Section 2

Financial Strategy

Financial Strategy

Summary

The purpose of the Financial Strategy (FS) is to provide prudent financial management by providing a guide for the Council to consider proposals for funding and expenditure against.

The theme of the FS supporting the Long-Term Plan 2015-2025 (LTP) is "Striking the right balance". At the last election the district gave a strong indication that affordability of rates is a key issue. The Council has listened to this message and has worked hard to reduce the total rates requirement[1]. While affordability is a key issue, discussions with the community as part of the Mayor's community engagement programme – Shaping Our Future Together – provided a strong message that the community values its assets and services and would like them maintained. This means the Council has the challenge of maintaining services levels while ensuring affordability and managing the ongoing growth projected for the district. The Council is confident that the FS below does "Strike the right balance".

The FS contributes to the community outcome of a strong and resilient economy built on the sustainable management of economic resources. It also contributes to the community enjoying the great Taranaki lifestyle by ensuring the maintenance of community assets.

There have been a number of challenges facing the Council when developing the FS, including an improvement in services provided to the public through the New Plymouth Wastewater Treatment Plant upgrade, the new refuse collection and recycling system (which begins later in 2015) and growth across the district. However, the main challenge has been a reduction in the Perpetual Investment Fund (PIF) annual release from $20 million five years ago to a proposed $7.4m in the first year of the LTP. This is discussed in more detail below under the discussion on investments.

There has been a focus on reducing operating costs, increasing revenue where possible, reducing the amount of new capital expenditure and factoring in initiatives that will provide long-term savings. There is also some reduction in service levels in roading, water and wastes, community funding and community development.

The FS builds resilience and sustainability by lowering the borrowing requirement from previous LTP levels, reducing the total rates requirement in comparison to the previous LTP and reducing reliance on the PIF.

[1] The total rates requirement is the amount the Council collects annually in general and targeted rates from all four rating groups - Commercial/Industrial, Residential, Small Holdings and Farmland. This includes general rates plus targeted rates for refuse collection and recycling, wastewater treatment and disposal, roads and water supply.

Overall financial picture

The financial picture of the FS is illustrated in Figure 1 and reflects a sustainable plan that is building resilience for the community. This is demonstrated by the Council's borrowing levels which rise only six per cent over the 10 years and the key financial ratio of interest expense to rates income reducing from 10.9 per cent to 9.1 per cent over the 10 years. As discussed below, the average total rate requirement increase is 3.43 per cent, but will reduce below three per cent for most residential ratepayers once growth in the district's household numbers is factored in.

Total operating expenditure rises on average 1.9 per cent annually over the 10 years, primarily driven by the Local Government Cost Index (LGCI) which averages 2.9 per cent. The organisation has a strong focus on being effective and efficient and the plan includes invest to save initiatives that will help reduce operating costs into the future. A key project in this regard is the replacement of the street lights with new LED technology and offering more digital services to our customers that will help reduce future operating costs.

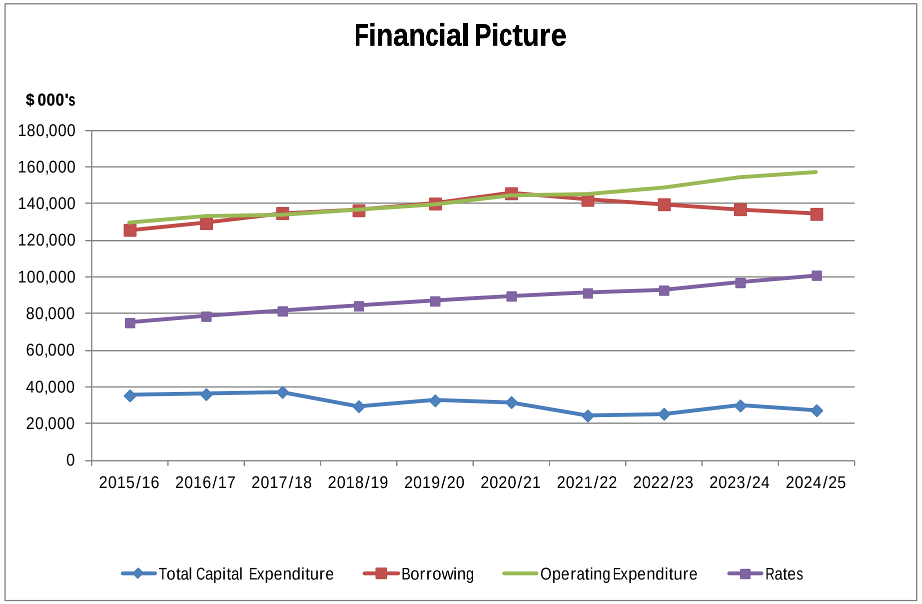


Figure 1: Overall financial picture

Rates and rate limits

The Council is very conscious of rates affordability. The FS sets a limit on percentage increases in the rates requirement of five per cent in any one year with a 10-year average increase in rate requirement of between 3.5 per cent and 3.9 per cent (see Figure 3). This is a significant reduction from the LTP 2012-2022 where the limit was seven per cent and the average was 5.5 per cent. This is illustrated in Figure 2 where the rate requirement for the seven overlapping years of the two LTPs differs by $76m. With estimated growth within the district over the next 10 years of approximately one per cent per year this will mean the majority of residential properties will face a rates increase of less than three per cent.

Due to a number of contributing factors, including increase in service levels through the Wastewater Treatment Plant upgrade, the new refuse collection system, growth in the district, and the reduced release from the PIF, the first year of the plan is under pressure, and the increase is 6.7 per cent.

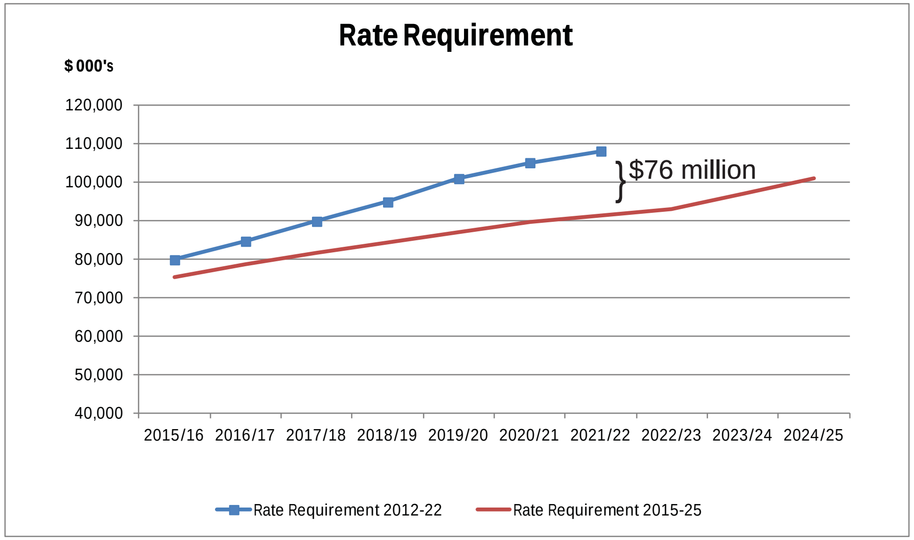


Figure 2: Total rates requirement over the LTP 2015-2025 compared with 2012-2022

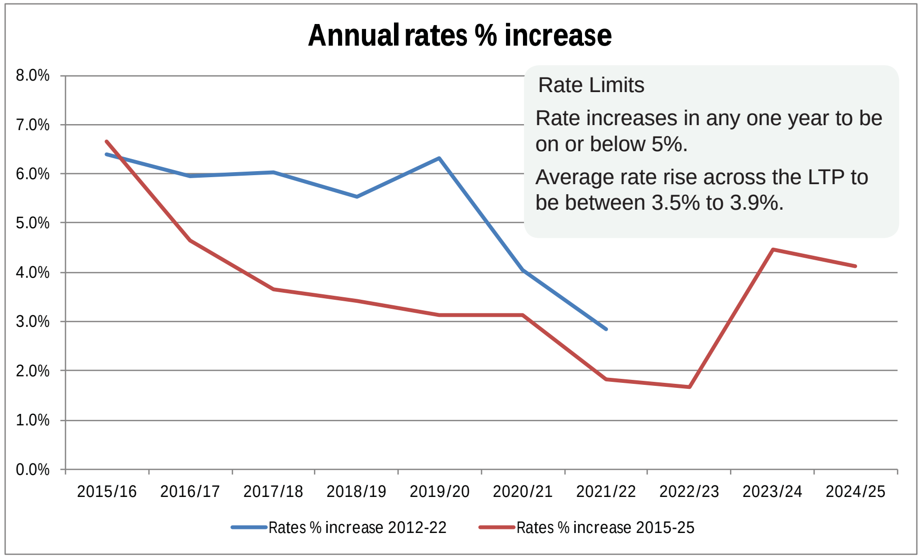


Figure 3: Percentage increases to the total rates requirement over the LTP 2015-2025 compared with 2012-2022

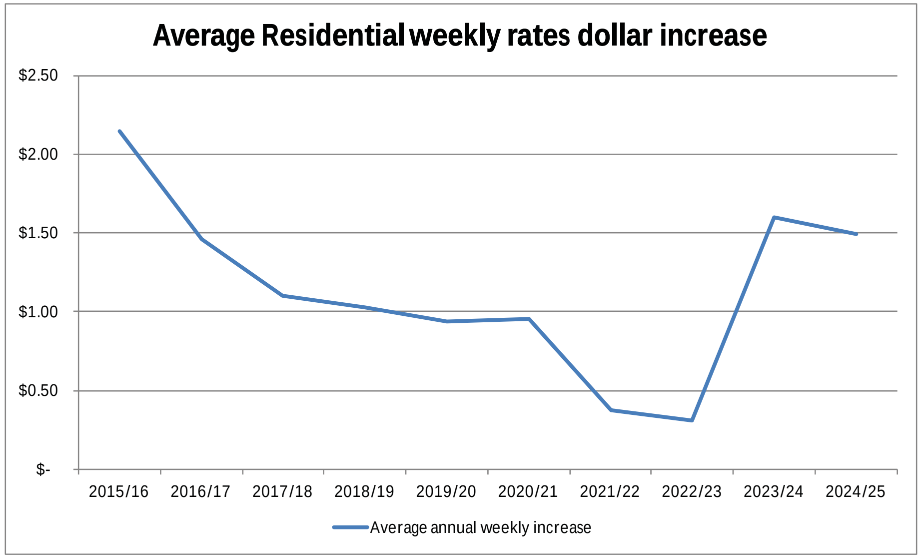


Figure 4: Average residential annual weekly dollar increase

Capital expenditure (purchasing and maintaining assets)

Capital expenditure is categorised into renewals (renewing existing assets), service level (new assets that improve the services provided to the community) and growth (new assets required to accommodate growth within the district).

Total renewal expenditure of $225m is in line with our historical spending (this relates to all council assets, not just infrastructure assets). It is important the Council continues to maintain its assets with this level of spend to ensure the assets are well maintained and deliver the level of service that is required. Funding for renewal expenditure is rates funded and is based on a long run average renewal approach based primarily on the age of our assets. Detailed rationale and analysis of the renewal expenditure is contained within the appropriate Asset Management Plans (AMPs). A summary of core infrastructure renewal expenditure is shown in the table.

Capital renewal expenditure to maintain existing level of service for core infrastructure

	2015/16 $m	2016/17 $m	2017/18 $m	2018-2025 $m	Total $m
Roads	7.75	8.10	8.00	55.91	79.76
Wastewater management	4.56	9.05	7.56	16.51	37.69
Water supply	1.83	1.52	1.85	17.82	23.02
Stormwater drainage	0.16	0.17	0.17	2.14	2.64
Total network infrastructure	**14.30**	**18.84**	**17.58**	**92.38**	**143.11**
Flood protection and control works	0.03	0.01	0.01	0.10	0.15

Service level and growth capital (new capital spend) of $84m is a significant reduction from the previous plan proposed spend of $157m. There are two primary drivers for the lower capital spend. Firstly the TSB Stadium and Todd Energy Aquatic Centre projects included in the previous LTP have been deferred outside the 10 years but are contained within the 30-year Infrastructure Strategy. Secondly a number of growth infrastructure projects are proposed to be developer led, which will mean the Council will not need to fund the upfront borrowing or costs. These projects on completion will vest with the Council. The Council will then be responsible for the ongoing costs of maintaining such assets. These costs have been factored into the plan. These initiatives are the main reason the Council's borrowing is being maintained and are also helping to keep rates to a lower level.

Significant new capital projects and their impact

The major projects included in the plan relate mainly to core infrastructure within water, wastewater and solid waste and are associated with district growth and an increase in the level of service for solid waste. The following are some of the key major projects:

- **Solid Waste collection system and associated Resource Recovery Facility including public good area.** This project relates to the district's new system for kerbside collection of recycling and refuse and the processing of collected recyclables. It will help divert material from the landfill and minimise transport and disposal costs. The total capital cost is $5.5m and the operating cost impact over the LTP is $1.75m.
- **New pipe to Henwood and Mountain Road reservoirs**. This project relates to increasing the capacity of the eastern trunk water main to keep up with growing demand due to growth in Bell Block and Tikorangi by installing a duplicate main. The total capital cost is $9.9m and the 10-year operating cost impact is $4.1m.
- **New trunk main - Lepperton to Faull Road (Tikorangi).** This project relates to providing redundancy for water supply to the district east of the Waitara River and increasing the capacity of water supply to Tikorangi due to growth in demand. The total capital cost is $7.3m and the operating cost impact over the LTP is $4.8m.
- **New Plymouth Wastewater Treatment Plant upgrade phase two, biosolids treatment.** This project relates to upgrading the dewatering process of biosolids produced during the treatment of waste water, along with improving the grit and screenings removal processes at the plant. The total capital cost is $9.5m and the operating cost impact over the LTP is $3.8m
- **NPWWTP - thermal drier upgrade and renewal.** This project relates to renewing the thermal dryer at the Wastewater Treatment Plant as it reaches the end of its operational life. This plant is the final treatment process for our biosolids, converting them into a fertiliser called Bioboost. The total capital cost is $7m and the operating cost impact over the LTP is $0.36m.

A list of projects included in this plan can be found in Section 4 Council Services.

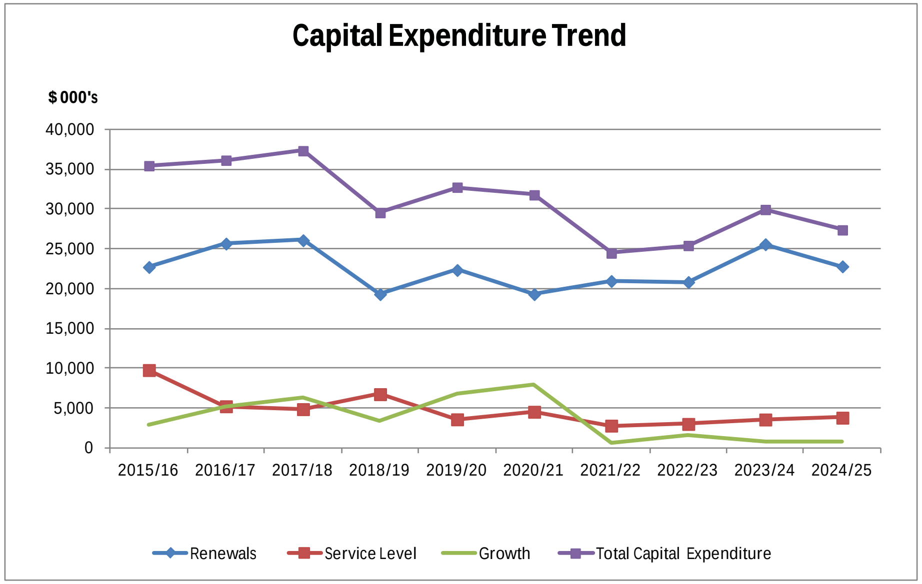


Figure 5: Capital expenditure trend over the LTP 2015-2025

Growth

As per the significant forecasting assumptions outlined in Section1 Introduction and Strategic Overview, the district population is forecasted to grow by 8,000 or 11 per cent over the next 10 years. This will equate to approximately 350 dwellings annually which is approximately a one per cent growth rate. The Asset Management Plans and Infrastructure Strategy have taken these growth forecasts into consideration and our existing assets together with the growth projects included in the plan will ensure the district will continue to meet the levels of service outlined in this plan. There is also adequate land supply and provisions within the District Plan to ensure the adequate availability of land.

Capital expenditure growth and service level	
	2015-2025 $m
Roads	17.63
Wastewater management	11.99
Water supply	28.49
Stormwater drainage	2.09

Debt (borrowing)

The Council's debt profile is outlined in Figure 6. There is minimal growth in overall debt over the 10 years. This is a result of reduced spending on big capital projects and the Council's policy on loan repayments, which means approximately four per cent of principal is repaid annually. For details on debt management refer to the Treasury Management Policy, contained in Section 7 Policies.

The Council is required to have a limit on debt. The Council's limit is to have a maximum external debt level where interest costs are no more than 12.5 per cent of rates income, occurring within the 10-year period. This is a prudent measure and well within the requirements of our rating agency Standard and Poor's and the Local Government Funding Agency (LGFA). This limit would allow maximum debt in 2025 to be approximately $206m assuming an interest rate of six per cent. Forecast debt for the plan at the end of 10 years is $137m (see Figure 6).

Managing debt in a prudent manner helps the Council build resilience and sustainability as it provides the Council with the financial capacity to cope with exceptional circumstances, or unforeseen events.

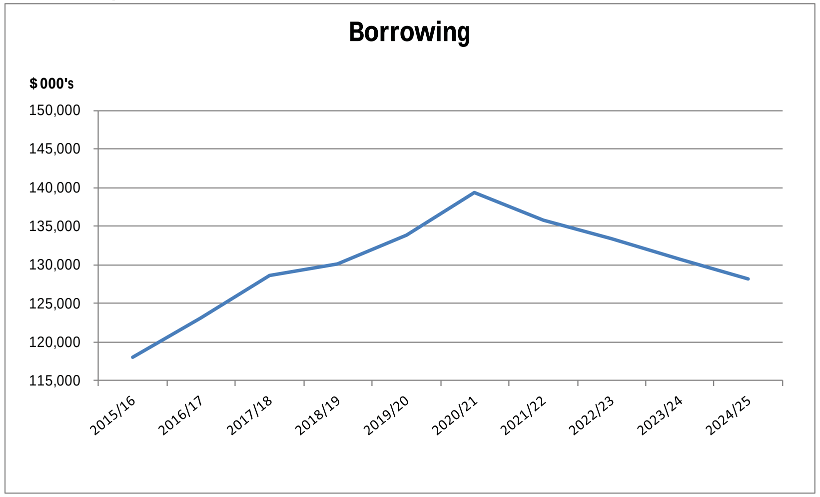


Figure 6: Borrowing profile over the LTP 2015-2025

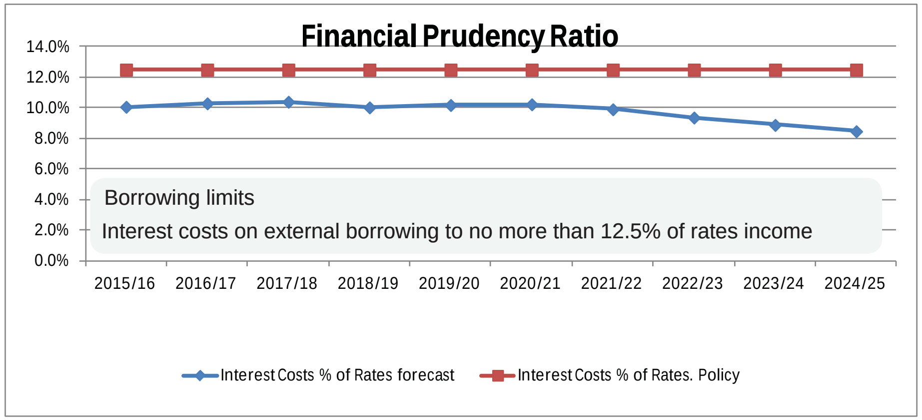


Figure 7: Financial prudency ratio for the LTP 2015-2025

Investments

The Council holds investments in short-term deposits which relate mainly to restricted reserves and renewal funds. These investments are managed in line with the guidelines set out in the Treasury Management Policy. The Council's main investment is the PIF.

The annual dividend to the Council from the PIF is an important component of the budgeted income. Historically the release has been too high and not sustainable, meaning the real value of the PIF has been reducing, limiting further growth. The last LTP recognised this, and factored in a declining release. Due to lower than expected returns the reduced release was still too high and the Council over the last few years has reduced this further.

In the development of this LTP a further review of the PIF and the release rule has been undertaken. The release rule has been amended and will be approximately 3.3 per cent of the capital value of the PIF on an annual basis. The complete release rule, which factors in a smoothing mechanism, is outlined in the Treasury Management Policy, refer Section 7 Policies.

The Council is now less reliant on the release, with the proposed release for 2015/16 approximately five per cent of total income. In 2010/11 it was 16 per cent of income. Reduced reliance on the PIF release has meant an increase in the total rates requirement to offset this loss of income. This is the key factor why the rates requirement for year one at 6.8 per cent is above the Council limit of five per cent. The rating impact would have been higher but the Council's focus on cost savings and efficiencies has helped limit the impact.

While investment returns are always uncertain an annual release of 3.3 per cent is considered conservative and should see the release slowly increase over the life of the LTP. The forecasted release is illustrated in Figure 8. The forecast PIF balance at six per cent return is illustrated in Figure 9.

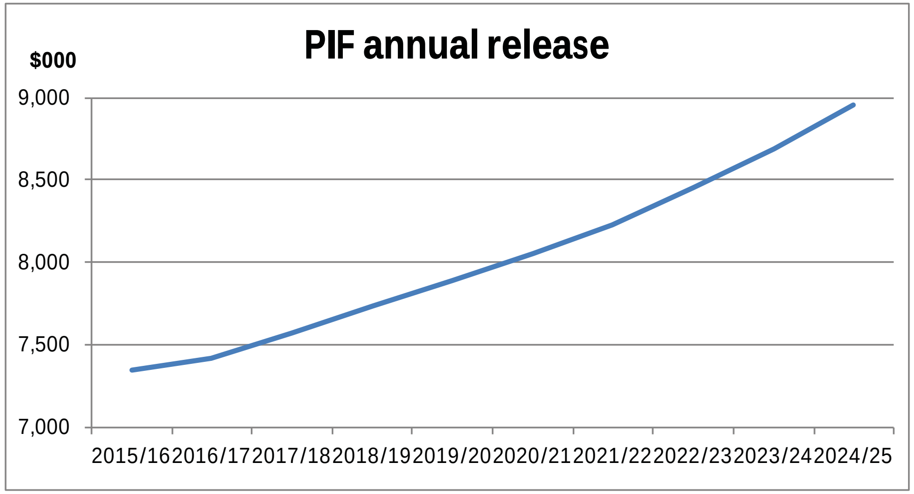


Figure 8: PIF annual release

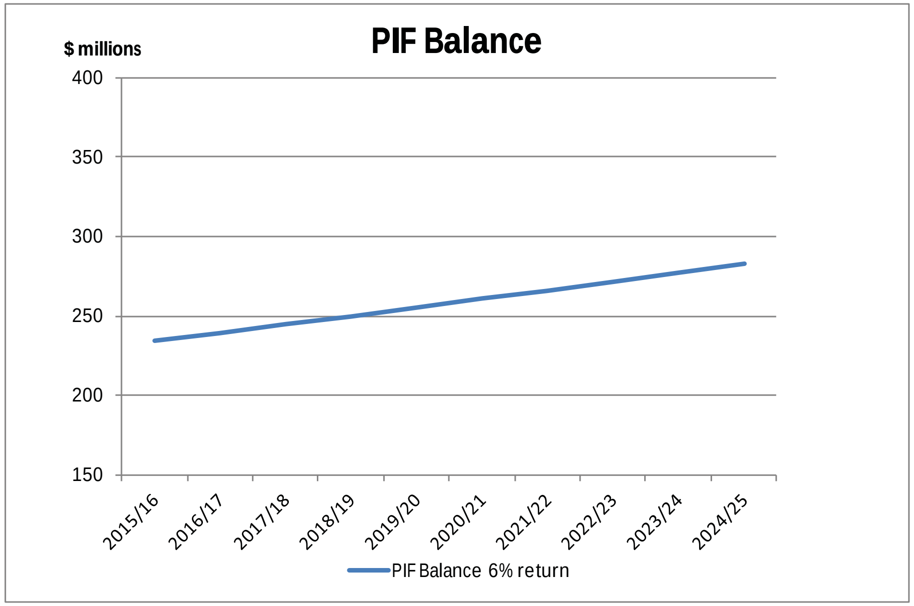


Figure 9: Annual balance of PIF at 6% return

Service level impacts

While trying to reduce the rates requirement the Council has reviewed its activities with a view to maintaining service levels where possible and appropriate. Almost all service levels are proposed to be maintained with the exception of the following activities: Community Funding, Community Development, Roads and Water and Wastes. The detail of the service level impacts can be found in Section 4 Council Services. The total dollar expenditure saving of these reductions over the 10 years is approximately $15m.

Beyond 10 years

The FS builds on the previous LTP but with a greater focus on affordability and resilience. This will ensure New Plymouth District is still a vibrant community with a strong resilient economy and a clean green liveable environment beyond 10 years.

The plan builds greater resilience through a number of initiatives.

1. It incorporates a further reduction in the PIF release which should help ensure the release is sustainable and slowly increases, while also providing the fund a greater opportunity to grow. As a percentage of overall revenue the release is a much lower, thus reducing the Council's reliance on the release.

2. The plan continues to focus on core infrastructure with the final stage of the Wastewater Treatment Plant upgrade scheduled for completion in the first few years of the plan. Provisions have been made for the closure of the Colson Road Landfill and a new refuse and recycling collection system, and there is a strong focus on ensuring the district has a robust water supply into the future. All these initiatives will help ensure the district is well placed to maintain and enhance service levels and handle the continued steady growth patterns forecasted.

3. A focus on essential infrastructure means overall borrowing has been greatly reduced from the previous plan, which helps to reduce costs but also provides resilience for unforeseen events and provides capacity for projects into the future.

While the plan does not include major community projects progress is still being made with the continuation of the "Let's Go" walking and cycling strategy. The start of the LTP will see the opening of the Len Lye Centre and, while not funded by the Council, the Vickers to City roading improvements will be ready during mid 2016. In summary the FS supports a vibrant community with a strong focus on affordability and resilience that will help ensure the district is a great affordable place to live beyond the next 10 years.

Mandatory disclosures

The Local Government Act requires mandatory disclosures on the following:

- A policy on the giving of securities.
- Objectives and quantified target returns for holding and managing investments and securities.

These are outlined below.

Security for lenders

It is noted that the Council has a debenture trust deed dated 21 May 2009, registered in favour of Foundation Corporate Trust Limited, representing the interests of all lenders to/investors in the Council. The security is a floating debenture but provides the lenders/investors with a specific charge over the rates (levied under the Local Government (Rating) Act 2002) revenue of the Council.

Expected return on investments and main ownership objectives

The Council's most significant investments are held within the PIF. The two key ownership objectives for the PIF are as follows:

- To at least maintain the real value of the initial settled capital of the PIF over a perpetual timeframe.
- For Taranaki Investment Management Limited to seek to deliver a return to meet the obligations of the founding principle and a sustainable release to the Council.

The long term target return for the PIF overall is an annual return of 7.5 per cent. The PIF holds a number of different asset categories and the target return on these are detailed in the following table.

PIF estimated asset class returns are lifted from Melville Jessup Weaver (actuaries), and updated annually.

Sector	Net of fees per annum annual return % per annum
NZ shares	6.0
Australian shares	7.0
Global shares unhedged	7.0
Global shares hedged	8.9
S&P 500	7.0
MSCI EAFE	7.0
MSCI emerging markets	9.0
NZ private equity	7.5
Tasmanian dairy farm	7.5
Australian distressed private equity	8.5
Chinese private equity	10.0
NZ direct property	6.8
NZ listed property	4.3
Global listed property hedged	6.7
NZ bonds (aggregate)	4.3
Global bonds (sovereign)	4.6
Global bonds (credit)	5.6
NZ cash	3.9

The PIF's strategic asset allocation is detailed in the table below.

Debt asset class	Minimum %	Target %	Maximum %
Cash and short term deposits	0.0	5.0	30.0
Fixed interest securities and bonds	0.0	5.0	20.0
Total debt asset class	**0.0**	**10.0**	**50.0**
Equity asset class	**Minimum %**	**Target %**	**Maximum %**
NZ equities	2.5	5.0	10.0
Australian equities	2.5	5.0	10.0
US equities	5.0	10.0	15.0
European equities	5.0	10.0	10.0
BRIC and emerging market equities	5.0	10.0	15.0
Total equity asset class	**20.0**	**40.0**	**60.0**
Property and alternative asset class	**Minimum %**	**Target %**	**Maximum %**
Property	0.0	20.0	25.0
Other alternative assets	25.0	30.0	35.0
Total property and alternative asset class	**25.0**	**50.0**	**60.0**

Further information regarding the management and philosophies of the PIF can be found in the Treasury Management Policy (Section 7 Policies).

The Council's other investments include the following:

- Production forestry on Council-owned land and other joint venture forests operations. The main aim/ownership objective of the forest investments is to help supply the local timber industry with available logs as well as other objectives ancillary to the primary use of the land, e.g. recreation, screening. While the forests are commercially managed, no specific target return has been set.

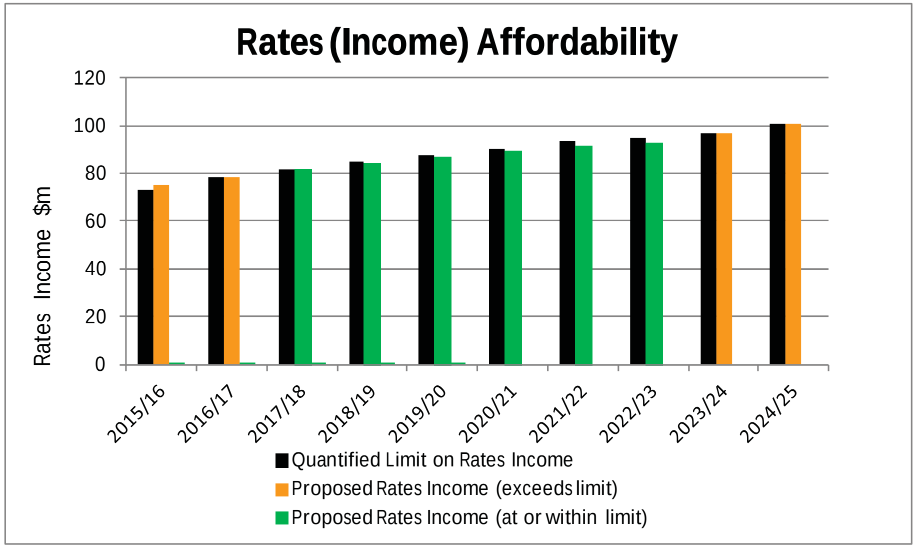
- The Council is a 50 per cent joint venture partner with the Crown in the New Plymouth Airport. The joint venture's objective is to run the airport operations and financing on a break-even basis.
- The Council holds varying amounts of cash as working capital and to help cover reserve balances. Cash is generally invested in term deposits with a maturity of less than six months. Target returns vary but are between three and five per cent.
- Other council properties and leasehold properties are managed to achieve a market return where appropriate.
- The Council has some minor shareholdings in Civic Assurance Limited and the LGFA. No target returns are set for these investments as they are largely focused on achieving lower costs for the insurance and borrowing needs of the Council.

Benchmarks

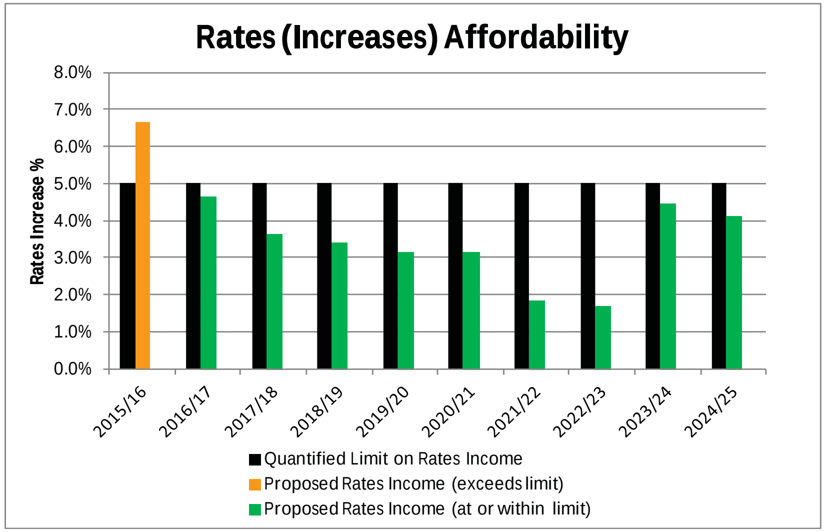
New Zealand local authorities have had a statutory obligation to manage their affairs in a financially prudent manner since 2002. However, there has been little discussion of what financial prudence means or how it is appropriately measured. The Government has introduced the Financial Prudence Regulations requiring the reporting of a range of local governments fiscal management measures. This is part of their ongoing focus on "Better Government".

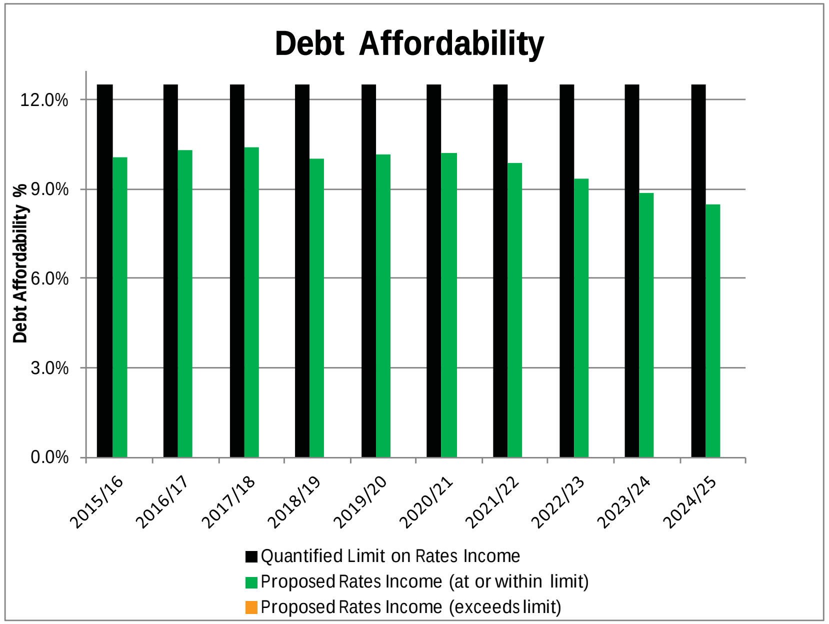
The measures don't provide all the answers to assessing fiscal prudence and because councils are not all structured the same way there will be variations within the sector. Therefore, in interpreting the measures, it will be necessary to consider those circumstances before reaching a conclusion as to the prudence of the authority's financial management. For example an authority may have low borrowings but this could be a result of not investing in their infrastructure. Where the Council does not meet a benchmark measure an explanation has been provided to explain why.

The following graph compares the Council's actual rates income in actual dollars, compared to the quantified limit on rates contained in the FS. The quantified limit in dollar terms is calculated based on an average annual increase of 3.9 per cent. The limit is slightly exceeded in earlier years due to the 6.7 per cent increase in the first year.

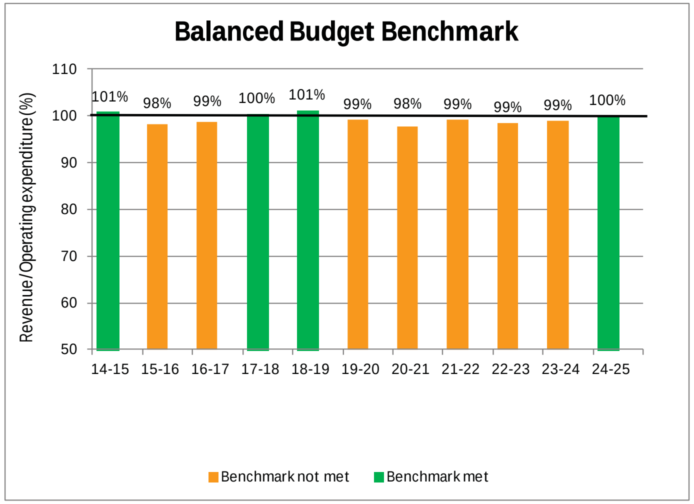


The graph on the next page compares the Council's planned rates increases with a quantified limit on rates increases contained in the FS. The quantified limit is set at no more than five per cent. It is exceeded in the first year due to the impact of the Wastewater Treatment Plant upgrade, the new kerbside waste collection service and a lower release from the PIF.





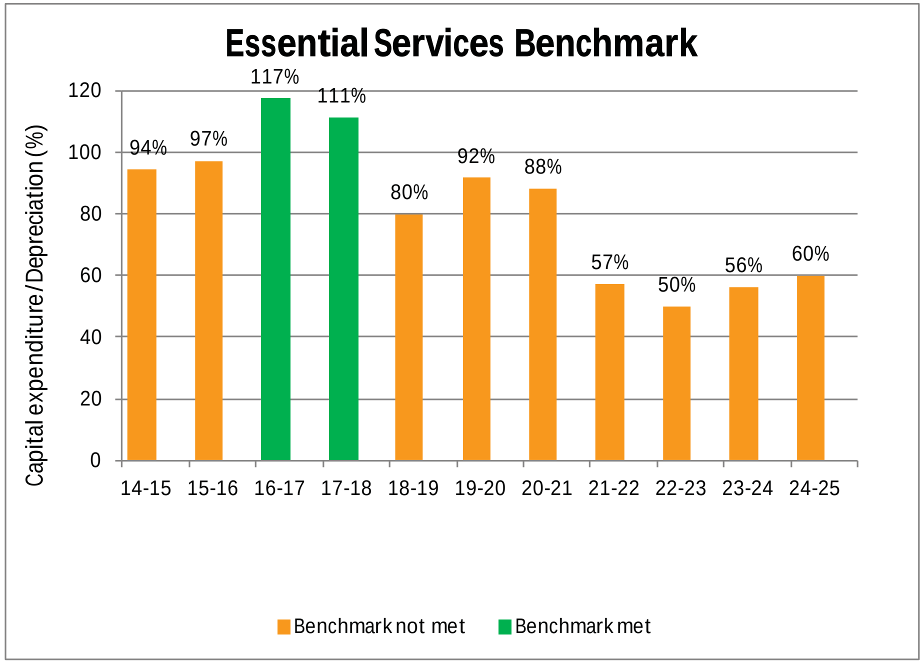
The Debt Affordability graph compares the Council's borrowing with a quantified limit on borrowing stated in the FS. The quantified limit per the FS is for interest expense on external borrowings to be no more than 12.5 per cent of rates income.



The above graph displays the Council's planned revenue (excluding development contributions, financial contributions, vested assets, gains on derivative financial instruments and revaluations of property, plant or equipment) as a proportion of planned operating expenses (excluding losses on derivative financial instruments and revaluations of property, plant or equipment). The budget is not balanced in line with the criteria as the Council does not fully fund depreciation. The Council uses a long run average renewal approach to renewal funding and carries renewal reserves in excess of $30m to ensure the right level of funding is held for renewal expenditure. For further information refer to Section 5 Financial Information and Statements (Balancing the Budget).

The Council meets the balanced budget benchmark if its planned revenue equals, or is greater than, its planned operating expenses.

The following graph displays the Council's planned capital expenditure on network services as a proportion of expected depreciation on network services.



The Council meets the essential services benchmark if its planned capital expenditure on network services equals or is greater than expected depreciation on network services. The Council bases its capital expenditure on robust asset management plans. The plans are regularly updated and reviewed to ensure assets are being maintained to meet the desired service levels, and are maintained or renewed based on optimised decision making. While the Council does not meet the benchmark in later years, the Council is confident in its renewals and capital expenditure programme. Due to strong historical capital expenditure, robust asset management plans and renewal reserves greater than $30m, the Council has confidence in its essential infrastructure and the resources to maintain it. For further information on infrastructure assets refer to Section 3 Infrastructure Strategy or relevant asset management plans.

The following graph displays the Council's planned borrowing costs as a proportion of planned revenue (excluding development contributions, financial contributions, vested assets, gains on derivative financial instruments and revaluations of property, plant or equipment). Because Statistics New Zealand projects the Council's population will grow slower than the national population is projected to grow, it meets the debt servicing benchmark if its planned borrowing costs equal, or are less than, 10 per cent.