Kāpiti Coast DISTRICT COUNCIL

Draft long term plan 2018-38

Consultation - supporting information

Financial strategy

DRAFT FINANCIAL STRATEGY

Contents

A Executive summary

B Introduction

C Council's long-term vision

D Strategic context:

1. Growth in population
2. Economic growth
3. Affordability
4. Review of rating system
5. Infrastructure strategy
6. Land use changes
7. Development impact fees
8. Intergenerational equity

E Financial strategy

1. Introduction
2. What has happened since the 2015–35 long term plan
3. A focus on reducing debt
4. Financial limits
5. The three financial levers:
   a) Capital expenditure
   b) Rates
   c) Borrowing
6. Security for borrowings
7. Investments
8. Level of service statement
9. Insurance

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A Executive summary

Overall the district is in good shape. The economy is strong, and the increased connectivity to Wellington and the attractiveness of Kāpiti as a place to live means we can be optimistic about our growth prospects for the next few years. Our planning is based prudently on the .id forecast of 0.76% per year population growth. We are able to deal with a higher rate of growth, should it eventuate, noting that with growth comes increased operational and maintenance costs of infrastructure assets.

While we welcome the growing prosperity of the district, we know that parts of our community are struggling. Rates rebates and remissions are effective tools for helping the vulnerable households in our community. The completion of our rating review will provide additional tools for managing rates affordability and any inequities arising from the revaluations.

The Council has recognised that while the direction set in the 2015–35 long term plan began to address our financial constraints, we need to go further and faster. The focus of the 2018 financial strategy is a reduced capital investment programme focused on infrastructure that supports resilience and agreed growth. We are planning to spend $169m on capital expenditure during the first six years of the plan, which equates to an average of $28m a year.

If we achieve our planned capital expenditure programme and also reduce the depreciation funding gap, we will be in a position to start paying down our debt during the course of this long term plan. This means that we will be well placed to fund a significant renewals programme in around 2045 when a large proportion of our water and wastewater assets, built between 1975 and 1981, will need to be replaced.

Our average rates increase for the first year of the long term plan is 4.7%; 4.8% on average for the first three years and 3% on average for the 20 years of the plan. This balances our focus on getting our debt down to more sustainable levels as quickly as possible with keeping rates increases at a manageable level.

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B Introduction

What is a financial strategy?

Our financial strategy sets out the overall financial goals of the Council for the 2018–38 long term plan. The strategy builds on our current financial position by setting out where we want to be positioned during, and at the end of, the long term plan period.

The Local Government Act 2002 (LGA) is the guiding legislation for all councils' planning and activities. The LGA requires that the long term plan period is for a minimum of 10 years however, our long term plan covers a period of 20 years. This is because we recognise the importance of planning for our long-term future as the decisions we make today can have significant impacts on future generations.

The financial strategy also provides guidance on how we consider and approach funding of expenditure proposals in the current long term plan, and informs all subsequent activity decisions made for the duration of the 2018–38 long term plan.

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C Council's long-term vision

The Council's draft long term plan strategy has identified the challenges that the district faces, including the affordability of Council services and the sustainability of the district economy. While all activities that are planned to move the district forward will have a financial component, the financial strategy focuses on the core financial actions.

The main targeted actions are to improve our financial position and give ourselves more room to manoeuvre within the current financially constrained environment, and to invest only in infrastructure that supports resilience and agreed growth. We will do this by undertaking a reduced capital expenditure programme that will enable us to start paying down our debt earlier than is currently forecast. In the short term this could lead to an improved credit rating. In the longer term this means that we will be in a better position to manage a substantial renewals programme for our three waters and roading infrastructure.

The key outcomes that these actions will support are to put the Council's finances on a more sustainable footing, and to increase the resilience of our assets and plan for the future.

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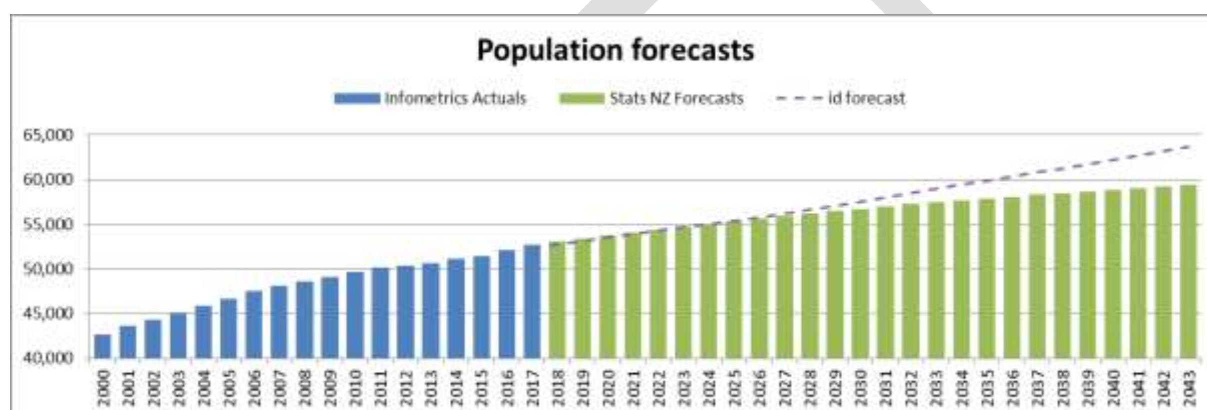
D Strategic context

There are a number of factors that inform, give context to and support the actions of the financial strategy. The most important of these factors are discussed in the following sections.

1. Growth in population

The chart below includes the Statistics New Zealand (Stats NZ) medium projection forecasts which reflect an average estimated population growth of 0.45% a year. The chart also shows the id forecast for the same period. The .id team comprises population experts who combine an in-depth knowledge of people and places with interactive web applications to help organisations decide where and when to locate their services to meet changing needs.

The id forecast is more optimistic than that of Stats NZ and reflects an average population growth of around 0.76% a year between now and 2043. The .id forecast is what we are using to underpin all our modelling for the 2018–38 long term plan.



Source: Infometrics – 2016 regional economic profile; Stats NZ subnational population medium projection 2013-43, February 2017; Population and household forecasts, 2013 to 2043, prepared by .id, February 2017.

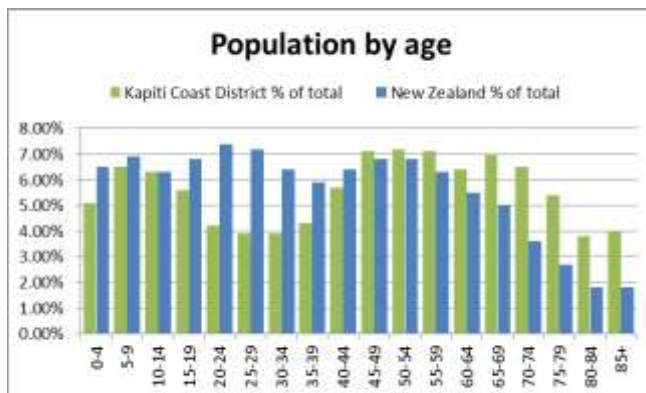
Both the id and the Stats NZ population growth forecasts are modest in comparison with the average growth of around 2% a year that the district experienced through to the early 2000s. The notable population increase of 1.15% for the year to 30 June 2017 compares favourably with the average annual growth of 0.90% for the preceding five years and with the long run id forecasts.

The single most likely explanation for this recent increase in population growth is the increased connectivity with Wellington following the completion of the expressway in late 2016. The Kāpiti Coast will become even ‘closer’ to Wellington in the next few years with the completion of Transmission Gully in 2020, and other Roads of National Significance. This is discussed further in the Economic growth section.

Population by age

The .id forecasts also anticipate that 32% of the population will be aged 65 and over in 2043, compared with 25% in 2013. The infrastructure strategy shows how the Council intends to meet the changing infrastructure needs of its community as the population ages.

The chart below shows the age range of the population for the district, compared with the country as a whole as at 30 June 2016. The notable differences are the higher proportion aged 65 and over; and the lower proportion of 20-40-year-olds, when compared with New Zealand as a whole.

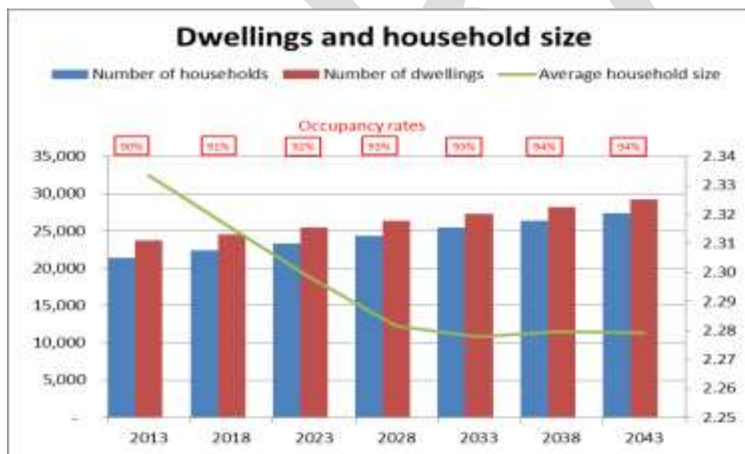


Source: Infometrics – 2017 regional economic profile.

Ratepayer growth

The link between the district population and the number of ratepayers is the average number of people per household, which determines the number of dwellings that are required. The lower the average household size, the greater the number of dwellings that are required. For the purposes of forecasting, the number of dwellings is used as a proxy for the number of rating units (ratepayers).

The average number of people per household is projected to decrease slightly over the next 20 years from 2.32 to 2.28, possibly due to our ageing population. Although recent growth in the number of dwellings has been sluggish, the forecast is positive and the expectation is for an average annual growth of 0.66% from now until 2043, as shown in the chart below.



Source: Population and household forecasts, 2013 to 2043, prepared by .id, February 2017.

The predicted growth in the number of dwellings is the key forecasting tool that we use to support our expectations for ratepayer growth. The total existing dwellings are only 91% occupied, which is likely to largely reflect holiday homes and baches. We don't expect this occupancy figure to change significantly, but any small occupancy increases will slightly reduce the need for increased dwellings and hence forecast ratepayer growth will marginally decrease.

This anticipated growth is supported by the house price and consent data in the next section.

2. Economic growth

National and international context

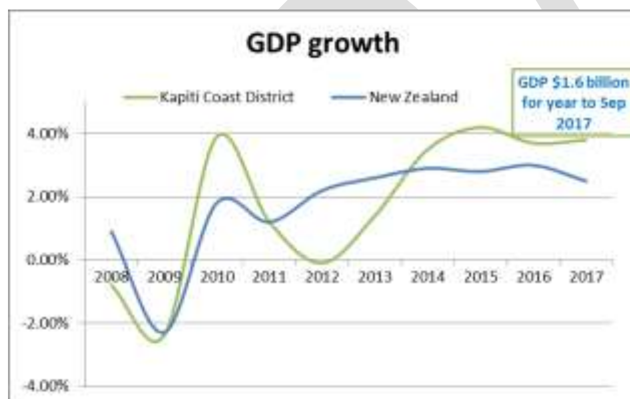
Overall, the economic outlook is reasonable. The falling house price growth, weak productivity growth, skilled labour shortage, peak inbound migration and slowing in the growth of international tourist arrivals are some of the factors that may negatively impact the New Zealand economy over the next few years.

The possible upside factors of solid household income growth, a more expansionary fiscal policy and terms of trade close to an all-time high mean that the New Zealand economy is likely to continue to grow for the foreseeable future.

On 8 February the Acting Reserve Bank Governor kept the official cash rate unchanged at 1.75% and signalled that it is likely to stay at this record low for more than another year. Interest rates are likely to return to more usual levels over the longer term; however, the speed at which this happens is uncertain due to a stronger than expected global recovery and resurgent inflation.

Kāpiti Coast district

With GDP of $1.6 billion for the year to 30 September 2017 the district is experiencing significant economic growth, higher than for the rest of the country, as shown in the chart below.



Source: Infometrics – Quarterly economic monitor – Sep 2017

Our GDP is understated due to the approximately 7,700 Kāpiti residents who commute out of the district daily for work and are estimated to earn around $480m. This amount is not included in our GDP. This highlights one of the challenges the district faces, along with the existence of a number of separate towns, limited employment opportunities in a few sectors and a high proportion of retirees.

All these things affect the ability of our economy to perform at its full potential. Our economic development strategy is helping to unlock Kāpiti's economic potential and bring more wealth into the district which in turn will enable us to invest in services and infrastructure that benefit all our residents.

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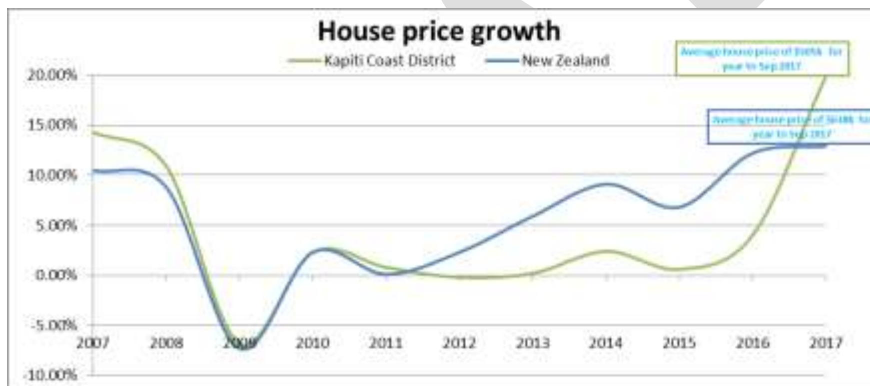
Construction is one of the key contributors to the economy, as witnessed by the scheduled roading infrastructure investment programme to 2021 that will see the completion of Transmission Gully as well as the Peka Peka to Ōtaki Expressway and Ōtaki to north of Levin projects, which together will comprise a substantial portion of the Wellington Northern Corridor.

After a brief delay, the New Zealand Transport Agency (NZTA) has confirmed a second round of consultation in February on the preferred route for the four-lane expressway from Ōtaki to north of Levin, with a recommendation to its board expected in mid-2018.

It is likely that these major roading investments and the increased connectivity with Wellington that they will bring have helped to stimulate building activity in the district. The value of non-residential resource consents was $30m for the year to September 2017 – a 19.9% increase over the previous year. In comparison, the value of consents in New Zealand increased by 5.9% over the same period.

Similarly, the 294 residential resource consents issued in the year to 30 September 2017 was 33% higher than the same 12-month period a year ago. The number of residential resource consents in New Zealand increased by 3% over the same period.

House prices on the Kāpiti Coast have continued to grow, while for the rest of New Zealand they have flattened and dropped off as shown in the chart.



Source: Infometrics – Quarterly economic monitor – Sep 2017

Another positive indicator of our growing economy is unemployment, which is 4.9% in 2017, down from the 10-year high of 6.7% in 2013. So there are many positive signs that the economy is growing.

3. Affordability

There is a converse to many of the positive indicators outlined above; that is the fact that the benefits of a positive economy are not necessarily accessible to all members of our community. For example, housing affordability (the average current house value divided by the average annual employment earnings from filled jobs) in the district has decreased in a manner mirroring the increase in house prices as shown in the chart below. The higher the value of the index, the less affordable housing is.

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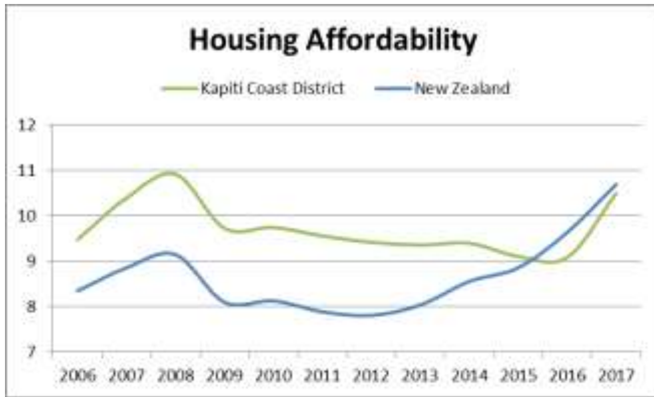
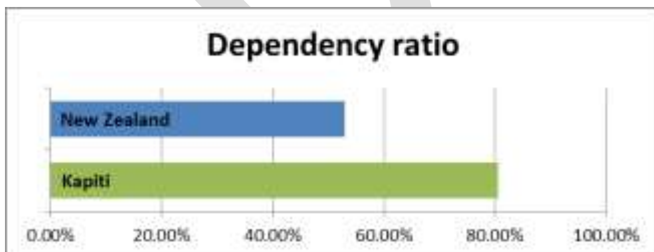


Source: Infometrics – Economic profile 2016

We know that housing affordability is an issue; so too is rental affordability, when compared with the rest of New Zealand, as shown in the chart below. The rental affordability index is the ratio of the average weekly rent to average weekly earnings. A higher ratio suggests that average rents cost a greater proportion of typical incomes, which indicates lower rental affordability.

Source: Infometrics – Economic profile 2016

Amongst our high proportion of people over 65, some people will still be working but many will be on fixed incomes. The dependency ratio is a measure showing the number of dependants, aged zero to 14 and over the age of 65, as a proportion of working-age people, aged 15 to 64. Our dependency ratio is very high compared with New Zealand as a whole, as can be seen in the chart below.



Source: Infometrics – 2016 regional economic profile.

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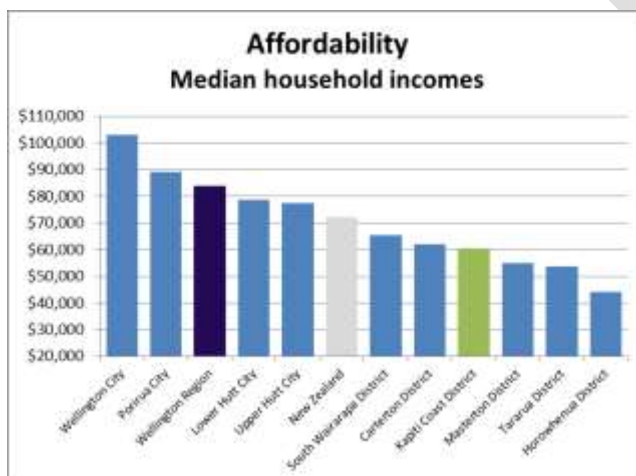
In addition, 11% of the working-age population are on benefits and many of those who are in employment work in low-wage industries, as shown in the chart below.

Source: Infometrics – 2016 regional economic profile.

So it is not surprising that our incomes are lower than most of our neighbours in the Wellington region, as shown in the chart below.

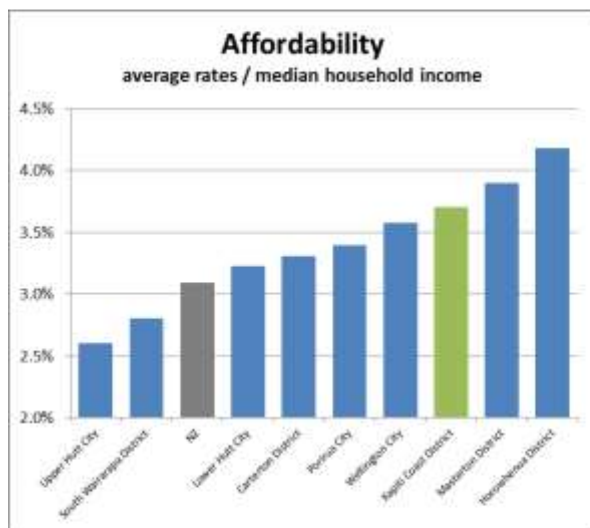


Source: Stats NZ – 2013 Census (uplifted by 3% per year based on MSD HHI trend)

Rates affordability

The Shand report in 2007 stated that “the forecast level of rates will not be sustainable in 10 years’ time”. The report also introduced “a very approximate threshold of rates affordability as being where rates exceed 5% of gross household income”.

The chart below indicates the affordability of our rates (excluding Greater Wellington rates) when compared with the other councils in the Wellington region.



Source: Stats NZ –2013 Census and Local Authority 2017 Annual Reports

At an overall level, Kāpiti rates are relatively high as a proportion of median household income. This is largely because household incomes are lower in Kāpiti, which means that rates are less affordable in Kāpiti.

Our most affected areas are Ōtaki, Waikanae West and Paraparaumu Central. These groups represent more than 7,500 households, and all have median household income below $50,000. Our analysis conservatively suggests that between 2,700 and 3,600 households may be experiencing rates affordability issues. This is before any rebates or remissions have been applied.

We administer and provide the government rates rebate of up to $620 per household to 2,200 households. And we also provide our own rates remission (hardship) of up to $300 per household to 600 households, usually in addition to (on top of) the government rebate.

For example, a property with a median household income of $30,800 and rates of $2,469 would have rates as a proportion of household income of 8%. After the combined rebate and remission of $900, the rates would effectively be $1,549 and rates as a proportion of household income would be 5%. So, using the Shand estimate as a measure of affordability, we can effectively mitigate against rates affordability issues using a combination of rebates and remissions.

4. Review of rating system

As part of the long term plan process, we are undertaking a review of our rating system. The aim of the review is to make our rates more equitable. We are concerned that some of the fixed charge components of our current rating system mean that our rates take a proportionally greater amount from those on lower incomes.

We have also recently had all the properties in the district re-valued, which has resulted in some areas being subject to higher increases than others. We have developed an option for change to the rating system that will help to mitigate the impact of these increases.

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The option comprises two parts – the first part involves changing the districtwide roading rate from a fixed charge per property to a charge relative to property value. The second part proposes to shift part of the economic development budget from a districtwide general rate to a separate targeted rate on the commercial sector based on a rate in the dollar of capital value.

5. Infrastructure strategy

What is an infrastructure strategy?

The purpose of the infrastructure strategy is to identify the significant infrastructure issues facing the Kāpiti district and options for managing them over a period of at least 30 years.

The infrastructure strategy must describe how we intend to manage our infrastructure assets, and associated expenditure needs, over the period of the strategy, taking into account a range of factors that affect the nature and cost of infrastructure provision.

Known infrastructural issues

The most significant natural hazard faced by the district is flooding. The stormwater network is under pressure from the combined effect of rising sea levels, higher groundwater levels and more rainfall.

Our preferred option is to upgrade the stormwater network to a level that protects houses in a 1:100-year event. The indicative costs of doing this are $489m. Given our need to balance our resilience investments against our financial constraints, this programme could take 45 years to complete. The early focus will be on properties that are susceptible to habitable floor-flooding.

Planned major projects

We have planned during the course of the long term plan for several major projects, including the town centres upgrade, which will cost around $26m, the development of Otaraua Park, which will cost around $10m, and the Mahara Gallery upgrade, costing around $5m.

Other major projects we are planning include the upgrade of the Waikanae Water Treatment Plant at around $17m and we will be investing up to $17.7m to replace the failing timber seawall in Paekākāriki.

In addition to this, we will be spending $121m on stormwater renewals and upgrades.

Renewals profile

Our below ground (water, stormwater and wastewater) and roading assets have an average remaining useful life of 25-60 years. This is a result of a lot of the existing pipe network being built over a six-year period between 1975 and 1981. This means that from around 2045 onwards, most or all of these assets will need renewing and this will represent a significant capital expenditure programme, as shown in the chart below.

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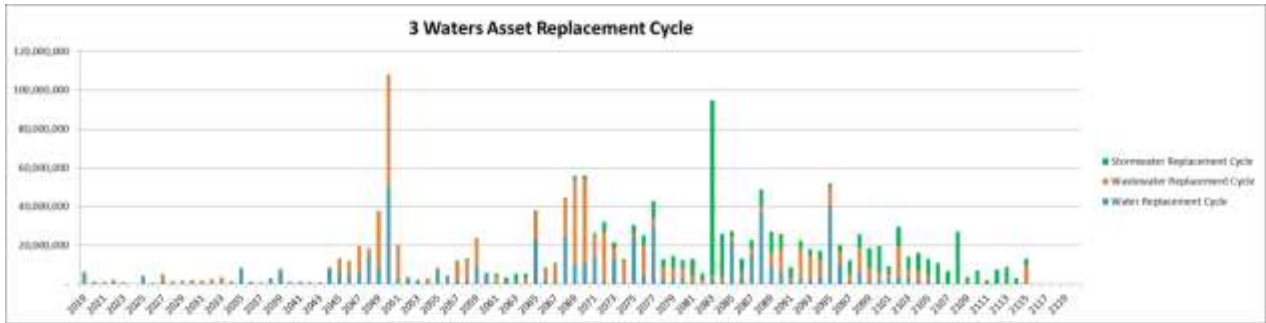

Source: internal data

It is important that the Council is in a strong financial position going into this major renewals period. Therefore, we will need to significantly reduce our debt before this time so that we are able to fund the renewals in a sustainable and managed fashion.

6. Land use changes

With the proposed district plan only just having been approved, its full impacts are yet to be known. The plan provides for the on-going growth and development of the Kāpiti District and does not anticipate any significant changes of land use.

7. Development impact fees

Development impact fees are a combination of:

- development contributions required under the provisions of the Councils development contributions policy (as amended in the 2018–38 long term plan); and
- financial contributions provided for under the Resource Management Act 1991 and the Council's district plan (part E).

Development contributions

Development contributions are forecast according to how we expect the district to grow and go towards the cost of capital expenditure for core infrastructure that is required as a result of growth. The Council's policy on development contributions states that 100% of the cost of capital expenditure that is needed to meet growth requirements is paid for by development. Or more simply – growth pays for growth. The Council funds some costs of development in advance of receiving the development contributions.

Having significant development contributions can be a disincentive for developers and can adversely impact housing affordability. Equally, large rates increases to fund growth costs would not be fair to our existing ratepayers so the Council needs to find a balance.

As required by the Local Government Act 2002, we are reviewing our current development contributions policy and we are consulting on any changes that we propose as part of the long term plan process.

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Financial contributions

Financial contributions consist mainly of reserves contributions, which are used to fund reserve development activities, such as the management of natural areas and the creation of recreation resources.

The Council intends to make the legislatively required replacement of financial contributions during the next three years.

8. Intergenerational equity

Intergenerational equity requires that each generation that benefits from an investment should contribute to the cost of that investment. Councils should generally only borrow to fund capital investment such as the building of infrastructure and amenities that benefit current and future generations. Debt is one way of smoothing the cost of construction over the generations that make use of, or benefit from, the service. It is a way of meeting the principle of 'intergenerational equity'.

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E Financial strategy

1. Introduction

The financial strategy in the last long term plan in 2015 aimed at achieving a balance by trying to deliver affordable rates to the community, minimise council borrowings and optimise capital spending. This balance can be represented by reflecting the three financial components of rates, capital expenditure and borrowings as levers, as shown in the diagram below.

The size of the triangle represents the level of service provided by the Council. A bigger triangle means an increased level of service (or new services). The triangle is affected by the three levers: rates, capital expenditure and debt. Changing only one lever can be achieved without affecting service levels by allowing the other components to adjust. Changing more than one component means the third lever also has to change, and thus service levels will change too.

Operating expenditure

It is worth noting that the triangle model does not incorporate operating expenditure. Clearly a significant increase in our operating expenditure would require a significant rates increase[1] to fund it, which in turn would affect the other two levers.

Our operating costs are already very low – in 2017 our costs were only 57% of the national average and we had the second lowest operating costs per ratepayer in the country, as shown in the following chart. This shows that we are providing value for money compared with almost all the other councils in New Zealand. However, it also means that there is limited scope to reduce our costs.

[1] Councils should not, as a rule, borrow to fund operating costs.

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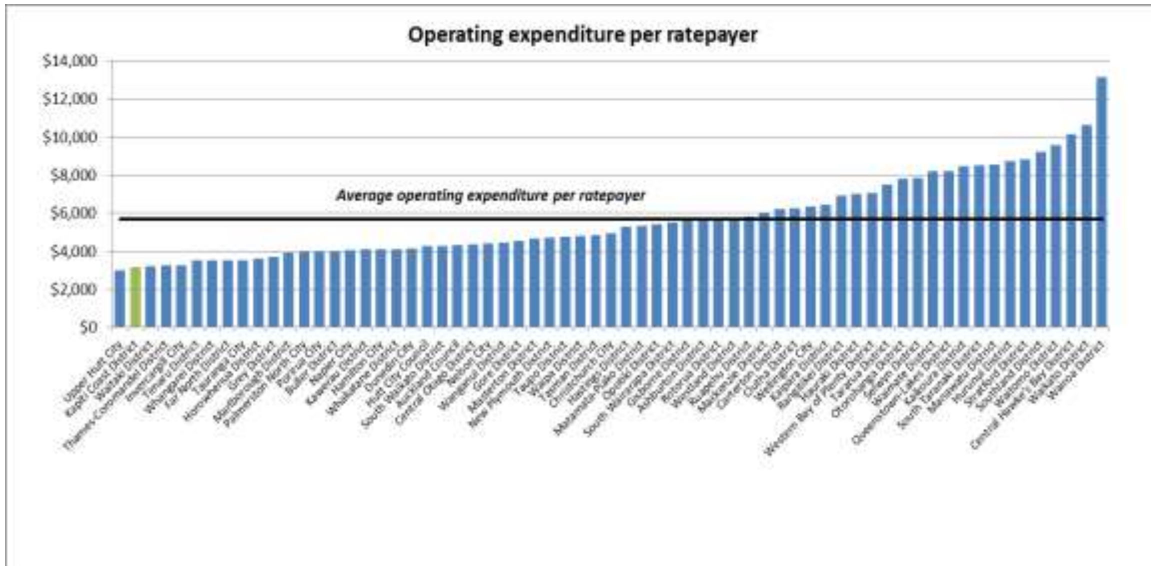
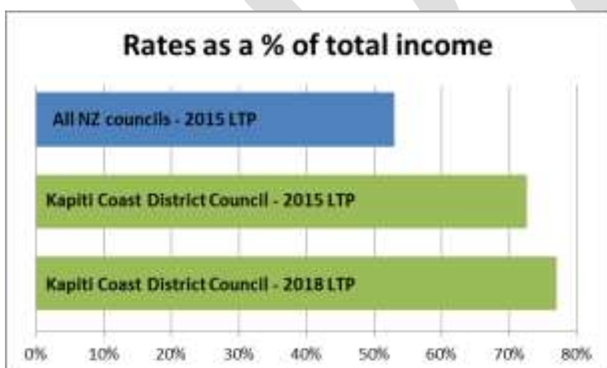


Source: Taxpayers Union - 2017 Ratepayers' Report

Our operations are funded largely by rates revenue

Similarly, we talk about rates as opposed to revenue – this is because we have limited sources of non-rates revenue compared with other councils. Rates revenue, on average, made up 53% of local authorities' total forecast operating income of $125.9b over the period 2015–25. For the same period, the Kāpiti Coast District Council rates represented 73% of the total operating income.

For the 2018–38 long term plan, our rates are forecast to be an average of 77% of our total revenue. This is shown in the chart below.



Source: OAG - Matters arising from the 2015-25 local authority long-term plans

This means that while we have very low operating costs per ratepayer, because our operations are substantially funded by rates, our rates per ratepayer are relatively high when compared with the rest of the country.

Other councils generate a greater proportion of rates revenue from the businesses that operate within their boundaries by charging them a higher differential rate. We have a small commercial sector to which we don't currently apply a business rate differential for general rates. However, following the review of the rating system we are proposing a commercial sector targeted rate of $500,000 to recover a portion of what we spend on economic development.

Other sources of revenue

The non-rates revenue that we can draw upon comprises mainly fees and charges, grants and subsidies, and development and financial contributions. Fees and charges are the largest item of non-rates revenue and include building and resource consent fees, community housing rental income, and library and swimming pool charges.

In previous long term plans, we have made a conscious decision to keep user charges low. For example, we keep our swimming pool fees low to encourage usage because we think it is important for children and adults to be able to swim.

2. What has happened since the 2015–35 long term plan?

The Council has delivered a significant programme of works and operations since the 2015–35 long term plan was approved, with investment in our roads, footpaths, cycleways and bridleways, as well as improvements to our stormwater and wastewater infrastructure.

The major projects worked on include ongoing work to transform and improve the Paraparaumu and Waikanae town centres and the redevelopment of the Te Ātiawa Park hard courts and the successful redevelopment of the Ōtaki pool and splash pad.

The economy is strong and the attractiveness of living in Kāpiti only increases with the increased connectivity to Wellington, and there is good reason to anticipate growth at a higher rate than signalled by the Stats NZ and .id forecasts. The Council has maintained its infrastructure assets well and welcomes sustained and manageable growth. However, it should be noted that growth impacts will increase the pressure on existing assets and result in increased costs to maintain new and existing assets.

For the 2017/18 year, the third year of the 2015–35 long term plan, the Council has exceeded its long term plan rates increase limit of 5.50% with an average increase of 5.70% approved in the annual plan. If the full capital expenditure programme was to be completed, borrowings would increase from $146m at the end of 2016/17 to $160m at the end of 2017/18. The 2017/18 annual plan also forecasts that our borrowings will exceed $200m in 2019. Therefore, while much has been delivered in the preceding two and a half years, the path that the Council is currently on cannot be sustained.

3. A focus on reducing debt

The Council has shown leadership by responding to the unsustainable current position with a new initiative that has a strong focus on reducing the council’s debt. The initiative proposes limiting capital expenditure to $169m for the first six years of the plan. This equates to an average of $28m per year.

Achieving this reduced programme of capital expenditure would result in a significant reduction in Council’s debt over the long term plan period and is the key driver of the 2018 financial strategy. If we achieve our capital expenditure targets and manage our operating budgets carefully, we will be able to get our debt down to $141m by the end of the long term plan.

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If the proposed capital expenditure programme is achieved, this will contribute to a smaller increase in rates in the short term. Over the longer term it will mean that Council will be in a position to start repaying its debt much earlier than currently anticipated.

In reference to the financial strategy triangle, reducing the level of capital expenditure means that debt can start to be reduced and rates can be kept within the proposed limits without affecting the current levels of service.

The Council has also recently updated its treasury management policy, which sets out a framework for the Council to manage its borrowing and investment activities in accordance with Council objectives, as well as incorporating legislative requirements. The updated policy supports the green line strategy by introducing targets and setting new limits on the amount of money that the Council can borrow.

4. Financial limits

The proposed new financial limits are set out in the following tables:

	2018–38 long term plan		
Measure	Lower limit	Preferred limit	Upper limit
Rates increases	2.90%	3.90% - 4.70%	5.50%
Debt	$Nil	< 200% of total operating income	The lesser of $200m and 240% of total operating income
Gross CAPEX	$15m	$25-35m	$38m

Treasury management policy limits:

	Target	Limit
Net interest expense over total operating income	< 10%	20%
Net external debt over total operating income	< 200%	< 240%

5. The three financial levers

a) Capital expenditure

The Council’s proposed capital expenditure budget of $169m for the first six years provides the key focus for the 2018–38 long term plan. The forecast capital expenditure for the 20 years of the plan is shown in the chart below.

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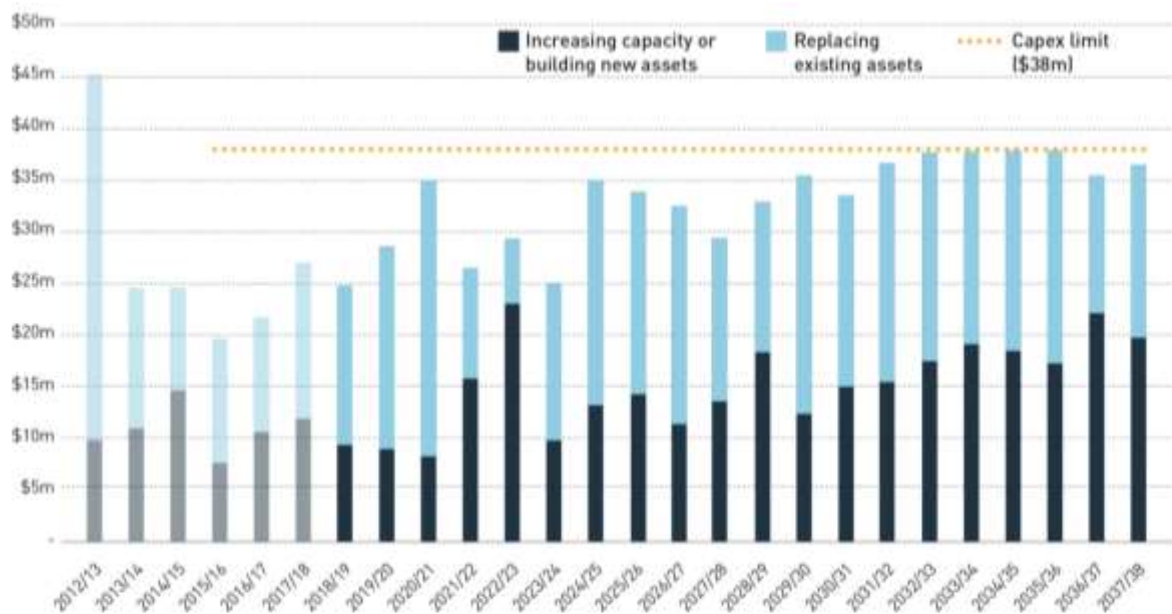
Capital expenditure



Source: internal data

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The capital expenditure figures stated in the financial strategy are gross figures, that is they exclude the impacts of external capital funding that the Council receives from, for example, NZTA.

The capital expenditure programme is driven by the infrastructure strategy, which prioritises a programme of capital work necessary to meet the ongoing needs of the community. The infrastructure strategy is constructed from the activity management plans for our core infrastructure (roads, three waters and solid waste, as well as some of our community facilities), which considers the age, condition and useful lives of our assets, and the costs of renewing and/or upgrading them.

Therefore, a key part of the financial strategy is to balance the requirements of the infrastructure strategy with the financial limits that the Council is proposing to work within. The infrastructure strategy covers a 30-year period to ensure that we are planning our asset requirements well into the future and that we are resourced to meet the requirements.

There are two main areas of capital expenditure – renewals and upgrades. Asset renewals are paid for by rates-funded depreciation. Upgrades may be required either as a result of growth or because we need to increase the level of service of a particular asset. Upgrades that are required as a result of growth should be funded entirely through development contributions; upgrades that are due to a level of service increase are funded largely through debt.

In the first three years of the 2012–32 long term plan, we spent an average of $31.5m a year on capital expenditure. In the 2015–35 long term plan we forecast average capital expenditure of $32.9m a year from 2018 to 2021. We are proposing to spend an average of $28m a year on capital expenditure for the first six years of the 2018–38 long term plan. This shows that we are moving in the right direction, prioritising our renewals and upgrades and managing our debt.

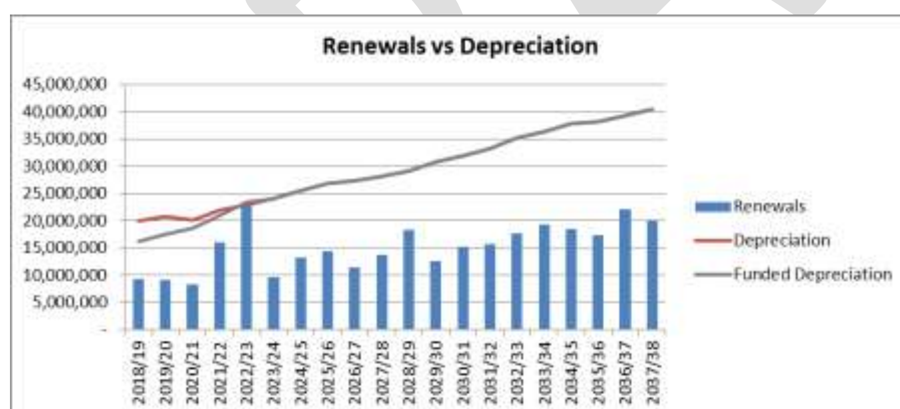
Renewals

We have $1.6b in assets, mainly relating to our core infrastructure of roads, three waters and solid waste. Our activity management plans identify the timing for renewals, based on the condition of the assets. We are undertaking a continuous programme of condition assessments to help us build a more detailed picture of all our assets. This is so that we can renew them all at the right time – before they deteriorate significantly or fail, but not while they still have a significant useful life. The aim for renewing within this optimal timeframe needs to be balanced with our proposed capital expenditure limits of $25-38m per year.

In the 2018–38 long term plan we are planning to spend an average of $15.3m a year on renewals. So we are still maintaining all our assets to a good standard with timely, but not early, replacement of assets.

A number of our underground pipe networks for water and wastewater were built between 1975 and 1981. These assets have estimated useful lives of 60-80 years, which means that there is the potential for a significant renewals cycle from around 2045 onwards. The reduced capital expenditure programme proposed in the financial and infrastructure strategies means that we can start to manage our debt down from 2025 onwards. By the end of the 2018–38 long term plan our debt is forecast to be $141m. This means that we will be well placed to manage the significant renewals cycle in around 25 years' time.

When we look at our planned renewals and our forecast depreciation together, the annual depreciation can be considered a reasonable estimate of the annual renewals cost. This is shown in the chart below.



Source: internal data

If, over time, renewals expenditure is approximately equal to depreciation, it can reasonably be assumed that the assets and the services that they are providing are sustainable. For the Council, the estimated cost of renewals is less than the forecast depreciation for the duration of the long term plan. This reflects the fact that the Council is managing its renewals programme well. It also reinforces the view that there will be a significant programme around 2045, at which point the annual cost of renewals will be much closer to, and probably exceed, the annual depreciation expense.

Upgrades

The planned capital works proposes undertaking fewer upgrades than in the recent past. In the first five years of the 2018we are planning to spend an average of $15.6m a year on upgrades.

Some hard decisions have had to be made to finalise the proposed capital expenditure budgets of $169m for the first six years of the long term plan. Further difficult decisions, prioritising expenditure and managing risk, will have to be made for the outyears of the long term plan if the Council's goal of paying down debt is to be achieved.

Funding depreciation

Including depreciation in our operating expenses each year is a way of ensuring ratepayers pay their fair share, and only their fair share, of the assets they use and benefit from – it ensures intergenerational equity.

In previous long term plans the council has opted not to fully fund depreciation, on the basis that the asset renewals and rates funding thereof was not required until later. In the 2015 long term plan we decided to tackle the issue of the non-funded depreciation which had resulted in a $6.4m annual shortfall. We decided to reduce the depreciation funding gap by rating for the $6.4m shortfall over a six year period from 2015/16 to 2021/22. In the 2018-2038 long term plan we aim to have completely closed the funding gap in 2021/22, one year later than originally planned.

The cumulative effect of the non-funded depreciation is significant. Debt caused by this will peak at $45m in 2022 and, based on current forecasts, will not be reversed until 2038.

b) Rates

In 2017/18 we increased our rates by an average of 5.7% across the district - higher than the 4.9% forecast and the 5.5% financial strategy limit set in the 2015–35 long term plan. For 2017/18, base cost increases accounted for 4.3% out of the 5.7% average rates increase. This included 1.7% for inflation relevant to Council activities, while 2.2% related to depreciation for assets that were built in 2016/17 and the effects of asset revaluation changes, and 0.8% related to closing the depreciation funding gap.

This long term plan proposes an average rates increase of 4.8% for the first three years of the plan and 3% for the 20-year period. The chart below shows our forecast rates increases and highlights the rates increase attributable to closing the depreciation funding gap.

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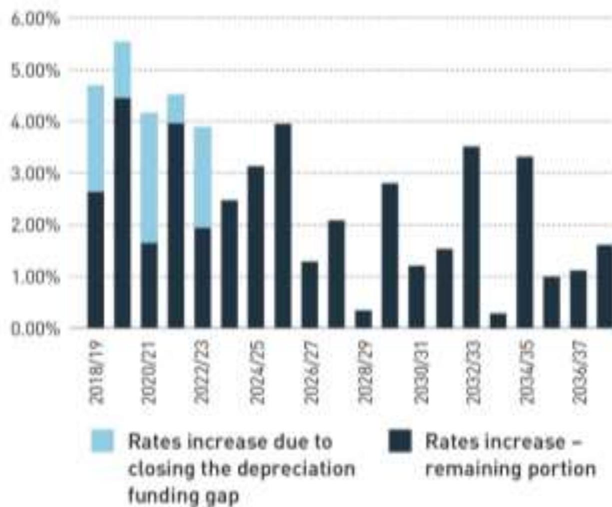
Rates

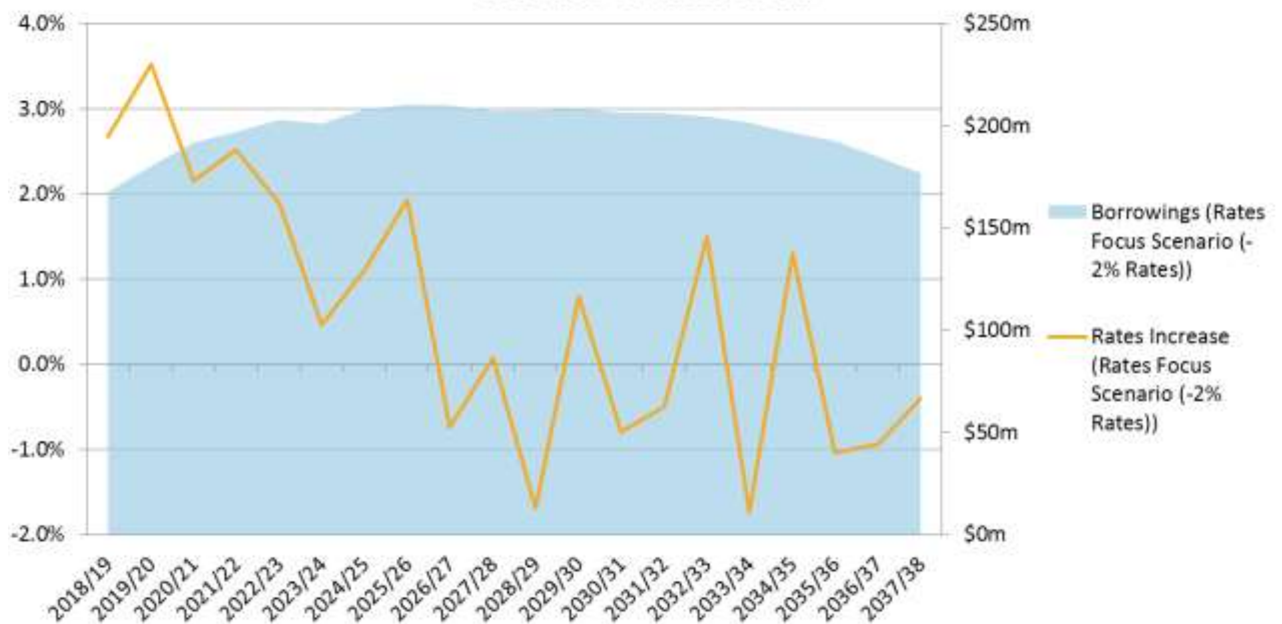


Source: internal data

This long term plan does not include any significant changes in levels of service so far. The forecast rates increases over the term of the plan are largely due to the operating impacts of our capital expenditure programme and inflationary pressures, while the non-funded depreciation affects rates up to 2022/23, when the gap should be closed. The non-funded depreciation also means that the Council does not currently have a balanced budget.

This financial strategy seeks to balance rates increases with our stated target of managing down debt as quickly as possible. We could propose lower rates increases over the term of the plan, but this would adversely affect our ability to reduce our debt. Similarly, we could try to pay down debt even faster, but this would result in higher rates increases over the term of the plan. These two scenarios are considered in the following charts.

Rates focus



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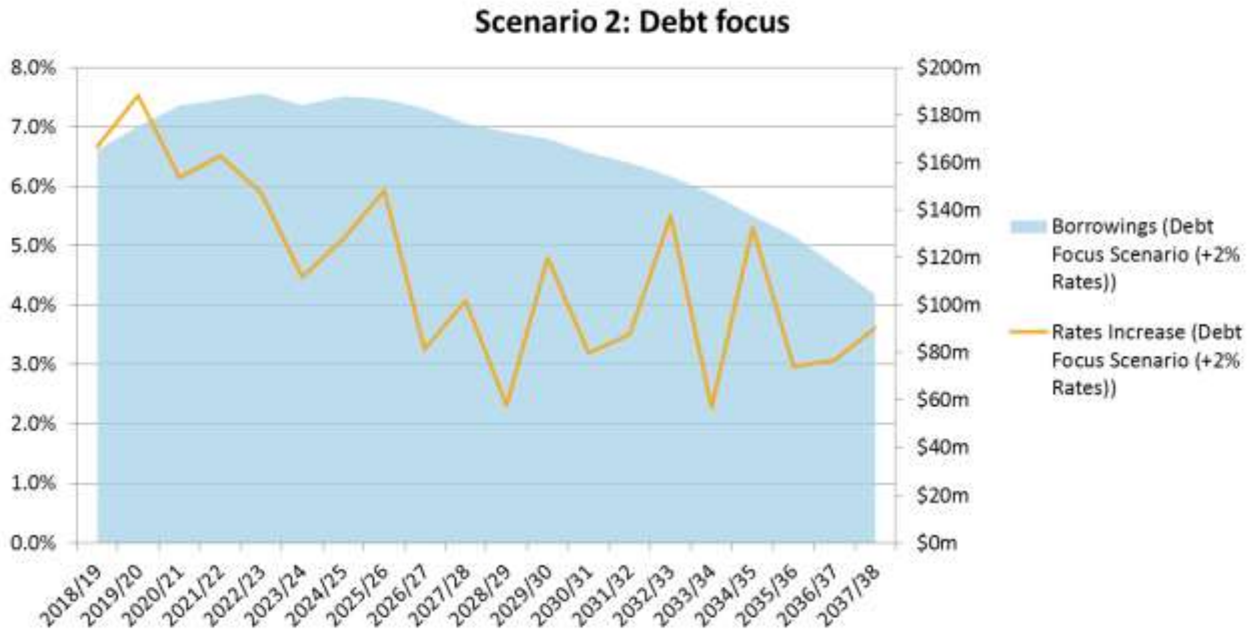
Source: internal data

This scenario considers a focus of lower rates by reducing the currently forecast rates by 2% each year for the term of the plan. The result is peak borrowings of $211m in 2025/26 and debt at the end of 20 years still relatively high at $179m. This chart shows the need for rates to be at a high enough level to make an impact on our borrowings.

Debt focus



Source: internal data

In this scenario we look at the impacts of increasing the currently forecast rates by 2% each year for the term of the plan, to focus on paying down our debt more quickly. Our debt peaks at $189m in 2022/23 and at the end of the plan our debt is $106m. While this chart highlights the benefits of higher rates on our debt position, the impact on the community is not sustainable.

Both scenarios highlight the trade-offs that have to be made in reaching a balanced approached to rates, capital expenditure and debt.

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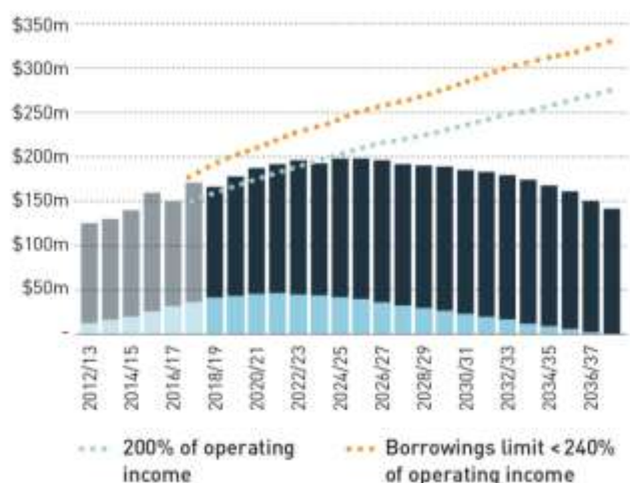
c) Borrowings

The chart below reflects our forecast borrowings profile based on the achievement of our capital expenditure limits.

Borrowings



Source: internal data

The blue dotted line in the chart represents our treasury management policy borrowings preferred limit where net external debt over total operating income[2] is less than 200%. This is identified as the sustainable (maximum) level of borrowing and if achieved should translate to an AA- credit rating, which in turn will enable us to borrow funds on better terms. We aim to achieve this preferred limit by 2023, year five of this long term plan.

A reduction in borrowings is the key outcome of the Council's proposed plan to implement a reduced capital expenditure programme. Before this happens, the funding gap in relation to non-funded depreciation must be addressed. Thereafter, the Council can start to rate-fund for surpluses, which can be used to start paying down the debt.

If the proposed reduction in the capital expenditure programme is achieved, it will mean that the level of debt will not increase as quickly as forecast by the 2015–35 long term plan, and debt will peak at $199m in 2025/26, before trending downwards with targeted debt of $141m at the end of the long term plan period.

6. Security for borrowings

Our liability management policy has recently been updated and can be found on our website.

The Council's external borrowings and interest rate risk management instruments will generally be secured through a Debenture Trust Deed. Under a Debenture Trust Deed, the Council's borrowing is

[2] Earnings from rates, government grants and subsidies, user charges, interest and other revenue and excludes non-government capital contributions (e.g. developer contributions and vested assets).

DRAFT

secured by a floating charge over all Council rates levied under the Local Government Rating Act. The security offered by the Council ranks equally with other lenders.

From time to time, and with Council approval, security may be offered by providing a charge over one or more of the Council's assets.

7. Investments

Our investment policy has recently been updated and can be found on our website.

The Council's primary objective when investing is the protection of its investment capital. Accordingly, the Council may only invest in approved creditworthy counterparties.

Through the long term plan process, the Council is proposing to borrows funds through the Local Government Funding Agency (LGFA) and invest the funds in a conservative managed fund with the aim of achieving a net return of 3.5% above the Council's borrowing costs, which are currently around 3% a year. The surplus will be used to fund increased insurance costs and Civil Defence costs and a contribution towards resilience-focused projects.

8. Level of service statement

As outlined in this strategy, for the 20 years to 2038 the expenditure incurred to maintain existing services, increase service levels and provide for additional capacity falls within the limits set in this strategy and its associated financial policies.

9. Insurance

The Kāpiti Coast District Council, together with Porirua, Hutt City and Upper Hutt City councils (collectively known as the Outer Wellington Shared Services Insurance Group or OWSS) has been purchasing insurance for their respective assets on a combined basis since 2009. This syndicate was necessary to provide the OWSS with scalability to the benefit of accessing wider domestic and off-shore insurers. In July 2016 Greater Wellington Regional Council joined the OWSS to insure their above ground assets through the collective.

The Kāpiti Coast District Council has a maximum insurance cover of $130m for natural catastrophe damage to infrastructure assets with a $1m deductible per claim per event. The Council has a sum insured value of $232m for material damage and business interruption insurance to above ground assets. Losses suffered to above ground assets by natural catastrophe/s trigger a deductible of 5% of the site sum insured. Any losses exceeding the $232m in aggregate will need to be fully funded by the Kāpiti Coast District Council.

The Council is facing a number of emerging potential financial risks. They include an increase in insurance premiums due to the perception of increased risk for the Wellington Region following the Kaikōura earthquake and the possible withdrawal of the central government 60/40 funding split for natural catastrophes to infrastructure assets.

To address the increased risk, the Council is undertaking a number of mitigation strategies, including the establishment of a self-insurance fund (contingency fund), exploring alternate insurance

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procurement strategies, completing regular loss modelling, insurance valuations and risk profiling and developing a resilience strategy.

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