2018-2028 Financial Strategy
Supporting Document for 2018-2028 Long Term Plan

February 2018
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Document Revision

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1. Executive Summary

This financial strategy sets the overall direction for the management of Council’s finances over the next 10 years.

The overall aim of Council is to continue to deliver its services in a financially sustainable manner that ensures that our communities continue to receive the services Council provides while recognising the need for rates to remain affordable.

At the 30 June 2017, Council had a strong financial position with $1.5 billion of assets, made up of $1.3 billion of roading assets, $78 million of wastewater assets, $54 million of water assets, $18 million of stormwater assets and $20 million in cash and no external debt.

This strategy discusses the challenges Council faces including those which come with having to provide infrastructural services to a number of small to medium sized communities spread over a large geographical area. Our future population projections show that in the future while our overall population will experience modest growth a number of our communities will experience a decline. These declines, when combined with an overall aging of the population will create a number of affordability challenges in the future. Council has identified a number of planning projects that’s it needs to undertake to inform this discussion over the coming years.

Additionally Council is also incurring a number of increased costs as a result of inflation and increasing compliance and environmental standards and it is also looking to improve Councils open spaces available for the community. The challenge for Council is to ensure rates remain affordable for current and future users whilst maintaining current levels of service. Any decisions taken today should not adversely affect the choices of future generations.

What is affordable can be a highly subjective judgement as the wealth and income of our residents will always vary. Council see it as important however, that we continue to consider the implications of the decisions we make on the affordability and thus the sustainability of rates. Council has started to undertake some work to inform the affordability discussion it needs to undertake with its ratepayers. This work, outlined further below, indicates that in terms of the affordability indicator outlined in the 2007 Independent Inquiry into Local Government Rates that council rates, before including the regional councils rates, for many of our townships are nearing the five percent of total household income indicator and in two of our communities they are over. This means that going forward, Council alongside the community will need to make some tough decisions on future needs and wants and the levels to which services are provided.

Financially, this strategy is generally one of transitioning, with a number of pieces of work to be completed in the coming three years in anticipation of the 2021-2031 long term plan. An important element of the strategy is a continuation of the decision we made in 2015 to increase the level of annual usage of core infrastructure assets (depreciation) that we are funding by 10% annually, until 100% is achieved in 2024-25. By doing this we are recognising that each generation needs to contribute towards the cost of replacing the assets that are used in the delivery of services to our communities. The infrastructure strategy indicates no significant new core infrastructure projects or renewals unless they are required to be undertaken to meet regulatory requirements or where the works will minimise the ongoing operational costs or for improvement of safety. However Council is indicating the need to review the accommodation of staff currently based in Invercargill. It is expected that if the planned projects are undertaken that external borrowings will need to occur which will be undertaken in line with Council’s Investment and Liability Policy.
The key mandatory measures are as follows and outline Councils key goals:

- Limiting rates increases to no more than the Local Government cost index plus 2% (in 2017/18 the limit was 4.61% with the actual rates increase being 3.63%)
- Rates representing no more than 70% of total annual revenue.
- External debt being limited to 100% of total annual revenue.

The goals and limits in this strategy have helped in developing the financial decisions in the Long Term Plan 2018-2028.

2. Financial Goals

The key financial goals for Council over the coming 10 years are to:

- review and maximise non-rating income opportunities, through advocacy to Government, commercial opportunities, fees and charges and income on assets held.
- review the way Council rates to gain efficiencies where possible (as part of looking at the sustainability and affordability of rates).
- ensure the costs associated with using services are shared fairly across the users of today and in the future.
- use debt appropriately.
- comply with all legislative and statutory requirements.
- ensure ratepayers money is invested and spent wisely and sustainably.
- allow capacity within the budgets to respond to events as appropriate.

3. Context and Strategic Issues

In preparing a financial strategy, Council faces the challenge of balancing the known with the unknown. Increasingly, it faces added pressure financially, geographically and politically. It is against these challenges that it sets its financial strategy and one in which it must incorporate some of the significant challenges it faces which include:

Our community is changing

The makeup of our community is changing. The modelling undertaken is showing that the number of people in our community will increase by 3,379 over the coming 10 years so that we will a total population of 32,992 in 2028. The average age of our resident population is also expected to rise following the current trend. Currently the 55 to 75 year olds make up 25.4% of Southland’s employed workforce compared to 12.2% in 1996. An older population has the potential to require Council to provide different services, but with potentially less disposable incomes from which to pay for the services.

It is expected that the amount of land used for dairy farming will rise from 5.7% currently to 6.6% in 2028 (an additional 26 thousand hectares). This land will come from current pastoral properties. At the same time land used for forestry is also expected to rise gradually. Given that the population is not significantly changing only minor increases in residential, lifestyle and commercial/industrial land is expected. To understand what the impacts of population changes and land use changes will have on Council long term, Council has included in the long term plan a budget of $2.6million over 10 years to investigate the issues further. At this stage Council has no capital or operating costs specifically included in its budgets for changes anticipated in these areas.
Rates made up 60% of Council’s income at $43m (30 June 2017) this was paid by 19,047 properties of which 48% are residential, 24% are dairy and farming non-dairy and 17% are lifestyle with the balance being commercial, industrial and other. With changes in the population and more elderly than ever before it will likely lead to changes in the types of services needed as potentially more will migrate to larger towns where medical services etc are available. These changes along with typically lower levels of disposable income means that it is even more important to ensure that rates are sustainable.

Affordability

Maintaining rates affordability where there are variations in the income and wealth of those within our communities is an ongoing issue. Council is not able to contribute to the wellbeing of its community if the cost of its services exceeds the ability of its community to pay. It is an issue that Council is going to undertake further investigative work to inform it and the community further in the coming three years.

The start of the project has been work around comparing the 2016/17 rates against the proposed affordable level of rates indicator identified in the local government rates enquiry commissioned by central government in 2007 which is that rates are less than 5% of total household income. The below table is looking at residential properties, as defined by Council’s valuer QV, within the following communities:

<table>
<thead>
<tr>
<th>Community</th>
<th>SDC Average Rate 16-17 (GST incl) for residential houses</th>
<th>Average 2013 Census Income - Total Household</th>
<th>5% of Average Household Income - Total Household</th>
<th>Difference between 5% of Average Household Income to SDC Average Rate 9. Average Rate (GST incl) as % of Average Income - Total Household</th>
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<tr>
<td>Ohai</td>
<td>2,119 34,200 1,710 - 409 6.20%</td>
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<tr>
<td>Nightcaps</td>
<td>2,100 39,900 1,995 - 105 5.26%</td>
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<tr>
<td>Tuatapere</td>
<td>2,365 49,000 2,450 85 4.83%</td>
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<tr>
<td>Wyndham</td>
<td>2,637 54,900 2,745 108 4.80%</td>
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<tr>
<td>Riverton</td>
<td>2,485 53,700 2,685 200 4.63%</td>
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<tr>
<td>Manapouri</td>
<td>2,443 54,900 2,745 302 4.45%</td>
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<tr>
<td>Balfour</td>
<td>2,057 47,100 2,355 298 4.37%</td>
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<tr>
<td>Te Anau</td>
<td>2,596 62,800 3,140 544 4.13%</td>
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<tr>
<td>Otatouau</td>
<td>2,281 55,700 2,785 504 4.09%</td>
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<tr>
<td>Lumsden</td>
<td>2,280 56,400 2,820 540 4.04%</td>
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<tr>
<td>Edendale</td>
<td>2,559 69,000 3,450 891 3.71%</td>
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<tr>
<td>Winton</td>
<td>2,297 63,300 3,165 868 3.63%</td>
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<tr>
<td>Athol</td>
<td>1,255 39,600 1,980 725 3.17%</td>
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<tr>
<td>Garston</td>
<td>1,580 52,600 2,630 1,050 3.00%</td>
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<tr>
<td>Stewart Island</td>
<td>1,904 64,700 3,235 1,331 2.94%</td>
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<tr>
<td>Mossburn</td>
<td>1,803 68,700 3,435 1,633 2.62%</td>
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<tr>
<td>Riversdale</td>
<td>1,748 67,200 3,360 1,612 2.60%</td>
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<tr>
<td>Wallacetown</td>
<td>1,890 73,100 3,655 1,765 2.59%</td>
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<tr>
<td>Waikaia Town</td>
<td>1,206 56,400 2,820 1,614 2.14%</td>
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<td></td>
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<tr>
<td>Woodlands</td>
<td>1,171 70,800 3,540 2,369 1.65%</td>
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For this Council the question of affordability is also complicated by the varying services amongst its communities. For example not all communities have a connection to water or sewerage schemes.

As the above only looks at residential properties, Council will continue to expand on this work in an attempt to understand and inform its communities of the implications of decisions made. Given the findings are currently excluding the regional councils rates the ability to continue to significantly increase rates is limited if using this measure as a level of affordability.

Set against this rising costs and increasing compliance requirements and changes in the demographics of our community, the challenge to ensure rates remain sustainable is even harder. Currently we receive a contribution of 52% from the NZ Transport Agency (NZTA) to assist with the maintenance of our roading network. The NZTA’s contribution is set to decrease a further 1% to 51% in 2018/19. Council has assumed for this plan that funding will remain at that level. Overall NZTA income makes up 21% of Council’s overall income but is conditional on the planned roading programme meeting the criteria of NZTA. Changes in the criteria and/or the level of funding exposes ratepayers to contributing more towards the overall financial cost or potentially reducing the roading programme which will affect the quality or quantity of the roads.

The infrastructure strategy also notes that council is continuing to push the life of the roading network for longer than its design life. The 80/20 policy introduced by Council is still in the early years and Council will understand more fully the implications of this policy as time goes by. The key is to invest at the correct time and not complete work early in the asset cycle life. A project is planned to get a greater understanding of when SDC roads will need rehabilitation. Additionally the stormwater network across the district is aging. A mixture of a lack of good quality asset data, no structured renewals plan and the potential of changes in consent discharge conditions as part of Environment Southlands Land and Water Plan has the potential to add significant cost.

**Sustainability of services and core infrastructure**

Council has 28 townships spread over its district, each with its own infrastructure. Due to the small size of these communities the cost of creating and maintaining the infrastructure is higher per person than if there were fewer communities or greater populations in each. Going forward some small communities may need to consider alternative methods for water and sewerage to ensure the services remain affordable.

Council has $1.42 billion in infrastructure assets at 30 June 2017, including the largest roading network in New Zealand. In order for Council to manage its infrastructure it needs to ensure it holds accurate information on what assets it has, where these are, how long they have been there and their expected lives. It needs this information in order to plan maintenance, undertake renewals and to calculate the annual usage of the asset by residents and ratepayers. Not having the correct information impacts on the work programmes undertaken and ultimately the rates needed to pay for the overall infrastructure programme. Council has assessed that it has some improvements to be made to its data and has initiated some projects to start that process. In the meantime it believes that the current phased approach to funding of depreciation is a prudent approach.

The infrastructure strategy plans to maintain the minimum levels of service across its activities for the 10 years of the plan.

**Increasing Environmental and Regulatory Standards**

Council is bound by various regulations and legislation. Central Government continues to add additional responsibilities and standards on local councils. A revision of the Freshwater National Policy Statement is a recent example. These regulations and legislation are enacted to protect people, property and
environment. Stipulations around the quality of our drinking water, the level of discharge and where that discharge of wastewater can go along with health and safety requirements have all added additional costs to Council delivering its services to our community. Council is not saying that anything is wrong with these however it is important that residents and ratepayers understand that often these costs add considerably to the overall rate increases.

The potential impact of the regional councils land and water plan has been estimated in this plan and has added significantly to the costs of the stormwater networks of our communities.

**Community Resilience**

The Southland District, is widely dispersed. Areas are subject to flooding, storm damage and earthquakes. Any form of natural disaster can cause significant unbudgeted costs. These costs will be met from two main sources being Council ratepayers and Central Government. Currently the Government funds 60% of Council's costs. This approach is being reviewed and may well see Council funding a bigger share. Council will fund its share from three sources, its insurance policies, borrowings and reserves. Currently Council insures all of its above ground assets for replacement cost but “self-insures” for its underground assets. The decision to self-insure is being reviewed by Council with an allowance in these 10 years for insurance of underground assets should Council decide to do this. To fund this “self-insurance” Council had set aside $1 million in reserves with the balance to come from external borrowings, repayable by rates.

We still need to understand the impacts of climate change fully on our district. The assumptions section outlines the potential impacts. Council will need to make decisions where climate change occurs on a case by case basis. Climate change has the potential to add additional cost. Council’s key approach is to ensure it has appropriate insurance coverage, and capacity within its borrowing programme to fund potential works where it deems it appropriate.

**External Factors**

This financial strategy is developed on a number of assumptions around economic, political and environmental. Any changes to these, such as an increase in interest rates on external debt and changes to bitumen changes can impact on Council's Long Term Plan and the financing of such. Council needs to allow capacity in its finances to allow it to respond appropriately and yet ensure the ongoing sustainability of its rates, the level to which this is provided will form part of the work around the affordability of rates.
The below tables outline the sources of funding and the key costs, excluding depreciation of Council over the 10 years of the plan.

Funding of expenditure may come from any of the funding sources shown in the income graph above. The exception being that NZTA income is only for roading activities.
The following is the financial strategy of Council in regards to how it will achieve the financial goals discussed above whilst considering and including the impacts of the challenges and strategic issues it faces.

**Rates Funding**

Council will continue to receive the majority of its income from rates. The following table outlines the activities that rates have been collected for over the 10 year period of the Long Term Plan.

As part of its strategy, Council has set the following rates limits:
- Limit rates increases to the LGCI (Long Government Cost Index) plus 2%
- Total rates are no more than 70% of total annual income.

Council is still not certain what the changes in population and land use will do. However it is not expected that there will be a significant change in the number of ratepayers who can contribute to the overall costs. As part of future planning work Council needs to have some hard conversations with the community over the levels of service it needs versus what it wants. In the meantime this plan is based on generally maintaining the current levels of services, replacing assets where the long term cost of replacement is better than incurring maintenance costs. Other opportunities for risk adverse investment will be considered during the term of this plan but currently the strategy is to only estimate funding where investments are currently held.

Council will continue to use rating as a last source of revenue. Although Council will continue to seek funding from other sources where it can, apart from NZTA funding for roads, the other income that Council receives only makes up a small percentage of its revenue. Rates will continue to make up the largest percentage of funding of its services. Where grants and subsidies are used as a budgeted source of funding, but is not received, the project may not be completed or deferred while other funding sources are sought. Fees and charges will continue to be set where there is a private benefit from the service being provided. Council will continue to recognise that for some services there is a public good component in this service and contribute an element of rate funding to offset the overall cost eg; 20% of the building regulation department costs are funded from rates. Council wants to actively promote growth in our communities and as such has left the development contributions policy in remission. It is continuing to collect financial contributions for roading and reserves however these will cease in 2022 when the legislation is repealed.
In 2018/19, Council will collect from rates 40% of the annual cost of assets wearing out (depreciation). Many of Council’s assets provide benefits now and into the future. The annual cost of these assets needs to be shared by those who use the services that these assets help deliver. In ensuring that the burden of replacing these assets is not on future generations, the strategy is to put aside money every year to fund the replacement. The amount of money to be put aside is based on the average lifespan of the asset. Council considered the affordability of fully funding this change in policy in the 2015/25 plan and rather than ratepayers having a major increase in rates to meet this cost it has spread the increase over 10 years. This means that in 2024/25 100% of the depreciation will be collected. At this stage this policy only covers roading water, wastewater, solid waste, computers and vehicles. Council will consider the potential funding of depreciation for local assets such as stormwater, playgrounds as part of the lead up to the 2021 long term plan.

The funding taken for depreciation will be used to fund any capital work planned for these assets and to repay the principal of any loan taken out in relation to these assets. Additionally in 2018 the use of these funds has been extended to include the repayment of interest on these loans.

Funding of the roading programme is from NZTA and rates. It is assumed that the level of funding from NZTA at 51% will remain for the term of the plan. Generally the roading programme is smoothed to reflect the work needed but also the level of work that can be completed by qualified contractors in a year. Where the programme does have a higher or lower level of rates needed than usual, the rates required will be smoothed. This smoothing will either be done from loans or if the change is less significant from transferring money to reserves and drawing down from these reserves in future years.

Council will continue to fund the balance of its operational expenditure from rates. The increasing costs of compliance and maintaining the current levels of service across the plan will result in an increase in rates. During the course of the plan it is expected that Council will have other requirements placed on it that it needs to meet, any operational costs that arise from this will result in an additional increase in rates through future plans.

Council intends to ensure a level of fairness and equity in how those rates are spread across ratepayers but also ensure some efficiency in the way it rates. Currently Council has 171 rate types, in considering the type and collection method it is attempting to acknowledge those who benefit from the provision of the service, those who contribute to the cost of providing the service and the overall affordability of rates to everyone in its community. Overall the total amount required does not change, just who pays what.

Council wants to balance fairness and equity with the resources needed to manage the current rating system. It also wants to ask the larger question of its community around the sustainability of rating in communities where there is changes that could make rates unaffordable. To do this Council will over the coming three years undertake the following

- Undertake a full review of the rating mechanisms it uses to ensure the cost/benefit or administering and the purpose is appropriate.
- Undertake a number of community conversations around the issues of rating policy, rating sustainability and potential rating models

**Debt**

Debt will be used by Council where it is appropriate to do so. At 30 June 2017, Council had internally borrowed $20.2 million. At the 30 June 2017 Council had no external debt.

As part of its strategy Council is continuing to limit external debt to 100% of total annual income, for 2016-17, this is equivalent to $72 million.
Debt will be used to fund long term infrastructure where rates collected for the replacement of assets is not sufficient. It will also be used where Council has to meet the costs of any unplanned capital works. Unplanned capital works may result from the potential change in land use eg: a road now used by heavy traffic requires capital replacement before it was planned, natural disasters or from Councils policies to get the most from an asset resulting in work undertaken before it is planned.

The LTP is planning on $257.6 million of capital works during the 10 years. With the largest being roading $182 million, wastewater $30 million, community services $23 million, water $7 million and stormwater $5 million.

The infrastructure strategy does not identify significant new infrastructure projects and renewals unless they are required to be undertaken to meet regulatory requirements or where the works will minimise the ongoing operational costs apart from potential changes to the Invercargill office building. Where major renewals are planned, the long term plan reflects the work required however these works will only be completed if the long term business case stacks up. In considering the business case, Council will be looking at multiple alternatives for delivering the service in the most economical way to ensure that the long term benefits still exist. At times these conversations are going to be hard and the outcome may not suit everyone however they may need to occur to ensure the long term sustainability of services.

In the meantime Council will continue to internally loan to fund capital works necessary, in 2019/20 if all the planned works are carried out Council will need to externally borrow.

The debt facility sought will be on the most favourable terms to Council. In setting the limit Council has considered the effect of debt repayments at this limit on the overall rates. The impact on rates, if $70 million was borrowed would be an increase of $4 million at 4% interest, $4.5 million at 5% interest over a term of 30 years or a 9.4% rate increase on 15-16 rates of $42.4 million. The security for this borrowing will be by way of a charge over rates. This is in line with Council’s Investment and Liability Policy.

As a result of this strategy, external and internal debt are projected as follows

Variance between capital and depreciation, are we maintaining our service level capacity?

Depreciation is often used as a ‘surrogate’ indicator of the level of funding that is likely to be required to maintain an infrastructural asset.
In an ideal world the level of capital expenditure in any year would equal or exceed the depreciation on those assets. By doing so would clearly indicate that a suitable amount of replacement work is occurring and that the burden of future renewal costs is not on the future user. In this plan there is a number of years where a variance occurs with renewals being less than budget. In considering this Council has noted that:

- Infrastructure assets have lives of up to 100 years, often there will be years particularly with water and wastewater where capital renewals are not planned, however Council is contributing to its depreciation funding reserve for when replacement is necessary. Where the funds saved are not sufficient to meet the replacement costs Council may still have to borrow and currently with the low levels of debt it has the ability to do this, but is mindful of the debt repayments on the affordability of rates.

- The asset data held by Council is still being improved. During this plan period, Council will continue to improve the data it has on its assets to ensure that the annual cost is being calculated on the assets held.

- The number of years that an asset is expected to last may be wrong. Council currently uses NAMS (New Zealand Asset Management Support) assets lives to calculate the annual depreciation. This is recognised as industry standard however the actual life of an asset is dependent on many factors such as the environment it is in, the amount of use it gets and the maintenance undertaken on it. During the coming years Council will undertake further work to understand the lives of its assets better.

- Currently the funding of depreciation is not undertaken on all assets. Council will revisit this policy over the coming term of the plan. In the meantime, the use of loans or reserves held will generally fund stormwater and other local assets.

**Investments**

Council continues to hold and manage a number of investments for strategic reasons where this is some community, social, physical or economic benefit accruing. Councils investment and liability policy outlines in more detail the approach to investment, in summary:

**Equity Investments**

Council only holds such assets for strategic purposes. Council has shares in a specialist local government insurance company and a local company to assist in the development and operations at Milford Sound. Council does not expect a return on these investments.

**Property Investments**

Council’s main objective is to hold property that is strategically necessary for the economic, physical and social development of the district and secondly to achieve an acceptable rate of return. Returns vary depending on the purpose held, returns vary from none to market rents. Council continues to review its portfolio to ensure that the properties held are appropriate to meet these objectives.

**Forestry**

Council has forest planted on 1,800 hectares of land. Forestry assets are held as a long term commercial investment with returns reflecting market conditions. Surplus funds are used to offset rates.

**Loans and Advances for community development purposes**

Council will occasionally provide a loan or advance to a community organisation to provide the provision of community services or recreational opportunities that Council would normally be involved in. Council sets the terms and conditions including security requirements as they are granted.

**Treasury Investments**
Investments of cash held for specific purposes are usually held as low risk short term deposits or bonds. Returns are market related to the type of investment made. The Council maintains treasury investments for the following primary reasons:

- Provide cash in the event of a natural disaster
- Invest special funds, bequests and reserve funds.
- Investment of funds allocated for future expenditure, implement strategic initiatives or to support intergenerational projects.
- Invest working capital and surplus cash.