OUR PLACE | OUR PLAN

TŌTĀTOU WĀHI : TĀ TĀTAU MAHERE

THE NEXT 10 YEARS

TE TEKAU TAU E HAERE AKE NEI

ASHBURTON DISTRICT COUNCIL

LONG-TERM PLAN

2021-31

VOLUME 2

Ashburton
DISTRICT COUNCIL

ASHBURTON : THE DISTRICT OF CHOICE FOR LIFESTYLE AND OPPORTUNITY

HAKATERE: TE ROHE KA WHIRIA MŌ TE ĀHUA NOHO, ME TE HAPORI

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Our Financial Strategy 2021-2031[1]

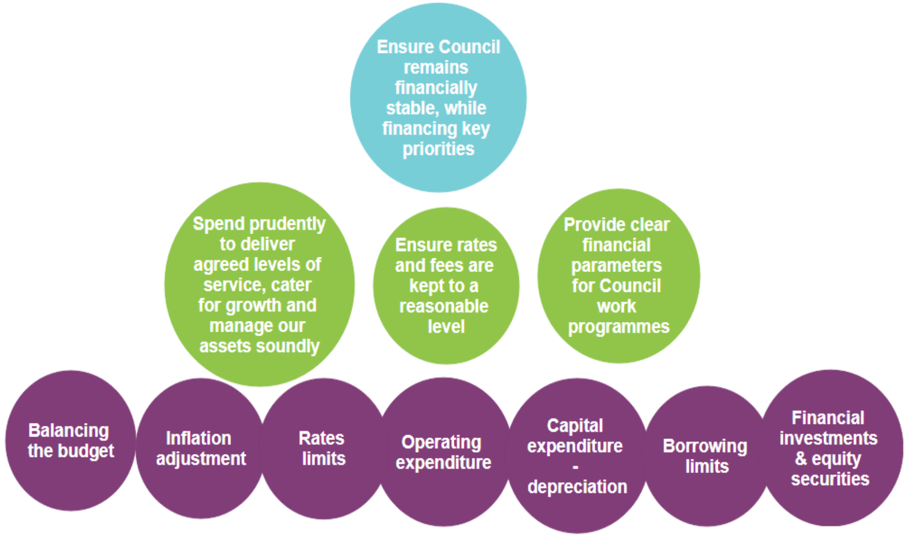
Summary

The Financial Strategy outlines how we will manage our finances over the next ten years. It sets out our general approach and principles that we will follow, and provides a guide to assess spending proposals. The Strategy includes limits on rates levels, rates rises and borrowing, and aims to promote financial stability and affordability over the short, medium and long-term. In simple terms, the strategy determines the size of our cake over the next ten years, while our policy decisions will determine how the cake is cut.

Our district has been growing and this growth coupled with fast-approaching regulatory deadlines for some of our network infrastructure, will see our biggest ever capital expenditure programme for our district over the next ten years. This will mean that we will be increasing our debt to levels that we have not done so before.

However, we are currently in a strong financial position, largely due to previous Council decisions and direction focused on infrastructure renewals and replacements. In 2019, we received our first Fitch Credit Rating, AA+, one of the highest ratings for a territorial authority in the country.

The aim of our Financial Strategy is to ensure Council remains financially stable, while financing key priorities. The following graphic shows our financial goals along with the strategies we will use to achieve these goals over the next ten years.



Our financial future

Our projections for the next ten years show the following picture for 2031:

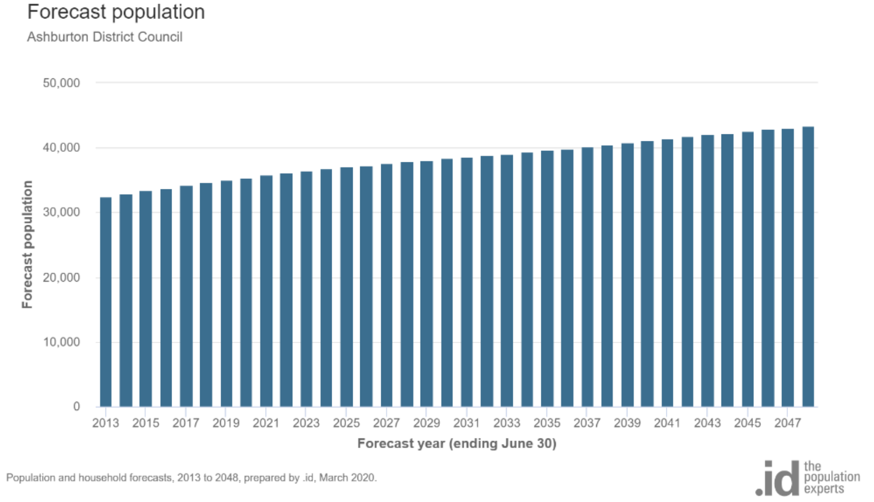
- Total assets are forecast to be $1,320 million (2020/21: $876 million).
- Total equity is forecast to be $1,148 million (2020/21: $801 million).
- Liabilities are forecast to be $172 million (2020/21: $76 million) and to be 13.0% of total assets (2020/21: 8.6%).
- Cash investments are budgeted to be $41.7 million, (2021/21: $7.8 million)
- Rates revenue is budgeted to contribute 55% of total income (2020/21: 53%).
- At no time over the period 2021/22 – 2030/31 are we expecting to breach our debt ratio limits.
- Council will remain in a strong financial position.

[1] Sourced from financials dated 20 Feb 2021

Context

1. Population growth

Our district has experienced notable growth over the past 20 years with a population increase of 36% since 2001 (approx. 1.9% p.a.). This growth is projected to slow going forward, increasing at a rate of 0.8% each year to a population of 43,500 in 2048.



Ratepayer growth

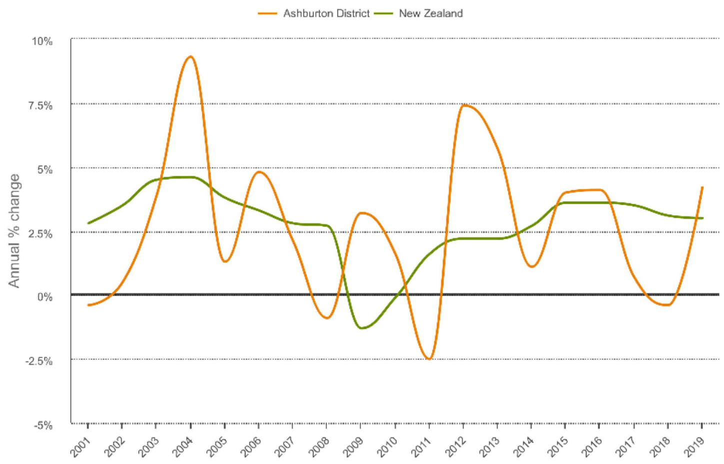
The link between our district's population and the number of ratepayers is the average number of people per household, which determines the number of houses that are required. The lower the average household size, the greater the number of houses that are required.

The current average number of residents per household is 2.5; however, this is expected to reduce to 2.45 by 2043, reflecting an increase in single-person households and couples without dependent children. This suggests, that by 2043, over 3,300 additional homes will need to be built.

In addition to an increase in rateable properties, population growth also leads to increased load on our infrastructure and assets, and increased demand on our services.

2. Economic growth

The effects of the Covid-19 pandemic on the local economy have not been significant to date. Our district's Gross Domestic Product (GDP) was $2.32 billion for the year to September 2020. This was a decline of 1.7%, compared to the national decline of 3.3% and the Canterbury region of 3.2% over the same period. Overall, the outlook for our economy is relatively strong, with the economy expected to expand by a third or around 2% per year over the next 15 years[2].



However, this growth is not guaranteed. It is worth noting that our local economy's reliance on land resources, and the ongoing concentration of the economy, presents some risks to the overall economy as exposed by the drop in milk prices in the past. Similarly, natural disasters and events, such as the

[2] AD EDS 2018

Covid-19 pandemic, and the impacts of the recently approved National Policy Statement on Freshwater Management pose risks to our local economy.

The long-term impacts of Covid-19 on our economy are still unfolding. The tourism sector (including accommodation, hospitality and some retail) have been impacted the most obviously within the district to date. However, effects of the pandemic on global trade markets could have a significant impact on our economy in the mid-long term.

3. Land use changes

Most land in our district is rural farmland. Irrigation has enabled land use changes, leading to a reduction in dry stock and arable farming, an increase in dairy farming and high-value cropping such as seeds. We have the highest concentration of irrigated land in New Zealand, however, the majority of land conversions are likely to have now occurred and the rate of land change has slowed.

Ashburton (including Lake Hood), Methven, Rakaia and Hinds are the main urban growth areas of our district. These areas continue to have new residential developments on the urban periphery of each town, expanding the urban footprint into surrounding rural and rural-residential areas.

There are sufficient residential and commercial sites available or planned, to accommodate current foreseeable growth for some years, and there may be over-capacity for residential land in the Ashburton North area.

4. Expenditure

While our district has been growing, the fast-approaching regulatory deadlines for some of our network infrastructure, will see our biggest ever capital expenditure programme for our district over the next ten years. This will mean that we will be increasing our debt to levels that we have not done so before.

Our level of expenditure is also closely linked to the level of service we provide to our community. Our 10 Year Plan details the levels of service we aim to provide over the next ten years, and is determined through considering the:

- legislative compliance;
- our community outcomes and strategic priorities;
- community expectations; and
- political mandate.

The following table shows our capital expenditure on growth, improved levels of service and renewals over the next 10 years.

ACTIVITY GROUP	Growth $000s	Improve service level $000s	Renewals $000s
Drinking water	$4,732	$23,283	$21,994
Wastewater	$7,416	$4,226	$24,381
Stormwater	$0	$17,378	$0
Transport	$0	$68,958	$82,073
Other	$0	$83,393	$11,461
All activity groups	**$12,148**	**$197,238**	**$139,909**

5. Affordability

Ensuring our rates remain affordable for our residents is a top-priority. The chart below indicates the affordability of our rates when compared with the other district and city councils in the Canterbury region.

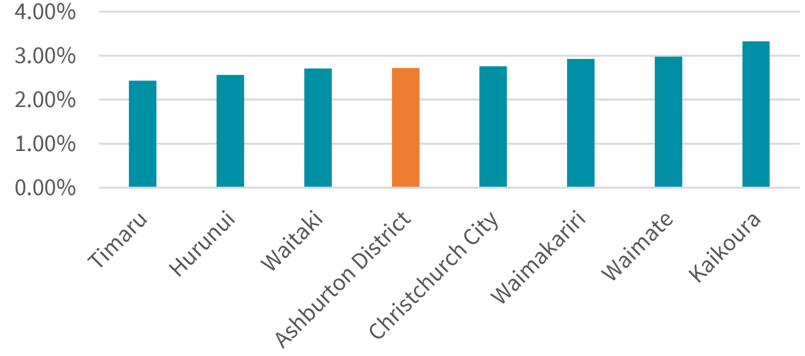


Figure 1. Affordability – Average rates 2020/21 by mean household income[1]

Although there may be individual cases of hardship for some ratepayers, the rating levels in our district remain affordable overall and are still comparatively low compared to other Canterbury Councils.

6. Rating review

We have reviewed our rates as a part of the development of our 10 Year Plan and considered who benefitted from each of our services. Further detail of our decisions can be found in our Revenue and Financing Policy[3].

[3] Our Revenue and Financing Policy can be found at *ashburtondc.govt.nz* → Council → Policies and Bylaws.

Our Financial Strategy

Our Financial Strategy is focused on making progress towards meeting the needs of growth, rising expectations of our community and regulatory compliance, while delivering affordable rates, minimising our borrowings and optimising our spending.

1. Balancing the budget

We are required by law to ensure that the operating revenue we budget for is enough to meet our operating expenses each year (a balanced budget) – unless it is financially prudent not to do so.

The work programmes and budgets included in this 10 Year Plan show a balanced budget.

Operating revenue e.g. rates, fees and charges.

Operating expenses
The day-to-day costs of providing our services and maintaining our assets.

2. Inflation

We are required to budget for an inflation adjustment in each year of our plan. Our costs reflect the type of work we undertake for the community and are significantly affected by the price of items such as energy, bitumen and civil contracting services. This is quite different from the average household, and so using the Consumer Price Index (CPI) for inflation is not appropriate.

Instead, Business and Economic Research Limited (BERL) have prepared specific inflation values for councils - referred to as the Local Government Cost Index (LGCI). All budgets across the ten years have been adjusted using these values. They are also used as part of our setting of limits on rates and borrowing. See below for the average LGCI over the next 10 years.

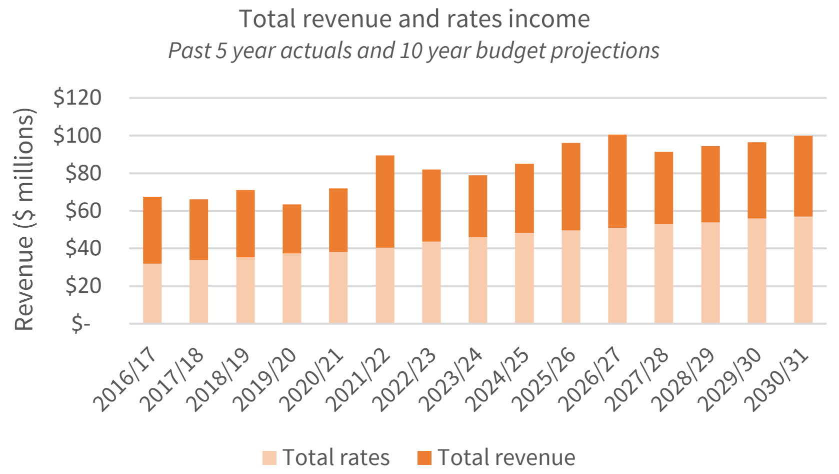
	2022/23	2023/24	2024/25	2025/26	2026/27	2027/28	2028/29	2029/30	2030/31
LGCI	2.9%	2.5%	2.5%	2.5%	2.5%	2.6%	2.7%	2.7%	2.6%

3. Rates over the coming 10 years

Rates are a form of property tax and must be paid by all property owners in the district.

The percentage of our annual revenue that comes from rates varies from year to year and over time - for the 2020/21 year it was approximately 53%. Other revenue comes from fees and charges, government subsidies, investment income and a variety of other sources.

The graph below shows the overall rate requirement and our total revenue for the past five years and the coming ten years covered by this 10 Year Plan.



Rates limits

Our plan for the next ten years has been prepared based on the following limits on total rates and annual total rates increases.

- Total rates in any one year are to be no greater than 1% of the total capital value of our district.
- Total rates increase for 2021/22 to 2024/25 to be no greater than 5%, exclusive of LGCI each year.
- Total rates increase for the years 2026/27 – 2030/31 to be no greater than 3%, exclusive of LGCI each year.

	2021/22	**2022/23**	**2023/24**	**2024/25**	**2025/26**	**2026/27**	**2027/28**	**2028/29**	**2029/30**	**2030/31**
Rates as a % of district capital value	0.2	0.2	0.2	0.2	0.3	0.3	0.3	0.3	0.3	0.3
Rate increase (%)	2.7	4.9	3.0	2.2	0.3	0.4	0.9	-0.8	1.0	-0.5
Average LGCI adjustment (%)	3.6	2.9	2.5	2.5	2.5	2.5	2.6	2.7	2.7	2.6
Rate increase after LGCI adjustment (%)	**6.3**	**7.8**	**5.5**	**4.7**	**2.8**	**2.9**	**3.5**	**1.9**	**3.7**	**2.1**

4. Operating expenditure

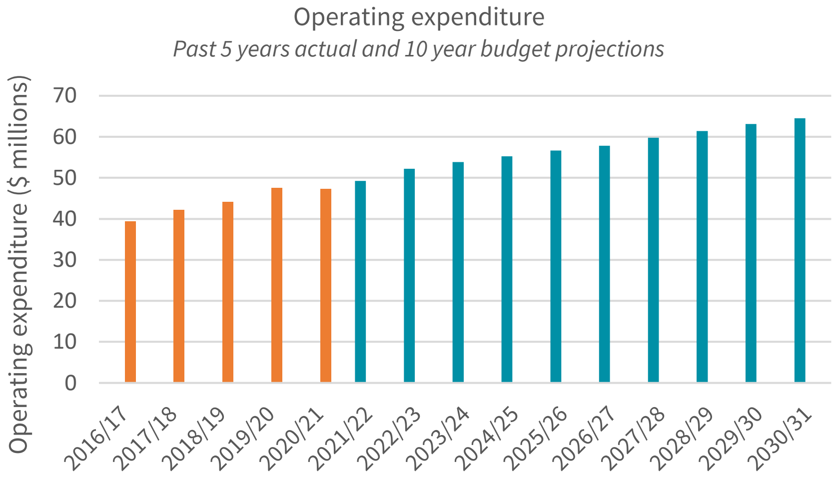
Our services and day-to-day maintenance of our assets are paid for using operating expenditure. We aim to raise enough revenue each year to cover our budgeted operating expenditure (including depreciation), unless it is prudent not to do so.

Rates are used to fund the balance of operating expenditure after all other revenue streams are accounted for.

We have budgeted for operating expenditure to increase from $49.2 million to $64.9 million between June 2021 and June 2031.

The increase is the result of:
- price increases (inflation);
- improvements to the level of service we provide; and
- to a lesser extent population growth.

The following graph provides a breakdown of our forecasted operational expenditure.



5. Capital expenditure

Capital renewals

In general, we look to at least maintain the level of service that we currently provide across our different activities. This means, each year, we need to ensure enough work is done to maintain our assets and, when necessary, to rebuild or replace them – this is called our capital renewal work programme.

The following capital renewal expenditure is budgeted for network infrastructure activities over the coming ten years to ensure we can continue to provide the current levels of service. The total cost of delivering this programme is expected to be $128 million over the next 10 years.

$000	2021/22	2022/23	2023/24	2024/25	2025/26	2026/27	2027/28	2028/29	2029/30	2030/31
Drinking Water	2,055	1,124	2,611	1,989	2,638	1,906	1,829	3,375	1,832	2,634
Wastewater	3,439	6,186	2,847	2,677	2,068	1,685	1,694	1,719	934	1,131
Stormwater	0	0	0	0	0	0	0	0	0	0
Transportation	7,297	7,810	7,894	8,062	8,064	8,303	8,450	8,514	8,798	8,881

Depreciation

We rate for depreciation each year based on how much it would cost to replace an asset, divided by its expected useful life. Different assets have different expected useful lives – the time you can expect them to work efficiently before they need replacing.

These funds are included in our operating expenditure, and are used for any capital work that is required on that asset. Any funds that are not required in the year they're rated for, are held for future expenses. We see this as fair, as this spreads the costs evenly across the ratepayers who use the asset over its lifetime. This is the principle of intergenerational equity.

However, due to our concern about the affordability of the rate rises, we have chosen to only fund deprecation on the equipment at the EA Networks Centre to the value that is required for capital works in the year we are rating for it. In addition, we have also only partially funded depreciation on the Ashburton Library & Civic Centre building across our 10 Year Plan (this affects Year 3 onwards). We also will not fund hall depreciation and will instead rate for repairs and renewals as needed.

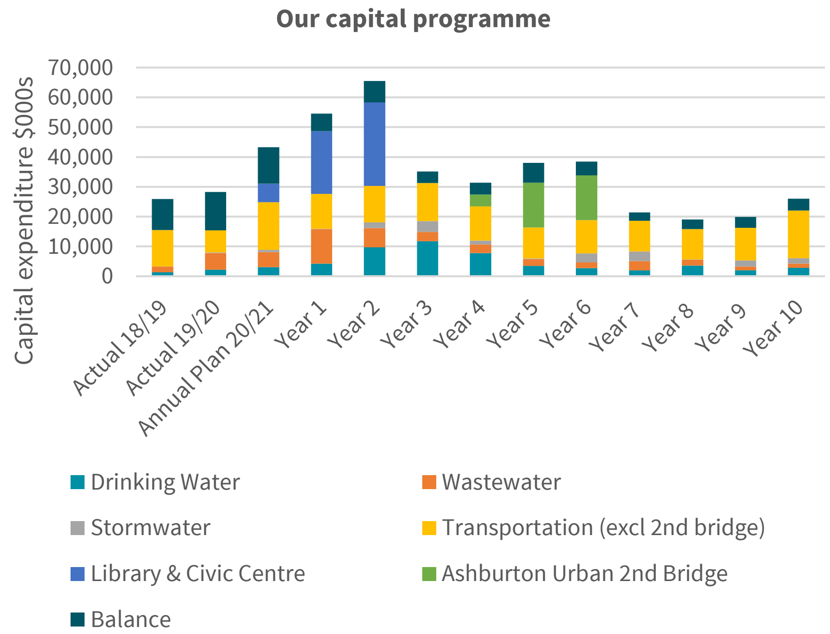
New capital expenditure

Capital expenditure (including renewals) is budgeted to be $54.5 million in 2021/22 and $66.0 million in 2022/23, due primarily to investment in improving roads, drinking water, wastewater and stormwater, and the new Library & Civic Centre building.

Over the next ten years, we have budgeted a total capital expenditure of $349 million, including capital expenditure on network infrastructure - transportation, drinking water, wastewater, stormwater and stockwater.

New capital expenditure is budgeted to be funded mostly from loans, with the principal and interest costs being funded by targeted rates over 25 years.

The following new capital expenditure is budgeted for network infrastructure activities over the coming ten years to ensure we can meet additional demand - due to either population growth or improvements to the level of service we provide. Our total capital expenditure for both new and renewals is displayed in the following graph for the next 10 years.



6. Borrowing

In developing this strategy, we have set limits on borrowing, to promote financial stability, affordability and value for money over the short, medium and long term.

These limits have guided the preparation of our work programmes and budgets set out in our plan for the next ten years and will be used to guide the preparation of yearly work programmes and budgets in the future.

We can exceed borrowing limits if it is prudent to do so; however, any breach must be explained in the relevant Annual Plan, along with the reasons why a breach is considered prudent.

During the period of this ten year plan, we have budgeted to repay debt as soon as prudent to reduce finance charges.

Internal debt

As well as external borrowing, an option available to us is using realised investment funds to internally fund capital expenditure. This reduces the net cost of borrowing as we can internalise the lender's margin.

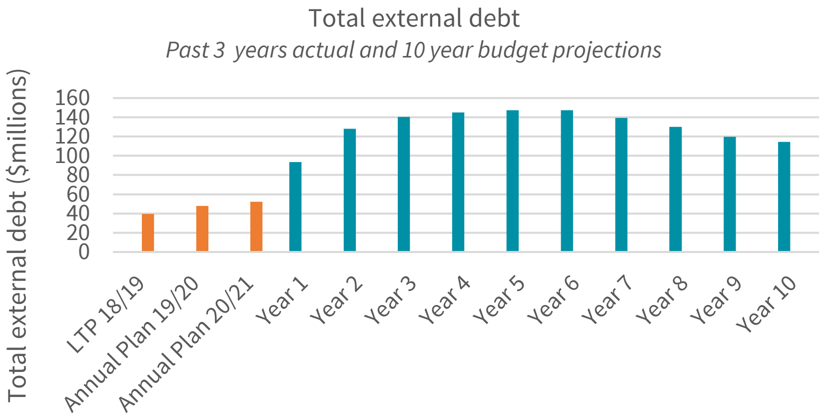
We have used internal funding from our investment pool in the past and may do so again in the future. However, the current strategy is to borrow externally because of the low interests rates available. This will be reviewed on an ongoing basis using our Treasury Advisor.

External debt limits

Debt interest no more than 10% of total income is widely considered appropriate. It is important to note that having debt interest higher than this does not necessarily mean debt is not sustainable, but it could limit future options and we need to be mindful of managing debt at this level. The cost of future borrowing may also increase if lenders perceive a greater risk.

Our ten year plan has been prepared based on the following limits on external debt:

- Net interest payments to service external debt must be less than 20% of our total revenue (excluding vested assets, infrastructure revaluations and other gains).
- Net interest payments to service external debt must be less than 25% of total rates for the year.
- Net debt shall not exceed 250% of total revenue.
- Council must maintain access to liquidity of not less than 110% of projected core debt



	2021/22	2022/23	2023/24	2024/25	2025/26	2026/27	2027/28	2028/29	2029/30	2030/31
Interest as a % of revenue*	2.6	3.1	4.1	4.2	3.8	3.8	4.2	4.1	3.9	3.9
Interest as a % of rates revenue	5.4	5.5	6.7	7.0	7.1	7.0	6.9	6.8	6.4	6.2

* Excluding development contributions and vested assets.

Managing interest rate risk

Interest rates are still at historically low levels. If we were carrying high levels of external debt, any marked increase in interest rates could present difficulty in managing the increased cost of capital in the future.

We have treasury management policy that seeks to minimise the impact of any such interest rate increase on our overall financial position.

7. Cash reserves

Our projected balance sheet shows external gross debt of $156 million by 2030/31 and a building up of cash reserves to $41.7 million over the same period.

Much of the cash generated is from general rate activities (such as sales in the Ashburton Business Estate) and cannot be used to repay debt funded from targeted rates (such as for drinking water or wastewater capital expenditure). Over this period, cash reserves also increase through repayment of internal debt.

We consider it prudent to rebuild cash holdings (primarily through land sales and depreciation funding). This will increase our funding flexibility by enabling cash reserves to be used, or internally borrowed against, rather than requiring external borrowing.

8. Approach to debt security

We provide lenders with security on its borrowings through a debenture trust deed. This gives lenders a charge over our rates income.

In the unlikely event of Council defaulting on a loan, the lender can ensure a rate is set to recover the outstanding amount owed. This security is attractive to lenders, which helps ensure we have ongoing support for our debt programme, while reducing the interest rates lenders charge.

Our Treasury Management Policy permits us to give security over specific assets, where

a) there is a direct relationship between the debt and the asset being funded and,

b) security over the asset is considered preferable to security over our rates income.

Currently, we have no securities issued over our assets and our plan for the next ten years does not include any provision to secure debt directly over assets.

Our approach to debt security seeks to maximise access to the capital needed for providing appropriate services to the community at the lowest cost possible.

9. Financial investments and equity securities

We have financial investments that generate a return, which can be used to pay for services and reduce rates. This section explains our objectives for holding and managing financial investments and equity securities and its targets for returns on those investments and equity securities.

Ashburton Contracting Limited

We own 100% of the 4,500,000 shares in Ashburton Contracting Limited (ACL).

Our objectives in holding this investment are to:

- ensure local capacity and capability to undertake civil works, particularly for infrastructure
- promote competition in the district for civil construction and maintenance activities
- form part of a balanced portfolio of investments.

Our expected rate of return on average shareholder funds is a minimum of 10% after tax, based on the rolling average of the last five years, excluding any tax loss offset / subvention payment or the costs of ACL's investment in the Lake Hood extension project.

This return, paid by way of dividend, is used to offset rates in the year it is received. This has been budgeted at $400,000 per year before inflation.

Transwaste Canterbury Limited

We are a 3% shareholder in Transwaste (600,000 shares) in Transwaste Canterbury Limited. As at 30 June 2017, these shares had a net asset backing of $1.34 per share ($804,000).

Our objectives in holding this investment are to:

- provide an environmentally sustainable facility for the disposal of the district's residual solid waste
- form part of a balanced portfolio of investments.

Dividends are determined by the board of directors and dividend returns are applied against the general rate and the uniform annual general charge as detailed in our Revenue & Financing Policy. This has been budgeted at $500,000 per year before inflation.

10. Cash

We hold cash to operate and maintain stable cash flows. We also hold cash in reserves, largely to fund the renewal of assets. These funds are invested in internal borrowing or deposits as provided by our Investment Policy. Our target return on cash is the average 90-day bill rate. The return on net cash investments is budgeted at 0%.