reducing in the last 3 years.
- Total rates need to increase by 4.75% in 2018/19, 4.69% in 2019/20, by 5.72% in 2020/21 and by between 1.79% and 7.62% in the remaining years of the plan.

The costs of providing for growth

As stated previously growth is not a significant factor for Stratford District. Growth is projected to be 0.3% per annum and existing infrastructure has the capacity to deal with this level of increase within the planning horizon of the Council. The Long Term Plan contains only one item to cope with Growth. This item is the residential subdivision Council is planning to complete in 2018/19.

Council does have provisions in the District Plan if there is any infrastructure required to deal with a new sub-division. Those provisions allow Council to obtain a financial contribution from the developer to contribute to the costs of any new assets required by Council. In the meantime, there is sufficient headroom in council's borrowing capacity to bridge the gap in timing between infrastructure costs being incurred and financial contributions being collected.

Looking after existing Infrastructure

A priority for Council is to maintain the existing levels of service. These levels of service are outlined in the Long Term Plan activity statements and in the Asset Management Plans of Council. Many of the levels of service are dependent on the on-going maintenance and renewal of network assets. To manage these assets Council maintains Asset Management Plans and also a 30 Year Infrastructure Strategy. These documents are continually reviewed and are updated every three years.

To continue to deliver the levels of service for an Activity council must ensure that it has sufficient funding to do the maintenance and asset replacement outlined with in the plans. The 10-year plan includes provision for renewal capital works of $4,733,000 in 2018/19 and the range over the remaining 9 years is between $4,310,000 to $4,929,000.

The renewal requirement is taken from the Asset Management Plans of the activities and indicates when an asset reaches the end of an average economic useful life for that type of asset. With the average life of the assets being around 80 years, it is likely that each asset will not exactly match the expected average life. Some assets will last longer and some will not last as long. The replacement requirement is relatively even and variations in timing for different assets should be able to be managed to closely match the funding provisions made for renewals. However, if that is not the case, Council is maintaining a low level of debt relative to many Councils. This will enable short to medium term debt to be drawn down if unexpected urgent replacements are necessary. Before drawing down debt Council will seek to prioritise other Capital work, renewal or level of service, to keep costs and debt down.

Other significant factors affecting Council's ability to maintain levels of service and meet additional demands

Council has made a number of forecasting assumptions in preparing the 10 year plan. These are contained in the Financial Statements section of the plan.

These assumptions range from global issues such as the worldwide economic position and climate change; to assumptions about natural disasters; the level of funding grants from the New Zealand Transport Agency; from inflation and interest rates to the conditions for resource consents on Council services (stormwater and sewage discharges and water take).

Although Council believes it has made prudent assumptions in each case, there is a high level of uncertainty in some assumptions. In most cases Council has some flexibility to cope with changing circumstances. Depending on the issue, Council's response could involve reducing maintenance for a short period, postponing scheduled capital renewals or levels of service capital items, or using "headroom" in the Council's borrowing capacity.

Equity Between Generations

Council will manage its finances in a way that promotes the interests of current and future residents and ratepayers of the community. This means trying to ensure that the current ratepayers pay a fair share of the costs of district services and assets, and that future ratepayers are given a sound foundation to be able to address future challenges and grasp opportunities.

Intergenerational equity is promoted through a number of mechanisms. The charge for depreciation means that existing users are meeting the cost of the value of the asset that is being consumed by them. Borrowing for part of the capital work programme for growth and improved levels of service means that future beneficiaries are contributing to the cost of acquiring the new assets.

Primarily intergenerational equity is served by maintaining consistency in the funding levels for rates, ensuring debt does not increase to a level which may place a greater financial burden on future ratepayers and ensuring that assets and levels of service are appropriately maintained.

Levels of Service, priorities and funding levels

As part of each Long Term Plan (LTP) Council considers the levels of service for its activities. If there is a change in the level of service Council raises that in the long term plan. As an example this Long Term Plan contains a project for the rebuilding/ redevelopment of the pool complex plus a range of other issues. When considering the levels of service, Council reflects on the level of asset needed to continue to deliver that service standard.

Asset Management Plans are maintained for all major asset intensive services. These plans contain information on the life and age of the asset, and on the condition of the assets. To keep costs contained Council does not maintain detailed information on each asset's condition. Rather it takes a risk based approach to monitoring the condition of assets. Where assets have low risk because they are in the first half of their life, condition monitoring is low. If the consequences of running an asset through to failure are high, asset management plans and systems hold more information on condition.

In deciding what level of capital expenditure is sustainable Council considers the following:

- What are the consequences of not doing certain projects.
- What other options are available to deliver the service.
- What is a reasonable level of public debt.
- What are the rates and revenue impacts of the capital work.

Where the need for capital spend is high Council must trade off the level of borrowing and the level of increases that can be afforded by the community. In some cases the impact of not undertaking certain work is such that Council will have rates increases higher than it would like. In past years Council has had a very clear message from the ratepayers that vital services like water, wastewater, roads and stormwater need to be well maintained.

In other periods the capital spend may be lower and in those times Council may be able reduce debt to a lower level or reduce the level of its rates increases. The choice between those will be impacted by the level of debt, and also the consideration of the future capital spending requirements. The goal for Council in its financial strategy is to keep rates rises predictable and sustainable, to ensure there are sufficient funds available now and in the future to keep debt at reasonable levels and to maintain the levels of service to the community. Current generations pay a fair share and don't burden future ratepayers but also that future ratepayers are not subsidised by the current generation.

Council will set fees, charges and rates at levels that balance Council's budget. Rates are set each year at a level sufficient to fund all operating expenses including funded depreciation. Council receives revenue from NZTA for subsidy of roading maintenance. The renewal of assets is funded from the combination of rates revenue and NZTA subsidy. Council does not smooth the capital work programme in its plans but expects that the level of work is reasonably consistent. Funding of the highs and lows in the programme will be through debt. Rates are set to ensure that in the medium term debt is maintained at less than total annual revenue. This provides the capacity to level revenue requirements and have a "buffer" to provide options in unexpected events.

Funding and Financial Policies

Grants, subsidies and capital contributions will be actively sought to help fund the capital work programme of the district.

Growth expenditure is not a major feature of the Council's capital work programme however the Council has invested in a subdivision to facilitate the growth that is occurring. That subdivision has some cost in the first year of the plan and is funded from short term borrowing, which will be repaid from the proceeds from the sale of sections in the subdivision.

Council will borrow for capital work in the Long Term Plan period. That borrowing is to fund the cost of levels of service improvement. Council may borrow for renewals work in individual years due to the variations in the level of that expenditure. Council's revenue requirements are set to ensure that over the period of the plan, revenue funds renewals as well as new levels of service capital spending via debt servicing.

Council's treasury function allocates debt and the costs of servicing debt to the activities funded from borrowing. Where a targeted rate is set for a service, the funds from that targeted rate will only be used for that purpose. Surplus funds in any year will be used to repay loans, if possible, or be separately invested.

Rates are set so that as much as possible the beneficiary pays. Council sets a number of targeted rates for particular services. If a property is not able to use a Council service which has a targeted rate that property does not pay the rate. Examples are water supply, wastewater and refuse collection. Those rates are only paid by properties that are serviced by those activities.

What this means for 2018 to 2028

Levels of Service

Council is planning to maintain the current levels of service and to improve them in some instances, such as the pool complex, improved environmental standards for sewage disposal and improving storm water drainage. Council believes that subject to the significant forecasting assumptions, there will be sufficient revenue to fund the levels of service outlined, including debt servicing costs required to fund any level of service improvements. The Long Term Plan contains more information on levels of service for each activity.

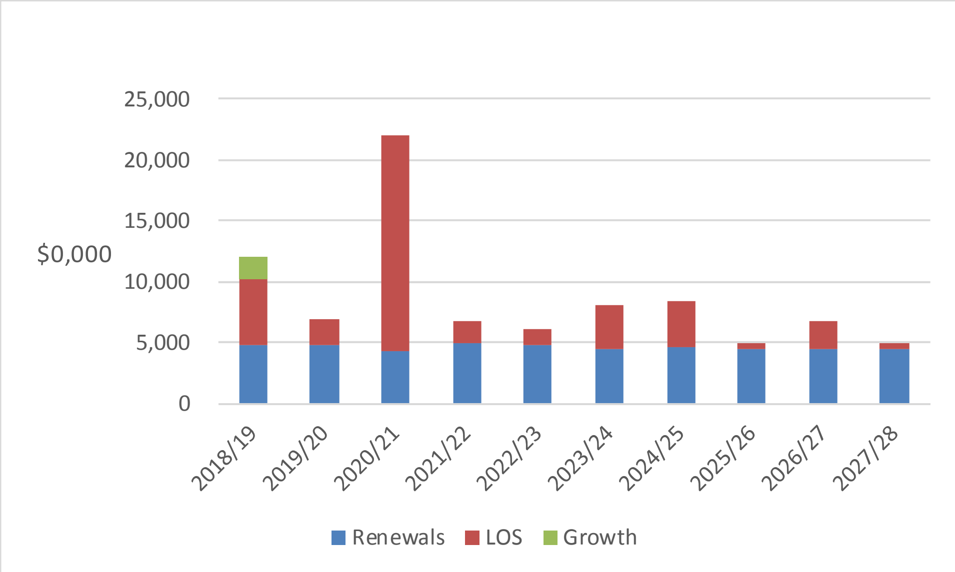
Asset Condition

Council manages an asset base of $334 million; these assets are mainly essential network assets of roads, water supplies, sewage disposal systems and storm water networks. The holding value of these assets is $288.8 million. These assets have very long lives of up to 120 years, and have an estimated replacement value of $346.1 million. While this assessment of value indicates that the assets are on average only 17% through their expected economic life, a number of high value critical infrastructure assets, such as a large number of bridges are nearing the end of their life.

The balance of assets are in reasonable condition and council has an ongoing renewal programme to address asset replacements.

Level of capital

Council has moderate growth and with the exception of 2018/19 does not have any expenditure classified as being to meet increased demand for services. The graph below shows the profile of planned capital work for the period of the plan.



The major point that stands out is 2020/21 which is the year the pool complex is expected to be improved.

The capital work programme is determined as explained above. The Infrastructure Strategy is based on the estimated useful life of assets and helps to predict when the asset will need to be replaced. Those predictions are based on assumed average lives. Some assets will not last as long, and some will last longer. Council staff only replace the asset when it is at the end of its life based on the condition of the asset rather than the assumed life.

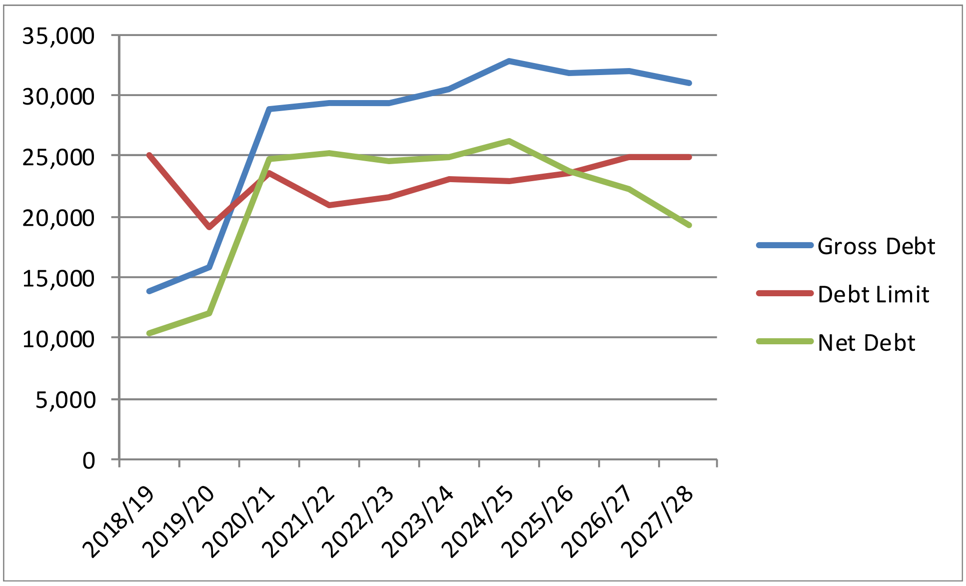
If the capital work programme is reduced, then levels of service will reduce over time, and the costs to catch up will increase with higher risk of asset failure. The capital work programmes are set at the level Council believes is prudent to maintain levels of service and to be affordable to the community for rates increases while keeping debt at sustainable levels.

Borrowing

The level of borrowing is directly related to the capital programme and the level of rates. A higher capital programme will either require more borrowing or higher rates.

Borrowing flows directly through to rates requirements by increasing the level of debt, which increases the cost of interest. An increase in debt of about $250,000 per annum aligns with expected inflation, and so should not add to the affordability of services. Increases above this level add to rates directly in the ratio that every $1 million of increased borrowing adds around 0.4% to the rates required.

Borrowing is a method of achieving fairness between generations but it also adds to the rates rises of the current generation within a few years. The future holds uncertainty, and assumptions made in the Long Term Plan mean that potential major events, which cannot be predicted, are not included in the costs. Maintaining "headroom" in the level of debt means Council is able to respond if these things occur, and take time to address the on-going costs if the capital spending requirements are higher.



The graph above shows the planned levels for total debt and net debt for the period of the Long Term Plan. Both net debt ($10 million) and gross debt ($13 million) are proposed to increase at the start of Long Term Plan, with net as well as gross debt peaking in year 7 (2024/25) - net debt at $26 million and gross debt at $33 million. By year 10 (2027/28) net debt reduces to $19 million due to increased cash holdings while gross debt remains reasonably stable for the remainder of the Long Term Plan.

The graph shows Council's debt limit as outlined below. From year 2020/21 onwards the gross debt is over the limit set in this strategy. Net debt is also over the limit from years 2020/21 to 2025/26 (years 3-8 of the Long Term Plan). This breach from 2020/21 is as a result of the swimming pool development being upgraded from a $6.0 million project, as per the Consultation Document, to a $15.0 million project following deliberations by Council as a result of public submissions. Council has chosen net debt as the suitable measure rather than total debt, as it better reflects the true Council position in regards to borrowing and cash holdings.

Council's limit for debt is:

> *Net debt levels will be below annual total revenue. Net debt is total borrowings minus cash holdings.*

This measure is consistent with the 2015-25 Long Term Plan. The other measures in that plan have not been carried forward into this plan as we believe they do not add any substance to the prudence of the financial strategy. They make the management of debt more complex, and that is not required for an organisation the size of Council.

Rates

Rates cover the net operating costs of Council, after deducting other revenue, and part of the cost of replacing and building new assets. The portion of capital not recovered from rates flows to debt or must be funded from assets sales. Council has budgeted for some asset sales, but on-going asset sales is not a realistic option to reduce rates or debt, as it would reduce the levels of service.

The rates level is also influenced by the level of user charges and other revenue. A large part of the other revenue is a subsidy from New Zealand Transport Agency. The council does what it can to maximise the level of subsidy received but NZTA does have maximum allowances for a Local Authority, and it needs to do this to be fair to all local authorities. Then there are user charges; Council tries to maximise the level of user charges it can recover. However, the services provided by Council are services which in many cases are provided because it is not possible for a private provider to supply them as user charges do not recover the cost, or there is no practical way to charge effectively.

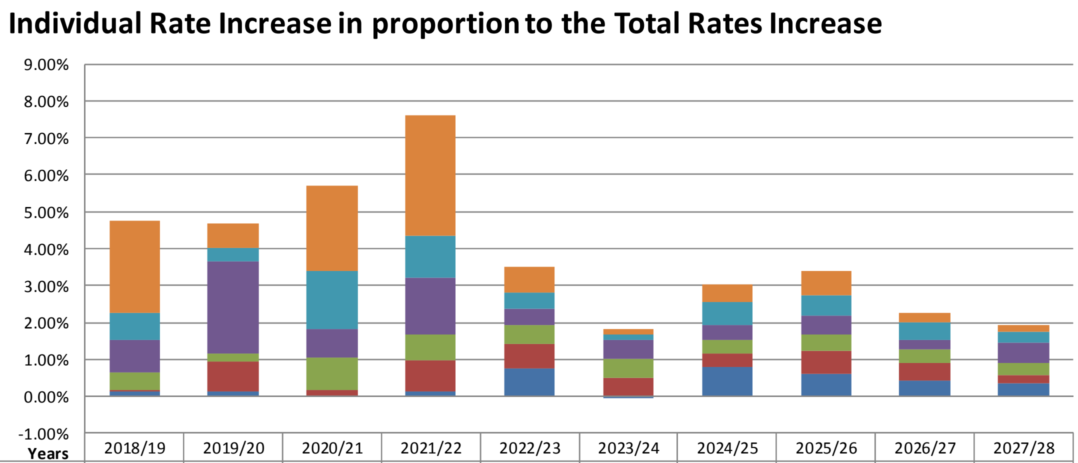
Council sets rates on the following basis:

- District wide rates on all properties:
  - General Rates (including a Uniform Annual General Charge)
  - Roading Rates (for the costs of the roading activity)
- Targeted rate on serviced or serviceable properties
  - Wastewater Disposal Rates (for sewage disposal to serviced properties)
  - Solid Waste Collection Rates (for refuse collection from serviced properties)
  - Water Supply Rates (for the supply of water to serviced properties)

Targeted rates are not paid by all properties. If a property is not able to be delivered that service then the rate is not charged for that service.

The general rate covers all services that are not recovered by a targeted rate, and targeted rates are set to recover the on-going sustainable delivery of the service.

The table below identifies the expected rates increases over the 10 years of the Long Term Plan. It shows projected rates rises over the period of the plan. As can be seen the level of rates increase required for the next 3 years is between 4-5%.



Years	2018/19	2019/20	2020/21	2021/22	2022/23	2023/24	2024/25	2025/26	2026/27	2027/28
General Rates Ave % Increase	2.48%	0.67%	2.32%	3.26%	0.70%	0.15%	0.48%	0.65%	0.25%	0.20%
Roading Rate % Increase	0.73%	0.35%	1.58%	1.17%	0.45%	0.15%	0.63%	0.55%	0.47%	0.27%
Wastewater % Increase	0.88%	2.51%	0.77%	1.53%	0.44%	0.52%	0.40%	0.51%	0.26%	0.55%
Waste Management % Increase	0.48%	0.20%	0.88%	0.71%	0.53%	0.52%	0.38%	0.46%	0.38%	0.34%
Water Rates % Increase	0.03%	0.81%	0.15%	0.83%	0.63%	0.49%	0.37%	0.60%	0.47%	0.23%
UAGC '% Increase	0.15%	0.14%	0.02%	0.13%	0.77%	-0.03%	0.78%	0.62%	0.43%	0.35%

The individual rates rises for a property will depend on the mix of Council services they are rated for. The table below shows the expected rates rise for individual rates within the plan.

Rates Increases	**2018/19**	**2019/20**	**2020/21**	**2021/22**	**2022/23**	**2023/24**	**2024/25**	**2025/26**	**2026/27**	**2027/28**
Average % Total Rate Increase	4.75%	4.69%	5.72%	7.62%	3.52%	1.79%	3.04%	3.40%	2.25%	1.94%
UAGC % Increase	0.73%	1.18%	0.07%	0.63%	4.42%	-0.30%	4.35%	3.56%	2.60%	2.40%
Water Rates % Increase	0.15%	6.56%	0.73%	4.06%	3.61%	4.43%	2.04%	3.41%	2.87%	1.56%
Solid Waste % Increase	2.34%	1.61%	4.26%	3.47%	3.03%	4.68%	2.09%	2.63%	2.29%	2.37%
Wastewater % Increase	4.29%	20.39%	3.72%	7.46%	2.51%	4.67%	2.24%	2.92%	1.58%	3.81%
Roading Rate % Increase	3.54%	2.84%	7.61%	5.70%	2.55%	1.31%	3.48%	3.13%	2.86%	1.86%
General Rates Average % Increase	12.08%	5.45%	11.17%	15.92%	3.99%	1.36%	2.68%	3.73%	1.52%	1.41%

As can be seen, the increases in rates are both different for each rates type and also different for each year. In addition to the changes in individual rates the next rates bill will be affected by the latest revaluations for properties.

The revaluation doesn't increase the amount of money Council gets from rates as the rate charged is set by Council revenue requirements rather than the increase in the rating base. However, the changes to the rating base affect who pays what amount.

The financial strategy does not address changes in the Rates Valuations. It addresses changes in revenue requirements for services. However outside a rates revaluation year Council will be seeking ways to keep the level of rates a particular ratepayer pays as close to the average as possible. This is to address the issue of rates certainty and predictability.

Council currently sets rates based on a formula which sets an annual rates requirement for each service. Council is able to set rates on a basis which is more even across the next three years. This will mean Council could have a predictable level of rates rise for the next three years.

Council has a preference for having predictable increases in rates as the variability means that it is hard for people to budget and also makes it difficult for people to understand what is happening to Councils costs. This is because they, obviously, consider that there is a direct relationship between the level of their rates and the costs of Council.

Council has exceeded the rates increase limit in years 1 – 4 of the Long Term Plan. In 2018/19 Council is borrowing $600,000 towards tourism infrastructure and $200,000 for sports field drainage. These two items are included in the Long Term Plan as a result of public submissions. Also in year 3 (2020/21) as a result of submissions, the swimming pool upgrade was increased from a $6 million project to a $15 million project. This also affected the 2021/22 year.

Why do rates rise by more than inflation

- Revenue from NZTA is not increasing at the rate of Inflation being 13% higher in year 10 than in year 1.
- Revenue from user charges is not rising at the rate of inflation being 15% higher in year 10 compared to year 1.
- Depreciation on assets is rising faster than inflation. The calculated increase in depreciation is 48% higher in year 10 than in year 1.

Most of these factors are outside the control of Council, However user fees could be increased to keep pace with inflation. Council has spent considerable time considering user charges. This will continue to be a focus for future years.

Financial Strategy measures for rates:

- To keep the increase in the total rates collected below 4.15% plus growth in the rating base in any year. (Growth in the rating base is assumed to be 0.3% per annum).
- To keep the total amount of rates collected in any year to be no higher than the previous year plus 4.15% plus growth.

These measures are slightly different to the previous measures, but have the same intention. They have been reworded to make it easier for a reader to understand the intention. The measure in relation to the ratio of rates to the Capital value of the district has been removed as it adds no substantial value to the strategy.

Council is also aiming to keep the annual rates rise at a predictable level for each year so that a ratepayer has certainty, that in any year outside a revaluation year that their rates will not rise by more than 4.15%, unless that ratepayer has done something to their property that increases the rateable value of the property. Council is investigating methods to achieve this.

Charging for the Uniform Annual General Charge

Currently Council sets the Uniform Annual General Charge (UAGC) to cover the maximum amount that legislation allows, that is 30% of rates. The charge will now be set on the basis of the number of separately used or inhabited parts of a property (SUIPS – refer to the Funding Impact Statement for definition page 106), rather than on the basis of the number of properties.

The difference this makes is there are more separately used or inhabited parts of property than there are properties. That means the UAGC on each SUIP is lower than the method of UAGC per property. However it does mean that some properties may pay more than one charge. This occurs if the property has two or more "used or inhabited parts". This applies to all types of property whether they are commercial, residential or rural.

It is expected that the Uniform Annual General Charge will reduce by about 5 - 10% and the number of charges would increase by 5- 10%.

A change to "separately used or inhabited parts" of a property does not affect the amount of money Council collects from the UAGC as the UAGC is set as follows:

Amount of rates required / Number of charges assessed.

So if there are more charges assessed the value per charge is reduced.

Policy on giving security for borrowing

Council's ability to borrow is directly related to rates. Council has granted security over its rates and rates revenue under the Debenture Trust Deed.

Council also has the ability to borrow from the Local Government Funding Agency (LGFA). The accession to LGFA was completed in May 2018.

Borrowings from the Local Government Funding Agency will be under Debenture Trust Deed security documents and a professional trustee will be appointed. The security for the loans will be a charge over rates.

Council may also choose to secure certain borrowings by a charge over assets. This will only occur when;

- there is a direct relationship between the debt and the asset purchase/construction and
- Council considers a pledge of the physical assets to be a more appropriate mechanism than the general charge over rates.

Any pledging of physical assets must meet the terms and conditions of the debenture trust deed and the Local Government Act 2002 (which prevents water service assets from being used as security for any purpose).

Financial Investments and Equity Securities

The Council has no plans to undertake new investments in long-term financial instruments or equity securities. However Council does have investments in property including a farm and has cash available for investment from time to time.

Council maintains financial investments primarily to allow:

- investment of surplus cash, and
- investment of amounts allocated to special funds and trust funds.

Council also holds shares in cooperative companies for the farm operation to support the activity which requires the holding of those shares.

Council's objective in holding investment is to achieve the strategic objectives and levels of service identified in the long term plans.

It is not the role of Council to be an investor. When it does invest for the above purposes its policy is that those investments do not have a long-term impact on the rates required from the community.

Investment and financial instruments will be with entities that have strong credit ratings being equivalent to Standard and Poor's "A1" for short-term and "A" for long term. An exception to this would be for investments in local government or government bonds.