

D20/10817

June 2020

STRATFORD DISTRICT COUNCIL

FARM BUSINESS REPORT 2020

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Executive Summary

In 2020, the new Farm and Aerodrome (Council) Committee was established to provide governance and oversight of the combined activities of the Council owned Dairy Farm and the Stratford Aerodrome. This report is presented to the Committee in order to enable it to fulfil its responsibilities under the *Farm and Aerodrome Committee Terms of Reference*.

The Stratford District Council Farm Business Report 2020 provides an overview of the Farm Activity, a report on the financial results for 2019/20, and discussion of the financial budget for 2020/21.

The actual results for the year ended 30 June 2020 have actual (forecasted for May and June 2020) Net Profit up on budgeted Net Profit, at \$204,717. This is largely due to budget assumptions around revenue, specifically milk price forecast. Although milk solid production was less than budgeted, the \$0.90 cent difference in the pay-out from what was originally budgeted (\$6.20) had a significant positive impact on revenue for the year. This contributed to \$42,000 additional net profit, even though the budgeted dividend did not result.

Farm debt has decreased in 2019/20. The loan repayment of \$836,071 was largely due to the sale of the Campbell house, but also included remaining net profit after the rates rebate of \$50,000 was applied to Council.

Note: the actual results for 2019/20 will not be finalised until mid-July.

The operational budget for 2020/21 is in line with the financial results for the 2019/20 season – no significant changes are proposed.

Environmental Plan

The Farm engaged the services of Tiaki Sustainable Dairying to develop a Farm Environmental Plan in October 2019, completed February 2020. Out of this report came seven actions to be addressed. It is recommended that the Farm and Aerodrome Committee monitor the progress of each of these actions at each Committee meeting.

Goals and Objectives of the Farm and Aerodrome Committee

1. To operate the farm as a separate, economic, business unit.
2. To physically support the aerodrome by way of providing a buffer zone between it, and surrounding, existing or potential, properties, and
3. The profits from the farm to be returned to Council to provide a 'dividend' to Council, offset debt or be reinvested in the farm as set by Council during the Annual or Long Term Plan process.
4. To ensure the Aerodrome activity is contributing to the Council's Community Outcomes in a cost-effective manner.

Each of these objectives has been fulfilled in the 2019/20 year.

Local Government Purpose

The farm is considered to be an economic investment that was purchased for the purposes of providing a financial contribution to ease the burden of rates on the community.

The purpose of local government was amended in May 2019, back to as it was established originally in 2002, to provide for local authorities to play a broad role in promoting the social, economic, environmental, and cultural well-being of their communities, taking a sustainable development approach.

Section 10 of the Local Government Act 2002 (new):

(1) The purpose of local government is—

(a) to enable democratic local decision-making and action by, and on behalf of, communities; and

(b) to promote the social, economic, environmental, and cultural well-being of communities in the present and for the future.

The wellbeing framework is much broader than the previously strict “core infrastructure” approach but is still restrictive in that it has a community well-being focus. An analysis of the farm business with respect to the four well-beings is discussed below. The conclusion drawn is that ownership of the farm contributes to the economic well-being of the district.

Social – The farm does not directly benefit social well-being in any fundamental way.

Economic – The farm contributes to the economic well-being of the district by providing rates mitigation for ratepayers. It is not in direct competition with other businesses in the district and therefore does not diminish economic activity. It provides some employment opportunities and contributes to the district economy through procurement of goods and services.

Environmental – Dairy farming is generally not viewed as an environmentally friendly activity. However, the Council is directly involved in riparian planting and complies with environmental regulations. An increased effort has been expended in this area as industry stakeholders demand better farming practices.

Cultural – The farm does not directly benefit cultural well-being in any fundamental way.

Summary of the Farm

Address: 202 Flint Road East, Stratford
Farm Area 158ha, 132 ha effective
Topography – flat
Soil type: Volcanic

Farm and Aerodrome Committee Members x3

Grant Boyde (Chair), Peter Dalziel, Vaughan Jones

Council Staff Committee Members x2

Council Farm Liaison – Property Officer
Accountant – Finance Officer

Share-milkers

Fernharp Trust Partnership: Aaron Riddick and Fiona Hogan-Riddick
Share-milking agreement is in effect until 31 May 2022
Consultant: Jono Buchly

Infrastructure

Cow Shed:
Herringbone 36 aside, cup removers, and automatic teat sprayer (owned by share-milker).
Milk room, office, toilet and pump room.
16,000 L vat (owned by Fonterra)

Yard:

Main yard 300 – 320 when rowed up (72 in bales)
Bobby calf shed with loading ramp
Lockable shed for bikes and tools
2 x 4 bay hay sheds
Silage pit concrete floor

Water tank: 30,000 litres

Irrigation – travelling irrigator – 20ha

Campbell Block

Old cowshed, loading race and vet race
Two bay shed / calf rearing
Lockable shed – Fertiliser spreader storage
2 x one bay hay barns
Sheep shearing shed
Two metal pits

Houses

4 bedroom house, car port and small shed
1 self-contained cabin
3 bedroom house – relocated from Pembroke Rd

Operational

370 Fresian-Cross Cows (owned by the share-milker)

System 3 Feeding – 10-20% of total feed is imported to extend lactation and increase production

Financial Performance

Financial Results 2019/20 – *(Have used estimates for May/June 2020)*

Net Profit for the year is expected to be \$204,717.

Total Revenue was up against budget by \$41,908, at \$546,204.

Milk supply revenue came above budget by \$65,704, at \$546,204. This was a direct result of the final forecast milk price being higher than the original milk price expectations of \$6.20 per KgMS. The final Fonterra payout has not yet been determined but will be within the range of \$7.10 to \$7.30 - for the purposes of determining actual revenue for the financial year, \$7.10 has been used. Note, 37,000 milk solids were fixed at \$6.80 earlier in the season. The remainder of milk solids have been priced at \$7.20 to get year-end forecast revenue.

The Council budgeted for a dividend of 30 cents per share based on historical data. Fonterra have advised there will be no dividend paid out for the 2019/20 year.

Operating expenditure overall was down against budget by \$4,638, at \$341,487.

Farm working expenses was over budget by \$25,400 at \$208,650 for the financial year. This was due to fertiliser and permit costs being over budget – refer to Table 2. The permit costs include Dairy NZ Levies and Biosecurity Response Levies. Also, the aerodrome lease was not budgeted for this year, as the original intention was to do away with the internal journal between the farm activity and the aerodrome activity.

The overhead budget allocation from Council came under budget by \$5,349, at \$31,400 for the year. This includes an allocation of Council overheads including finance, property management, and asset director services.

Interest came under budget by \$5,753, at \$62,973, as the interest rate charged by Council will be 2.66%, much less than originally anticipated, and the loan repayment is \$836,071, rather than the \$717,117 originally proposed.

Depreciation is expected to be lower than what was budgeted due to the revaluation of Council land and buildings effective from 1 January 2020.

Summary of other measures:

- The value of the farm investment reduced by \$720,763 due to a drop in the value of Plant and Buildings, from \$1,840,000 to \$713,152 by the end of the financial year as a result of the asset revaluation in January, and the sale of the Campbell farm house and surrounding land. However, there was an increase in land value and Fonterra shares also reduced from the start of the year.
- In this financial year, the number of cows milked increased to 370 (previous year, 362). Production in the 2019/20 season was the highest it has been in the past 4 years.

- Actual total expenditure per Kg/Ms produced was \$2.22.

Financial Budget 2020/21

Budgeted Net Profit for the year is expected to be \$118,665.

Assumptions around number of cows (370), effective hectares for farming (132), production KgMS per cow (roughly 400), and interest rate (2.66%) remain the same for the 2020/21 budget.

Total revenue for the farm for 2020/21 is budgeted at \$507,340.

The milk price assumption of \$6.50 is based on the forecast assumptions at the time the Annual Plan 2020/21 was initially prepared. This is an estimate, based on conservative forecasts as history has shown that the milk price can drop significantly from the original forecast over the course of the season.

Fonterra have not paid out a dividend for shares owned, for the past 2 years. However, a dividend has been budgeted for in the 2020/21 year of 25 cents per Fonterra share, with half of the dividend to be paid to the share-milker.

Total expenditure for the farm is budgeted at \$388,675 in 2020/21.

Farm working expenses are expected to be higher than budgeted for in 2019/20, but similar to actual expenditure in 2019/20. Increases to the budget are largely in the areas of R & M costs, fencing, urea and aerodrome lease, at \$210,534. Refer to Table 2.

The Council overhead allocation is expected to be higher than 2019/20, at \$58,441 (previous year, \$31,400). The amount of overhead allocated by the Corporate Services department and Property Asset Manager has doubled due to the increased amount of time spent on the Farm Activity by these two areas.

Interest expense is expected to reduce by \$14,725 from the previous year budget, due to a large sum loan repayment in 2019/20 and a lower anticipated interest rate, and is budgeted at \$54,001 for the financial year.

The depreciation expense is budgeted at \$65,700 for the 2020/21 year. However, since the revaluation of land and buildings in 2020, it is likely that actual depreciation for next year will be more likely around \$45,000.

The budgeted net profit could potentially allow for a loan repayment of \$68,665 – refer to Table 4 for the expected loan balance at year end.

Budgeted total expenditure is \$2.59 per kg of milk solid produced.

Stratford District Council - Profit and Loss

	<i>BUDGET</i> 2019/20	<i>ACTUAL</i> 2019/20	<i>VARIANCE</i> 2019/20	<i>BUDGET</i> 2020/21
Assumptions				
Cows	375	370	-5	370
No. of Fonterra Shares	158,716	158,716	-	158,716
Effective Ha	132	132	-	132
Production KgMS	155,000	153,779	(1,221)	150,000
Production KgMS/Cow	413	416	2	405
Payout	\$ 6.20	\$ 7.10	\$ 0.90	\$ 6.50
Dividend (cents per share)	0.30	0.00	\$ (0.30)	0.25
Term Loan and Internal Loan	2,779,394	1,944,149	835,245	1,944,149
Debt Repayments	717,117	836,071	118,954	68,665
Interest rate	2.88%	2.66%	0.22%	2.66%
Value of Investment (Land, Buildings, Shares)	9,863,467	9,142,704	(720,763)	9,142,704
Revenue				
Dairy	\$ 480,500	\$ 546,204	\$ 65,704	\$ 487,500
Dividend	\$ 23,796	\$ -	\$ (23,796)	\$ 19,840
Total Revenue	\$ 504,296	\$ 546,204	\$ 41,908	\$ 507,340
Expenses				
Farm working	\$ 183,250	\$ 208,650	\$ (25,400)	\$ 210,533
Overhead Allocation	\$ 36,749	\$ 31,400	\$ 5,349	\$ 58,441
Interest	\$ 68,726	\$ 62,973	\$ 5,753	\$ 54,001
Depreciation	\$ 57,400	\$ 38,464	\$ 18,936	\$ 65,700
Total Expenses	\$ 346,125	\$ 341,487	\$ 4,638	\$ 388,675
Net Profit	\$ 158,171	\$ 204,717	\$ 46,546	\$ 118,665
Return On Equity	2.23%	2.84%	0.61%	1.65%
Loan Repayment	\$ 717,117	\$ 836,071	\$ 118,954	\$ 68,665
Net Contribution to Rates	\$ 50,000	\$ 50,000	\$ -	\$ 50,000
CAPEX - Renewals	\$ -	\$ -	\$ -	\$ 42,000
CAPEX - Service Level/Growth	\$ 15,300	\$ 14,091	\$ 1,209	\$ 55,400
Sale of Campbell Farmhouse (excl GST)	\$ 608,696	\$ 592,482	\$ 16,214	\$ -

Table 1: Actual vs Budget for 2019/20 (note forecast figures are used for May/June 2020).

Farm working expenses - Budgeted 2019/20

		BUDGET	ACTUAL*	VARIANCE	BUDGET	Per/KgMs
		2019/2020	2019/2020	2019/2020	2020/21	2020/21
Administration						
		\$ 4,200	\$ 5,839	\$ (1,639)	\$ 6,000	\$ 0.04
		\$ 4,000	\$ 259	\$ 3,741	\$ -	\$ -
	1	\$ 700	\$ 4,700	\$ (4,000)	\$ 730	\$ 0.00
	1	\$ 1,000	\$ 508	\$ 492	\$ -	\$ -
	2	\$ -	\$ 2,500	\$ (2,500)	\$ 1,042	\$ 0.01
Farm Operating						
		\$ 27,200	\$ 28,570	\$ (1,370)	\$ 39,773	\$ 0.27
	3	\$ 45,000	\$ 58,370	\$ (13,370)	\$ 42,740	\$ 0.28
		\$ 35,600	\$ 38,015	\$ (2,415)	\$ 40,537	\$ 0.27
		\$ 5,000	\$ 8,500	\$ (3,500)	\$ 5,212	\$ 0.03
		\$ 5,000	\$ 1,500	\$ 3,500	\$ 5,000	\$ 0.03
		\$ -	\$ -	\$ -	\$ 3,000.00	\$ 0.02
		\$ -	\$ 389	\$ (389)		\$ -
		\$ -	\$ 6,500	\$ (6,500)	\$ 6,500	\$ 0.04
		\$ -	\$ -	\$ -	\$ 5,000	\$ 0.03
		55,550	\$ 53,000	\$ 2,550	\$ 55,000	\$ 0.37
Total		183,250	208,650	-25,400	210,534	\$ 1.37

*Forecast figures are used for May/June 2020

1. Permits and Levies & Fees operating expenses are costed together in councils financial programme. These are over budget due to the Dairy NZ Inc and Biosecurity Response Levy's charged each month.

2. Subscriptions were over budget due to Federated Farmers memberships fees, this has now been budgeted for in 2020/21.

3. Fertiliser costs were higher than budgeted due to the Ravensdown Fertiliser programme recommendations.

Table 2: Farm Working Expenses vs budget for 2019/20, and budget for 2020/21.

Capital Expenditure

Capital expenditure in 2019/20 was under budget by \$37,278 and is a result of:

- The \$30,000 set aside for a new generator in 2019/20 was not spent. It was decided that it would be more cost effective to hire a generator when required.
- Riparian planting was budgeted for in 2019/20 but over half was not spent due to the project nearing completion). Riparian planting has again been included in the budget for 2020/21 as it is considered a compliance cost that is required to be continually built on. The costs of riparian planting are treated as capital as they add to the value of the farm, and provide an enduring benefit.
- Actual unbudgeted costs relate to a heat pump and laying of concrete at the share-milkers farm house. The costs were not budgeted for as these were unexpected.

Capital Expenditure Budget 2020/21

The Council has budgeted for a new calf bay which is estimated to cost \$15,000.

Also \$60,000 has been set aside for yard upgrades which is to be split 50/50 over renewals (funded from depreciation reserves) and increase in service levels (loan-funded).

Projected Capital Expenditure

		<i>BUDGET</i> 2019/20	<i>ACTUAL</i> 2019/20	<i>VARIANCE</i> 2019/20	<i>BUDGET</i> 2020/21
Renewals					
Farm House	1	\$ -	\$ -	-	12,000
Yard Replacement		\$ -	\$ -	-	30,000
Total Renewals		\$ -	\$ -	-	42,000
Increase in Service Level					
Farm House	2	\$ -	\$ 5,683	(5,683)	-
Calf Bay		\$ -	\$ -	-	15,000
Generator	3	\$ 30,000	\$ -	30,000	-
Riparian Planting		\$ 21,369	\$ 8,408	12,961	10,400
Yard Upgrade		\$ -	\$ -	-	30,000
Total Service Level Increase		\$ 51,369	\$ 14,091	37,278	55,400
		\$ 51,369	\$ 14,091	37,278	97,400

1. Fireplace in farm house is to be replaced in 2020/21 which may be more than budgeted due to a faulty wetback on the fireplace and the cylinder in the roof is causing damage against the wall
2. Actual farm house service level increase were made up of laying of the driveway and a heatpump.
3. \$30k had been set aside for a new generator, however it was decided that a generator could be hired when required so the budget will not be spent, nor will it be rolled over

Table 3: Capital Expenditure actual vs budget for 2019/20, and budget for 2020/21

Farm Debt

The farm debt is expected to decrease by \$821,980 to a balance of \$1,957,414 as at 30 June 2020. The actual amount of service level improvements in the 2019/20 year, of \$14,091, resulted in new borrowings required to fund the capital expenditure.

A loan repayment of \$836,071 has been allocated to the debt balance as at 30 June 2020, this is made up of the net proceeds from the Campbell farm house sale (\$681,534) and net surplus for the year after a rates distribution of \$50,000 was allocated from the Farm to Council general rates.

In 2020/21, it is forecast that the loan balance will reduce by \$13,265 to **\$1,944,149** with a loan repayment of \$68,665 and additional loan funded capital expenditure.

The Interest Rate will be calculated on the Council's weighted average cost of debt – as at December 2019 this was 2.66%, expected to be 2.66% in December 2020.

Loan Interest		
	2019/20	2020/21
Opening Balance	\$ 2,779,394	\$ 1,957,414
New Borrowings	\$ 14,091	\$ 55,400
Less Loan Repayment	\$ 836,071	\$ 68,665
Closing Balance	\$ 1,957,414	\$ 1,944,149
Interest Rate*	2.66%	2.66%
Effective Loan Balance	\$ 2,368,404	\$ 1,950,782
Interest	\$ 63,000	\$ 51,891

*Interest rate calculated at Council's weighted average borrowing rate as at 31 December.

The loan repayment for 2019/20 included \$681,534 for Campbell farm house and section, and the net surplus less \$50,000 used for rates mitigation.

Table 4: Calculation of loan balance and interest for the 2019/20 and 2020/21 years.

Environmental Management Report

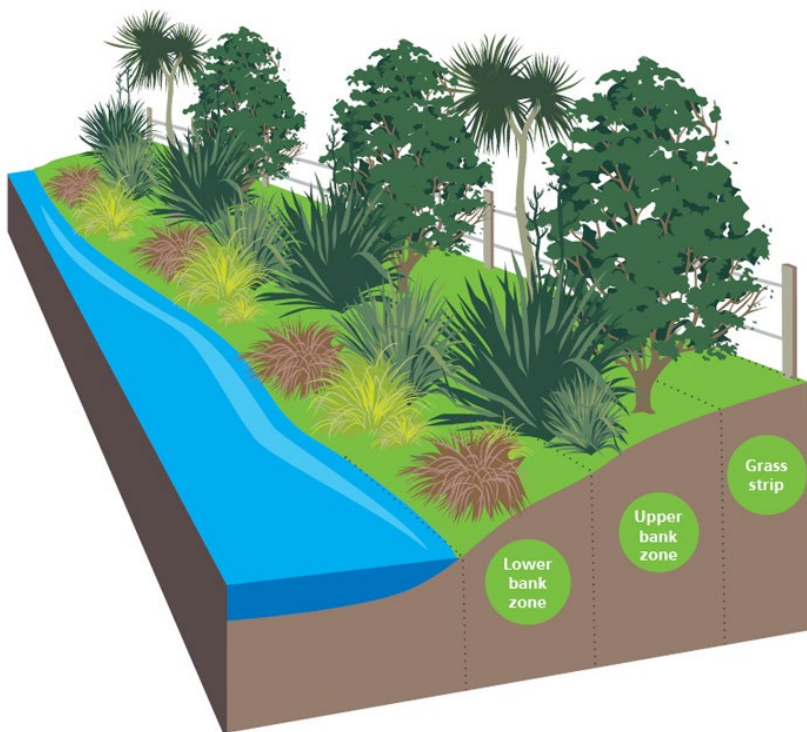
In October 2019, the Council engaged Tiaki Sustainable Dairying (free service provided through Fonterra) to develop a Farm Environmental Plan. The purpose of the plan was to describe the environmental conditions of the farm and the management of those conditions. Mitigations to potential impacts on water quality would be documented from this with timeframes established. The Environmental Plan was finalised in February 2020 and is attached to this report.

Out of this report came seven actions to be addressed. It is recommended that the Farm and Aerodrome Committee monitor the progress of each of these actions at each Committee meeting.

Riparian Planting

Planting in riparian areas benefits the environment as plants function like a sieve, helping to filter out sediment and nutrients before they enter waterways. Stabilising riparian plants help prevent land erosion and increase the habitat for native wildlife.

Fencing waterways protects freshwater from nutrients, effluent and sediment by excluding stock and creating a buffer between rivers and streams and the land. Fencing will help to maintain and improve water quality and create a habitat for birds and freshwater species.



In 2019/20, the Council spent \$8,408 on riparian planting and fencing off of streams. As at the end of the 2020 season **95% of the riparian planting** work required had been completed (previous year, 33%), and same for fencing (previous year, 83%).

Effluent System

Effluent is disposed by irrigation to pasture on the main block farm. The effluent system can hold up to 30 days of effluent storage. The average depth of application is <12mm.

Nitrogen Fertiliser Inputs

The nitrogen risk scorecard for the 2018/19 season identified nitrogen fertiliser as the main risk on farm and categorised it as a medium risk due to 144kgN/ha being applied and applications occurring in the months of Jul-Aug and at rates above 25kgN/ha. All other nitrogen risks on farm were either in the very low/low category.

In conjunction with Massey University the farm has been trialling a new management tool of undertaking soil testing from aerial vision. This has meant numerous paddock soil testing has occurred along with different application rates of fertiliser for individual paddocks from those results. This has ensured that plant demand is matched to a high level of detail from the results shown. Latest individual paddock soil test results indicated Olsen P levels between 23-35kgN/ha and the fertiliser plan/recommendation is to bring levels to optimum.

Nitrogen fertiliser policy is to apply around 150kgN/ha/year. This is generally applied in the form of urea & DAP (Di-ammonium Phosphate). Rates vary throughout the season but are typically between 25-35kgN/ha at approximately 4-5 applications throughout the season. Soil temperature and weather forecast are checked before fertiliser is applied and buffer zones around waterways are maintained. External contractors 'Corletts' are used to apply fertiliser and use Hawkeye (proof of placement) which are provided once fertiliser is applied.

- A nutrient budget is used to guide fertiliser use.
- Fertiliser is only applied if there is no significant rainfall forecast.
- A buffer distance is maintained around waterways when applying fertiliser.
- Spreading equipment is regularly calibrated or a Spreadmark certified spreader is used.
- No fertiliser is stored on farm.

The Government's Essential Freshwater Package

The objective of the reforms are to prevent further degradation of waterways and improve water quality within five years, and to reverse past damage and bring waterways and eco systems to a healthy state within a generation.

Refer to the Summary document from Dairy NZ attached to this report for further details of what will be required by the dairy farming industry under new proposed legislation.

Future Outlook for Dairy Farming

Dairying in New Zealand is currently a \$15 billion industry, responsible for 28 per cent of total annual exports.

There is no doubt that dairy farming will look a lot different going forward, fuelled by a growing level of intolerance for environmental damage, and an acceptance by the major players in the dairy industry that improvements must be made to farming practices to prevent a reduction in consumer demand for dairy products.

Dairy farmers have recently voted to continue with the Dairy NZ levy, currently at \$0.036 per Kg/Ms (collecting about \$67m a year), which funds research into improving dairying efficiency and industry issues. The vote occurs once every six years.

Some of the issues and opportunities currently facing farming right now include:

- Environmental regulations and standards e.g. freshwater
- Limitation of the use of urea spread on farm land
- Milk price fixing
- Farm worker shortage – difficulty finding good staff.

What this means for the Stratford District Council is that the Farm and Aerodrome Committee must have a good understanding and knowledge of:

- 1) Why the Council owns and operates a Dairy Farm (covered in section under heading “Local Government Purpose” in this report).
- 2) Whether the purpose, as per point 1 above, is being fulfilled effectively, and to what extent.
- 3) What the risks are for the Council and whether these risks can be effectively mitigated, and
- 4) Whether the Council is willing to accept the challenge, and opportunities, that will arise from an increasing focus on Sustainability in dairy farming, or if that is outside the scope of its responsibilities and purpose.

The analysis prepared below gives a summary of the strengths, weaknesses, opportunities and threats in relation to the farm business.

SWOT Analysis of the Council Dairy Farm Business

<p>STRENGTHS</p> <ul style="list-style-type: none"> - Contributes to the economic well-being of our district. - Consistent surpluses. - The farm provides a buffer zone for Aerodrome noise and accessibility. - Relationship between share-milkers and Aerodrome operators is conducive to the continued operation of the farm and Aerodrome side by side. 	<p>WEAKNESSES</p> <ul style="list-style-type: none"> - High risk exposure to weather conditions leading to uncertainty in production/profits. - Fluctuations in milk price leading to uncertainty in production/profits. - Maintenance, Capital Replacement costs, and council staff involvement make the farm more resource intensive than an alternative cash investment. - Further capital investment in the farm will be required, particularly in relation to new advanced technology and replacement of plant and equipment. This will require an increase in debt. - Vulnerability to increasingly stricter compliance requirements relating to staffing, health and safety, nutrient management.
<p>OPPORTUNITIES</p> <ul style="list-style-type: none"> - Innovative solutions and investment in technology to enable more productive use of the farm. - Potential opportunities for different land uses to provide a higher return on investment (dependent on soil and weather vulnerability of crops). - Land is a finite resource, where the value <u>generally</u> increases. Retention of land allows for potential high-value investment opportunities in the future. - Potential to gain revenue certainty by fixing up to 50% of milk price for next season. 	<p>THREATS</p> <ul style="list-style-type: none"> - Change in Govt legislation could affect Council liability and have an impact on compliance costs. Eg. Environmental management may become more expensive with greenhouse gas emissions and water quality being key govt concerns. - Change in Fonterra’s regulations eg PKE usage could affect production/profits. - Animal Welfare risks high in the dairy sector (not direct responsibility but can affect Council reputation). - Storm damage could create unplanned, unbudgeted costs. - Major Volcano eruption would likely destroy use of the land for farming in the medium to long-term. - Exposure to biosecurity risks eg Mycoplasma Bovis.

Table 5: Analysis of Farm Business’ Strengths, Weaknesses, Opportunities and Threats

Conclusion

Ownership of the farm at Flint Road is supported by elected members, and is seen as an investment into the economic wellbeing of the district, and a demonstration of Council's investment in and commitment to the rural industry.

The current share-milkers have done a great job at meeting production targets for the year and their contribution of economic benefit to the Stratford District ratepayers is to be acknowledged.

Council supports the Aerodrome and being effective in its role in providing a buffer zone to protect the continued operations of the Stratford Aerodrome.

The budgeted operating revenue and expenditure and net contribution to rates and debt repayments are made transparent to elected members to enable informed decision making with regards to the future of the farm.