
Financial Strategy

Summary of key information

Rates Increase Limit:	< 6%
Borrowing Limit:	Net Debt < 130% of Annual Operating Revenue
Growth assumption:	0.5% annually
Inflation assumption:	Average of 2.4% annually, varies across categories of expenditure
Waka Kotahi Subsidy:	61% over the 10 years of the Long Term Plan
Effects from Covid-19:	Nil

Introduction

The purpose of the financial strategy is to:

- Provide guidance for elected members and staff when considering proposals for funding and expenditure.
- Make Council funding and expenditure decisions and their overall effects on service levels, rates, debt and investments transparent to ratepayers.
- Ensure that debt, revenue and expenditure (Operating and Capital) are managed in a way that maintains service levels in a financially sustainable way.

This is a ten year Strategy, but will be reviewed 3 yearly in line with the review of the Long Term Plan ("LTP"). Compared to the Financial Strategy adopted in 2018, this Strategy is based on a higher population growth forecast (LTP 2018-28: 0.3%), significant service level increases, and a higher rates increase limit (LTP 2018-28: 4.45%). The Debt Limit is to increase from 100% to acknowledge that increased service levels desired by the community.

Guiding vision and desired community outcomes

Council's vision is to be "A vibrant, resilient and connected community – in the heart of Taranaki".

The Community Outcomes of a Vibrant Community, a Sustainable Environment, Connected Communities, and an Enabling Economy (based on the local government four wellbeings), guide the services Council provides and the level of service provided by each Council Activity.

Elected members have acknowledged that there is more work to do to achieve these Community Outcomes, above what would be considered business as usual. Capital expenditure on increasing the levels of service provided to the community is expected to be \$57,870,182 over the next ten years, mostly loan funded. This is a major reason why the rates increase limit of 6% has been set higher than the previous rates increase limit – to enable Council to deliver on the increased levels of service within the Long Term Plan.

Prudence

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 (Net Surplus figure below) of greater than zero. The financial projections show that Council has met this requirement.

The net surplus includes capital grant funding, e.g Provincial Growth Funding and Waka Kotahi funding for capital expenditure on roading – particularly high in year 2021/22, 2025/26 and 2026/27, and also includes the sale of assets in 2023/24.

As stated in the Revenue and Financing Policy “Prior to determining the amount to be funded by rates, Council identified and exhausted all other funding sources available to each Activity.” These include Fees and Charges, Grants and Subsidies, Borrowings, Asset Sales Proceeds, Financial Contributions, and Interest and Dividends from Investments. Fees and charges take into account the principles of user benefits/pays and exacerbator pays, while also recognising that many of the services that Council delivers provide wellbeing outcomes to the community and therefore affordability is also taken into account.

Long Term Plan forecast of Net Surplus

in \$000's	2021/ 2022	2022/ 2023	2023/ 2024	2024/ 2025	2025/ 2026	2026/ 2027	2027/ 2028	2028/ 2029	2029/ 2030	2030/ 2031
Total operating revenue	29,390	24,088	27,454	25,061	29,646	29,846	27,889	28,628	29,919	30,998
Total operating expense	19,985	20,957	23,420	23,190	23,797	24,072	25,090	25,889	26,412	27,832
Net surplus	9,404	3,131	4,034	1,872	5,849	5,774	2,800	2,739	3,507	3,167



Significant factors underpinning the financial strategy

Service Levels

The capital expenditure forecasts in the Long Term Plan provide for increased service levels – notably the new Swimming Pool, Economic Development initiatives, Waste Minimisation/Environmental initiatives, a new Water Supply Trunk Main, the rollout of universal Water Metering, and Roding initiatives with the proposed new Brecon Road Bridge and a significant upgrade to Whangamomona Road. There is no significant cost reductions forecast that would result in a decrease in service levels provided.

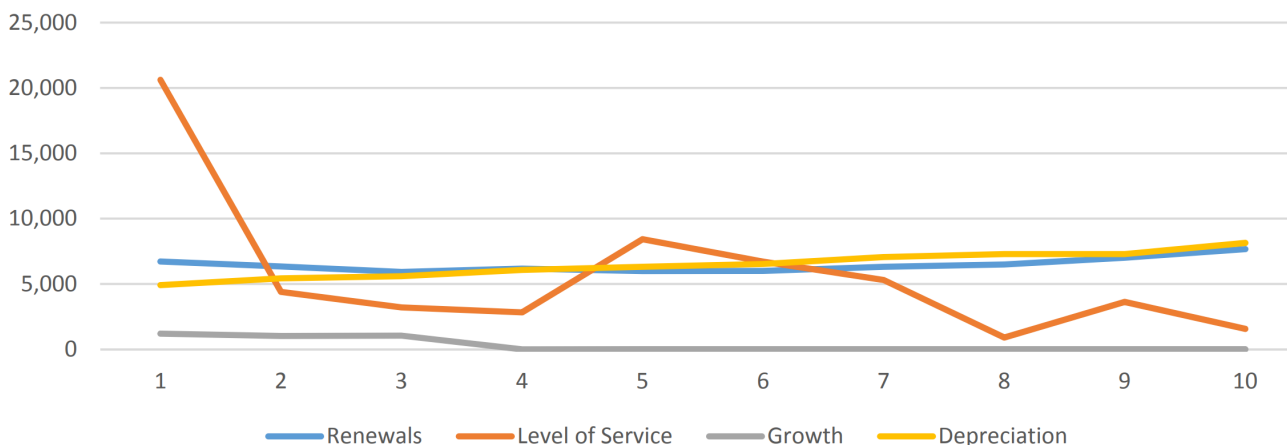
Grants and subsidies will be actively sought to help fund the capital work programme. Recently, the Council has been successful in confirming Government funding for the new Swimming Pool project of \$8,000,000, and the Water Supply second Trunkmain of \$2,390,000.

The majority of the remainder of capital expenditure that relates to increasing service levels shall be loan-funded (some additional grant-funding anticipated). This ensures that the cost of assets providing long term benefits, is spread over the expected life of the asset – aligning with the principle of inter-generational equity.

To continue to deliver the levels of service for an Activity council must ensure that it has made sufficient provision for funding to do the maintenance and asset replacement outlined within its Asset Management Plans. The LTP includes provision for renewal capital works of \$6,721,100 in 2021/22, and \$57,898,957 over the remaining 9 years.

Note: most assets that have been grant funded initially will be fully depreciated in the expectation that Council will fund the replacement of the asset from the appropriate reserve, except for roading where it is expected that the roading subsidy will continue to contribute towards the replacement of roading assets.

Capital Expenditure Categories and Depreciation Expense (\$'000's)



Maintaining Levels of Service

As the graph indicates above, depreciation over the years is at a similar level to renewals, demonstrating Council's commitment to maintain assets at a rate similar to the rate at which they are failing.

Generally, the Council takes a risk-based approach to monitoring the condition of assets and conducts condition assessments of its critical 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, the Council, through its AMP and systems hold more information on the asset condition. The Council has assessed the risk of sudden asset failure as minor and therefore has not budgeted for the replacement of assets before their useful life. To clarify, Council's strategy is to replace non-critical assets when they fail. This is a common strategy with many Councils, and Stratford has a good track record of fixing failures in a timely manner.

Council insures all infrastructure assets, except Rooding assets, at full reinstatement cost, ensuring that following a risk event, the Council is effectively positioned to return in a timely manner to its preevent state.

District Growth

Population and the number of rateable properties is expected to increase by 0.5% per annum.

Council has noticed the upturn in Taranaki's regional growth which appears to be flowing through most of the provincial areas. In recent years there has been an increase in rating units of around 1%. However, it is not expected that this level of increase will be sustainable over the next ten years and so for the purposes of determining rating unit growth, 0.5% growth has been used as a conservative measure.

The District Plan will be reviewed over the next few years and will take into account any potential change in use of land as a result of any higher than anticipated population growth. There is currently provision in the District Plan if new infrastructure is required to respond to new development. Those provisions allow Council to obtain financial contributions from developers to any response to the development required by Council.

Current assets have the capacity to cope with the moderate growth experienced and forecast. It would take consistent growth of 1-3% for a considerable number of years before this would change.

If growth was to occur at a higher than anticipated level, the Council and the community would have enough time to develop policies and a new financial strategy to cope with that growth. New debt would be the likely

source of funding for any new infrastructure required, after exhausting funding from financial contributions.

In 2019 – 2020, the Council developed a 33 section urban subdivision, with all sections sold within a year. Due to the high demand, Council plans to invest a further \$3,273,575 in a new subdivision, to be self-funding at the time the sections fully sold, and loan funded in the short term.

Forecasting Assumptions

Council has made a number of forecasting assumptions in preparing the 10 year plan. These are outlined in the Long Term Plan under Significant Forecasting Assumptions.

The Council also undertook a review of the current and forecast environment including the demographics, legislative reform, inflation, employment, and facilities available and in high demand in the district – including health and medical, educational and recreational facilities.

In the environmental review Council recognised that there may be a reduced ability to deliver on the planned capital expenditure program. To reduce this risk, additional staffing resource has been added in the project management area to provide greater assurance that projects are delivered on time, unless out of Council's control.

Refer to the Infrastructure Strategy for key forecasting assumptions with regards to infrastructure assets.

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 Council's borrowing capacity.

Current position (2021) and end position (2031)

Treasury Position

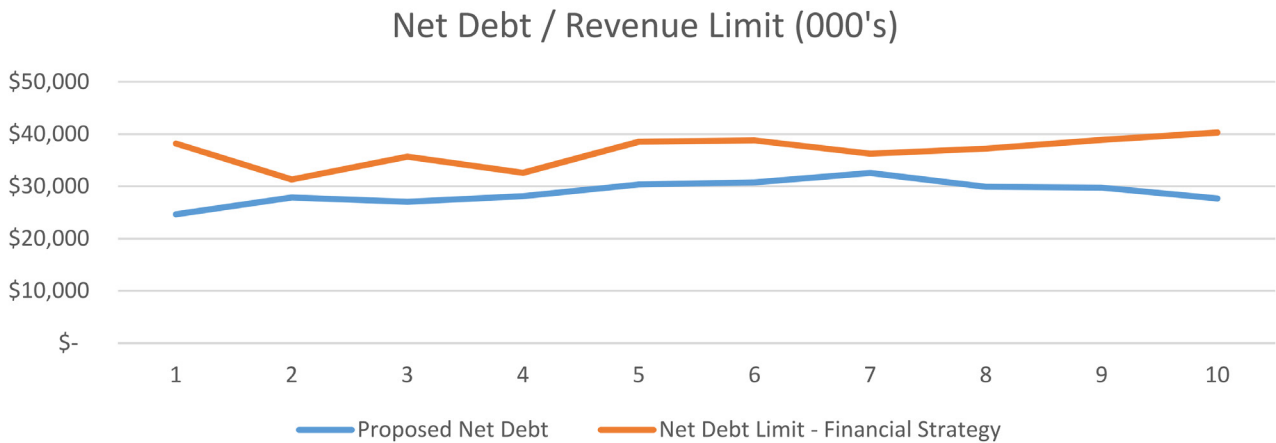
Opening net debt is expected to be \$11,500,000. This is expected to peak to \$32,554,032 by 2028, and gradually reduce down to \$27,667,632 by 2031. Loan funded capital expenditure proposed over the Long Term Plan is \$42,387,122. The Net Debt limit has been set at 130% of annual operating revenue to encourage prudent decision making when considering proposals for funding investment in level of service capital expenditure. Borrowing flows directly through to the rates requirement by increasing the cost of interest.

In terms of long term liquidity, and access to capital funding, the Council is not expected to breach its LGFA covenants over the next ten years, and based on the proposed net debt forecast, Council may access an additional \$14,294,000 through the LGFA before breaching the net debt to revenue covenant with the LGFA. In the short term, Council has access to a \$1,000,000 loan facility if needed.

The net debt limit is lower than the LGFA covenant of 175% of annual operating revenue, as elected members consider that future generations should not be inheriting a treasury position where debt is at its maximum. Council is mindful that although interest rates are currently at record lows, it may not remain that way in the years to come.

Council investments forecast to provide a financial return include Term Deposit investments of \$4,000,000, and a loan to the Stratford Agricultural and Pastoral Association of \$7,180,000. The forecasts maintain both at the same level over the next ten years, although it is likely the term deposits may need to increase as the level of reserves increases, and there is provision for \$3,680,000 of the \$7,180,000 loan to be repaid in the loan contract within the next 5 years so this may reduce, offsetting one another to some extent.

Council does not expect to breach its Net Debt limit over the next ten years.



Rates

A key challenge is to keep rates at an affordable level while delivering on the Community Outcomes and the increased levels of service desired by the community. Rates are a key source of funding as many of the services provided by Council are unable to be provided privately due to the public benefit associated with these services limiting the economic returns on investment, or there is no practical way to charge for services efficiently.

The level of rates for the 2020/21 year is comparable with other Councils with a similar district population. Refer to the graph below showing Stratford District (9,880 popn) rates levels with comparisons made to Opotiki District (10,020), Carterton District (9,960), Waitomo District (9,710), and Buller District (9,610).

Council will set rates on the following basis:

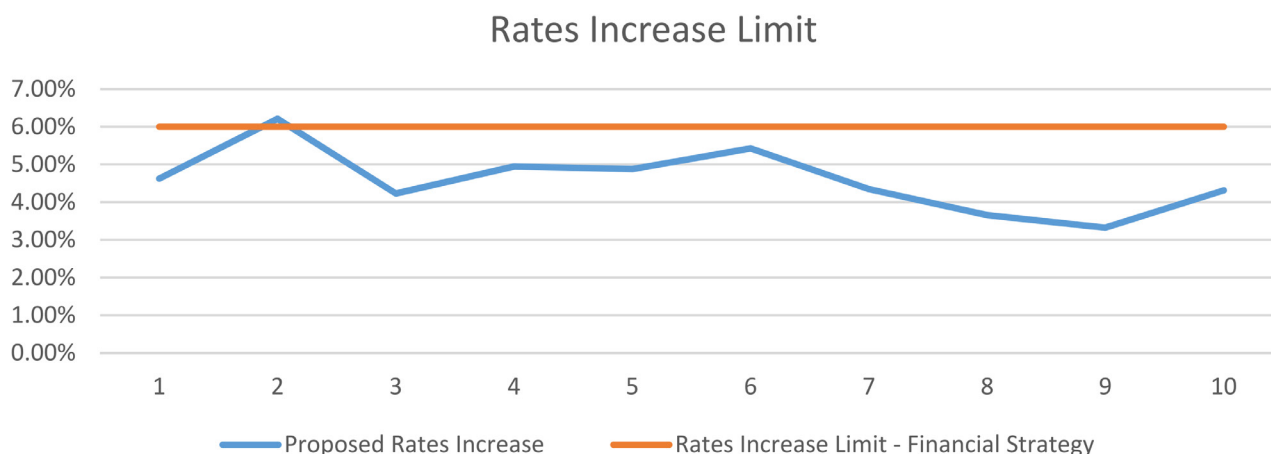
- District wide rates on all properties:
 - General Rates (including a Uniform Annual General Charge)
 - Rooding Rates (for the costs of the rooding activity)
- Targeted rate on serviced and serviceable properties
 - Wastewater Disposal Rates (for sewage disposal from serviceable properties)
 - Solid Waste Collection Rates (for refuse collection from serviceable properties)
 - Water Supply Rates (for water supply to serviceable properties)
- Targeted rate on properties in a specified area:
 - Community Centres (for the maintenance of local community halls)

Level of Rates 2020/21 for similar sized Districts



Inter-generational equity is better served by maintaining consistency in the level of rates increases year on year. The rates increase limit is to be set at 6%, up from 4.45% from the previous Long Term Plan. This is to take into account the increased levels of service desired by the community to deliver on the Community Outcomes, as revealed in the pre-consultation and consultation periods of the preparation of the Long Term Plan 2021-31.

The below graph shows the budgeted rates increase over each of the next ten years against the rates increase limit.



The proposed rates increases are less than the rates increase limit set by Council, except for in Year 2 of the Long Term Plan, where significant capital expenditure forecast is expected to increase rates significantly, as a result of significantly increased interest and depreciation on the new swimming pool.

Rates are rising at a level higher than expected

inflation of 2.40% largely due to the operational costs (depreciation and interest) arising from new capital expenditure on service level increases, and many of the fees and charges are not increasing at a rate higher than inflation as it is difficult to continue to keep raising fees and charges year on year. Fees and charges were reviewed by Council as part of the development of the Long Term Plan.

	2021/ 2022	2022/ 2023	2023/ 2024	2024/ 2025	2025/ 2026	2026/ 2027	2027/ 2028	2028/ 2029	2029/ 2030	2030/ 2031
Proposed rates increase	4.63%	6.21%	4.23%	4.95%	4.88%	5.43%	4.34%	3.66%	3.32%	4.32%
Rates increase limit - financial strategy	6.00%	6.00%	6.00%	6.00%	6.00%	6.00%	6.00%	6.00%	6.00%	6.00%
	-1.37%	0.21%	-1.77%	-1.05%	-1.12%	-0.57%	-1.66%	-2.34%	-2.68%	-1.68%

Council Infrastructure and Asset Condition

Council manages Assets with a value of \$328,722,000 (as at 30 June 2020), made up largely of infrastructure assets, including Roothing, Water Supply, Wastewater and Stormwater assets (total infrastructure asset value of \$288,000,000). These assets have very long lives of up to 120 years, and have an estimated replacement value of \$412,549,000.

By the end of the Long Term Plan, June 2031, the value of Council assets is expected to increase to \$518,776,000, as a result of asset revaluations and capital expenditure on new assets to increase levels of service.

The Council's Infrastructure Strategy and Asset Management Plans provide details on asset condition and expectations for asset replacement. Assets are only replaced when at the end of their useful life based on the condition of the asset, rather than at the end of the expected useful life.

Infrastructure deep dive 1 - Roothing

Council has identified seven bridges that will need to be replaced by Year 10 (2031) at a cost of \$2,000,000. There are a further 14 bridges to be replaced in Years 11 – 20, and a further 36 bridges to be replaced in Years 21-30. The Council's total budget over the next 30 years for bridge replacement is \$16,500,000. These will need to be funded from the rooothing reserve, the Long Term Plan 2021-31 seeks to build the Roothing reserve up from \$600,000 to \$3,632,000 by June 2031 to ensure there are sufficient funds in the reserve to cover this cost, allowing for intergenerational equity.

An increase in Heavy Commercial Vehicles (HCV's) and forestry activity combined, coupled with the current standard of Council rooothing assets in areas where forestry is prevalent, is resulting in reactive investment and inefficient allocation of resources. The preferred response option is to strengthen key rooothing structures to accommodate the HCV's, enabling these vehicles to efficiently use key routes, however there may still be reactive maintenance work required as notice of at least 4-6 months is required from the forestry landowners to enable road strengthening work to be carried out and this is often not achievable. Over the ten years of the Long Term Plan it is forecast that \$2,900,000 will be spent on proactive strengthening of these roads, and \$3,900,000 will be spent on reactive maintenance.

The costs above are expected to be subsidised by Waka Kotahi at 61%

Infrastructure deep dive 2 – Water Reforms

In July 2020, the Government launched the Three Waters Reform Programme - a three-year programme to reform the water, wastewater and stormwater service delivery arrangements. The work on this is still underway and no firm decision has been made yet on what the reforms might look like, so the Long Term Plan does not allow for potential Water Reforms at all. Instead the operating and capital expenditure budget are as per normal with some level of service expenditure required to ensure a sustainable water supply for future generations. This includes rolling out Universal Water Metering to all residential properties connected to the district's water supply, and investment in a second Trunkmain and a third Water Reservoir.

However, if the 3 Water Activities were to be shifted from Council to another entity, from say Year 4 of the Long Term Plan, this would have an impact on Council assets, debt, revenue, expenditure, and treasury covenants. With everything else remaining the same but overheads being reallocated to other activities, the total rates requirement in Year 4 would drop by \$2,724,611 – or roughly a 13% reduction in rates from the previous year. By Year 4, the debt for the three waters Activities is expected to be \$11,839,272, and it is proposed that this debt, along with any reserve funds – expected to total \$657,087 by Year 4, will be transferred to the new consolidated entity.

Although Council rates would significantly reduce, and the level of debt would too, it does not mean that the community would benefit economically, as the new entity will take over charging Stratford ratepayers the cost of the 3 Water Activities. Also, total annual revenue of \$3,588,274 (Year 4 forecast) would be transferred to the new entity and unable to be used by Council in determining Local Government Funding Agency (LGFA) covenants.

Policy on giving security for borrowing

Council has the ability to borrow from the LGFA. The accession to LGFA was completed in May 2018, and Council became a guarantor to the LGFA in April 2020.

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

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

Financial investments of \$11,200,000 is not expected to change over the Long Term Plan. Council also has non-financial investments in property including a farm, and has surplus cash available for investment from time to time.

Council maintains financial investments primarily to allow for:

- investment of surplus cash,
- liquid funds to be available to support Council reserves and/or a Civil Defence Emergency Event requiring significant capital expenditure, and/or
- a return on investment by way of improved community outcomes.

Over the ten years of the LTP, Council has budgeted to receive \$2,520,000 in interest revenue from financial investments.

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

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.

The farm investment is expected to contribute at least \$50,000 per year to subsidise rates, however the Farm and Aerodrome Committee is responsible for the allocation of year end profits and may decide to increase this amount in any year.

