Growing our future Together

Financial Strategy 2021 - 2041

Te Rautaki Ahumoni

Horowhenua
DISTRICT COUNCIL

Definitions

Business and Economic Research Limited (BERL)

Leading provider in economic research, analysis, advice, and consultancy for business and public sector clients.

Consumer Price Index (CPI)

Measures changes in the price of consumer goods and servcies.

Core Infrastructure

Horowhenua defines the following Groups of Activities as Core Infrastructure, Water Supply, Wastewater, Stormwater, and Land Transportation (roading and footpaths).

Deficit

The amount by which expenditures or liabilities exceed income (i.e spend more than you earn).

Funding Assistance Rate (FAR)

A subsidy from New Zealand Transport Agency (NZTA) to partially fund council owned roading networks. The subsidy partially funds maintenance, renewals and minor safety improvements. This is referred to as a "rate" which is different for each Council based on an assessment of the local economy and need.

Infrastructure Strategy

Describes how a local authority intends to manage infrastructure assets and associated expenditure over 30 years.

Legislation

A reference in this strategy to any law, legislation or legislative provision includes any statutory modification, amendment or re-enactment, and any subordinate legislation or regulations issued under that legislation or legislative provision.

Levels of Service (LoS)

The quality of service a Council Activity is committed to provide to the community.

Local Authority Protection Programme (LAPP)

A disaster fund to assist with the replacement of infrastructure following catastrophic damage caused by a natural disaster.

Local Government Cost Price Index (LGCI)

Measures the cost drivers of Local Government, such as the price of construction material for large infrastructure (i.e. Water reticulation networks, treatment plants and local road maintenance).

Local Government Funding Agency (LGFA)

Provides more efficient funding costs and diversified funding sources for local authorities.

Long Term Plan (LTP)

Council's key strategic planning document outlining Council's financial situation as well as the level of service Council is committed to for the activities it undertakes and capital work programme for at least ten years.

Manawatu-Whanganui Local Authority Shared Services (MW LASS)

Shared service partnership within the Manawatu Whanganui Region to achieve financial savings.

Society of Local Government Managers (SOLGM)

An organisation for local government professionals to support and promote professional management.

Surplus

Operating revenue in excess of what is required to meet operating expenses (i.e. earn more money than is spent).

Summary

What is a Financial Strategy?

This is a fundamental strategy in Council's Long Term Plan that sets out 20 years of prudent financial management. It covers the key financial parameters Council will operate within, including limits on rates and debt.

Financial Goal

Our key financial goal is to manage growth while living within our means. This includes achieving a balance between:

- ensuring affordable rates for the community
- minimising Council's debt
- making the best use of capital spending.

Financial Challenges

The key financial challenge Council is facing is funding the capital programme needed to support the projected growth of our district. The population is expected to almost double within 20 years, which increases demand on existing infrastructure and community assets and requires considerable investment in new assets. The funding of this investment needs to be managed prudently and sustainably.

Debt Limits

With significant growth on the horizon, Council is raising its debt limits. Debt is primarily driven by capital expenditure, and with growth comes a need to fund new infrastructure. It is proposed to raise the debt limit from 195% to 250% of operating revenue, still leaving adequate borrowing in the event of a natural disaster.

Rate Limits

Rates are Council's primary income source. The proposed rate increases and limits are in the table below.

Balancing the Budget

Balancing the budget means Council's revenue is equal to or exceeds operating expenditure so there is no budget deficit. Council has a history of budget deficits. However, we are planning to significantly increase the level of rates funding every year of this 20 year plan, apart from a small deficit in 2023/24. This will help us catch up for years where we haven't fully funded our renewals and help to ensure borrowings stay below the limit we have set in our financial strategy.

Our proposed rates increases over 20 years

	2021/22	2022/23	2023/24	2024/25	2025/26	2026/27	2027/28	2028/29	2029/30	2030/31	2031+
Rates Increase (after growth)	6.7%	7.3%	5.6%	5.5%	5.7%	5.5%	4.3%	3.6%	2.6%	2.0%	1.0% *(Average)*
Rates Limit (after growth)	7.0%	7.5%	6.0%	6.0%	6.0%	6.0%	4.6%	4.7%	4.7%	4.6%	4.4% *(Average)*

Note: penalties and remissions are not included in the above. Individual household rates may be higher or lower than the above percentage increases.

Introduction

“Balancing the budget while planning for growth and maintaining sustainable infrastructure”

Council aims to find a cost effective and efficient balance between the operating budget, prudent debt levels, levels of service, providing for growth and limiting rate increases. The Financial Strategy covers the key financial parameters Council will operate within, including limits on rates and debt. Council’s Long Term Plan (LTP) focuses on 20 years to better understand the effects of new projects related to Horowhenua’s anticipated growth.

Our community is currently experiencing significant growth which means Council is faced with the challenge of maintaining existing infrastructure assets, as well as providing new infrastructure to support a growing population while trying to keep rates affordable.

This Strategy is the foundation of Council’s LTP goal of managing growth while living within its means, focused on achieving a balance between:

- ensuring affordable rates for the community
- minimising Council’s debt
- making the best use of capital spending.

Council uses debt (loans) to fund the cost of providing new infrastructure for growth and increases to levels of service, to ensure future generations pay their fair portion of the cost of the new assets which they will use. We are also proposing to re-introduce the use of development contributions.

Council aims to use rates to fund the replacement (renewal) of assets, this ensures current generations contribute to the asset replacement as they use the asset. Council has not always funded renewals from rates in the past, this has resulted in the need to loan fund some of those renewals to maintain assets which is not sustainable. Council is continuing its strategy of increasing the rates funding of renewals to achieve a more sustainable financial position.

Council has set limits on debt and rates to ensure we are able to maintain existing levels of service and meet additional demands resulting from growth. Council has increased the level of renewal capital spending in this plan to be able to provide and maintain existing levels of service. This is particularly significant in infrastructure where we are catching up on renewals work needed. We also have additional demand for infrastructure due to our population growing significantly. We have increased our borrowings limit from 195% to 250% of operating income and are proposing the reintroduction of development contributions to enable the growth spending to occur sustainably. The increased rates funding of renewals also supports ensuring borrowings are below our limit.

Population Growth and Changing Land Use

The district is going through a period of transformation. Our population has been growing at a rate of 2% per annum since 2014 and is projected to increase at a rate of 2.6% per annum until 2031, increasing to 2.9% per annum until 2041.

The population of the Horowhenua District at the 2018 Census was 33,261, is projected to be 36,708 by June 2021 and reach 62,716 by 2041. This is an increase of 26,008 people between June 2021 and June 2041.

As a result of the increased population growth, there is projected to be an increase of 11,209 dwellings in the Horowhenua District between June 2021 and June 2041 (a total of 27,815 dwellings). This growth will result in an average of 434 dwellings being constructed per year between 2021 and 2031, and an average of 686 per year between 2031 and 2041.

Population growth will have an impact on land use in the Horowhenua and is likely to result in both greenfield (large scale development of previously vacant land) and brownfield (redevelopment/intensification within the existing urban footprint) housing and business land development. Growth is projected to be largely residential (85%) and in Levin (51.8% of the urban growth).

Council is currently working on three Master Plans for future development in the growth areas of Levin East (Tara-Ika), Waitārere Beach and Foxton Beach. Over a number of years these Master Plan areas will transition from rural/semi-rural areas to urban environments. Council is also in the early stages of planning for other future residential and commercial growth areas that will see land use transition over time.

The Ōtaki to North of Levin (O2NL) highway, part of the Wellington Northern Corridor project, is planned to be constructed by 2029. Land use is likely to change near the highway, particularly around interchange locations which are likely to attract commercial and industrial activities. In addition, O2NL will change how our local road network functions – some exiting roads will be severed, while other new road connections will be provided. This will change movement patterns, altering how people move around the District. Foxton and Shannon will each become the first towns on a State Highway outside of Wellington – both towns will likely experience changes in land use as a result of this as businesses seek to entice passing travellers to stop for a rest.

For more detail on the projected change in population see the Significant Forecasting Assumptions on our website as supporting information:

horowhenua.govt.nz/GrowingOurFutureTogether

Investing in Our Infrastructure and Community Assets

Council is facing a challenging environment and must respond to these challenges while trying to reach a balance between loan and rate funding.

The growth our district is projecting is significant. The population is expected to almost double within 20 years, which increases demand on existing infrastructure and community assets and requires considerable investment in new assets.

Council's growth capital programme has implications for operational expenditure. Over the 20 year plan, there will be an additional $1.3 million of operational spending occurring as a result of planned growth projects. This extra operational expenditure is due to ongoing maintenance requirements associated with parks and reserves, cemeteries and our wastewater treatment plants.

Figure 1. Major Capital Expenditure Projects.

	Total Project	2021/22-2023/24	2024/25-2026/27	2027/28+
Alternative water source for Levin	**$18.3m**	$0.2m	$0.5m	$17.6m
Endowment Subdivision Forbes Rd extension	**$6.2m**	$6.2m	-	-
Levin North East Stormwater drainage	**$4.1m**	$2.6m	$1.5m	-
Levin wastewater treatment plant - strategic upgrade	**$33.6m**	-	-	$33.6m
Donnelly Park development works	**$36.4m**	$0.5m	$7.5m	$28.4m
Foxton Beach reserves	**$21.8m**	$3.6m	$3.4m	$14.8m
Ōhau future supply of wastewater services	**$16.7m**	-	-	$16.7m
Ōhau future water supply services option	**$16.4m**	-	-	$16.4m
Subsidised Roading - road improvements due to O2NL	**$29.8m**	$3.1m	$12.0m	$14.8m
Waitārere Beach future water supply services option	**$23.7m**	-	-	$23.7m
Waitarere Beach Surf Life Club design and build	**$3.3m**	$3.3m	-	-
Foxton Pool Redevelopment	**$2.6m**	2.6m	-	-
Tara-Ika *	**$35.0m**	$28.0m	$7.0m	-

We are currently working with Central Government on options to ensure that this project will be provided externally and does not require the Council to increase its debt. For this long term plan we have assumed that the funding will be provided externally. If the project does require debt from the Council we will reprioritise the timing of the capital programme to ensure our projected borrowings remain within our limit of 250% of our operating income.

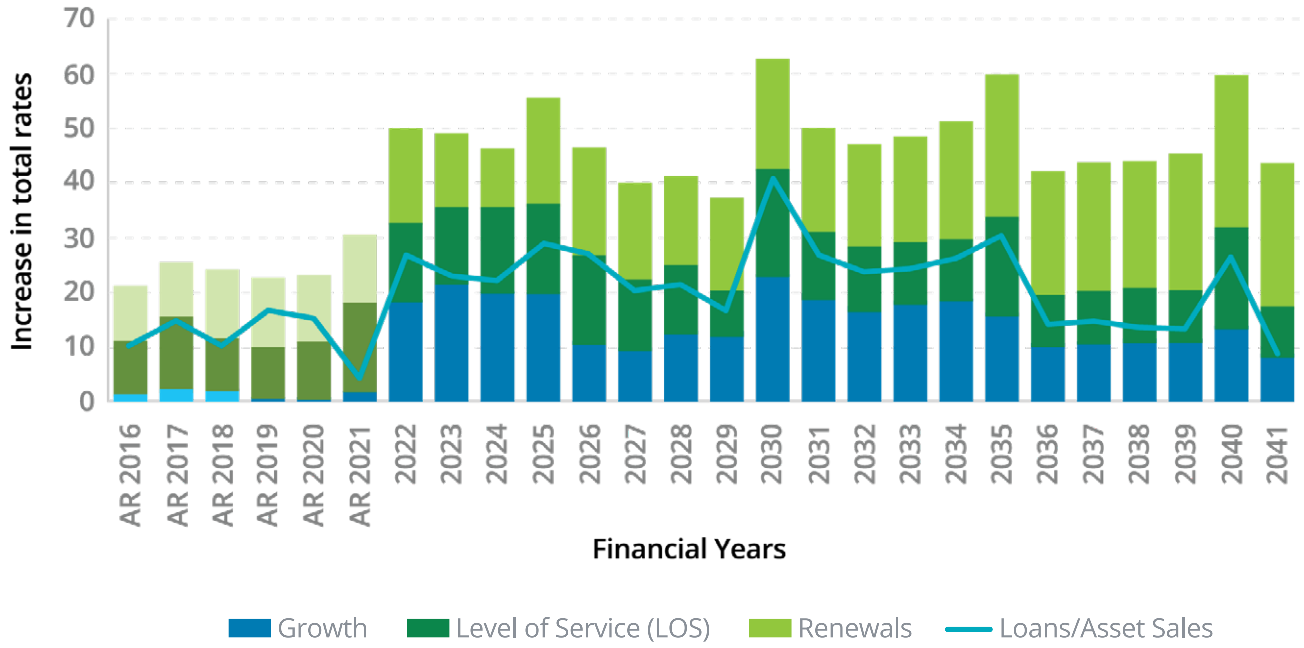
Council has plans in place to ensure the significant investment in our infrastructure assets are able to be delivered. For further information see the Infrastructure Strategy.

The primary challenges in managing our infrastructure assets are:

- Population growth resulting in increased demand. This includes the need to plan for changes to the roading network as a result of the Ō2NL expressway, finding a new water source for Levin and the need to make major upgrades to our parks and reserves.
- Ageing infrastructure and renewals, particularly for the three waters network. This includes maintaining our infrastructure networks to continue to deliver the levels of service the community has come to expect.
- Public health and environmental outcomes. Needed to increase investment in the three waters space to provide higher quality environmental outcomes and strengthening earthquake-prone buildings to protect public health and safety.

Figure 2 shows the capital expenditure required for our infrastructure assets for growth, levels of service and renewals, which averages $48 million each year. The capital expenditure required to service growth equates to about 30% of the programme.

Figure 2. Asset Expenditure and Loans



The loans/asset sales line in the graph shows that we do not need to use debt to fund all of the capital programme. We aim to fund our renewals through rates, grants from NZTA and other sources that contribute towards renewals and new assets.

We are also proposing to recover our growth spending through contributions from new households. This makes sure new properties pay their share which helps to ensure our borrowings will be below the limits we set by contributing $95m of the 20 year capital programme.

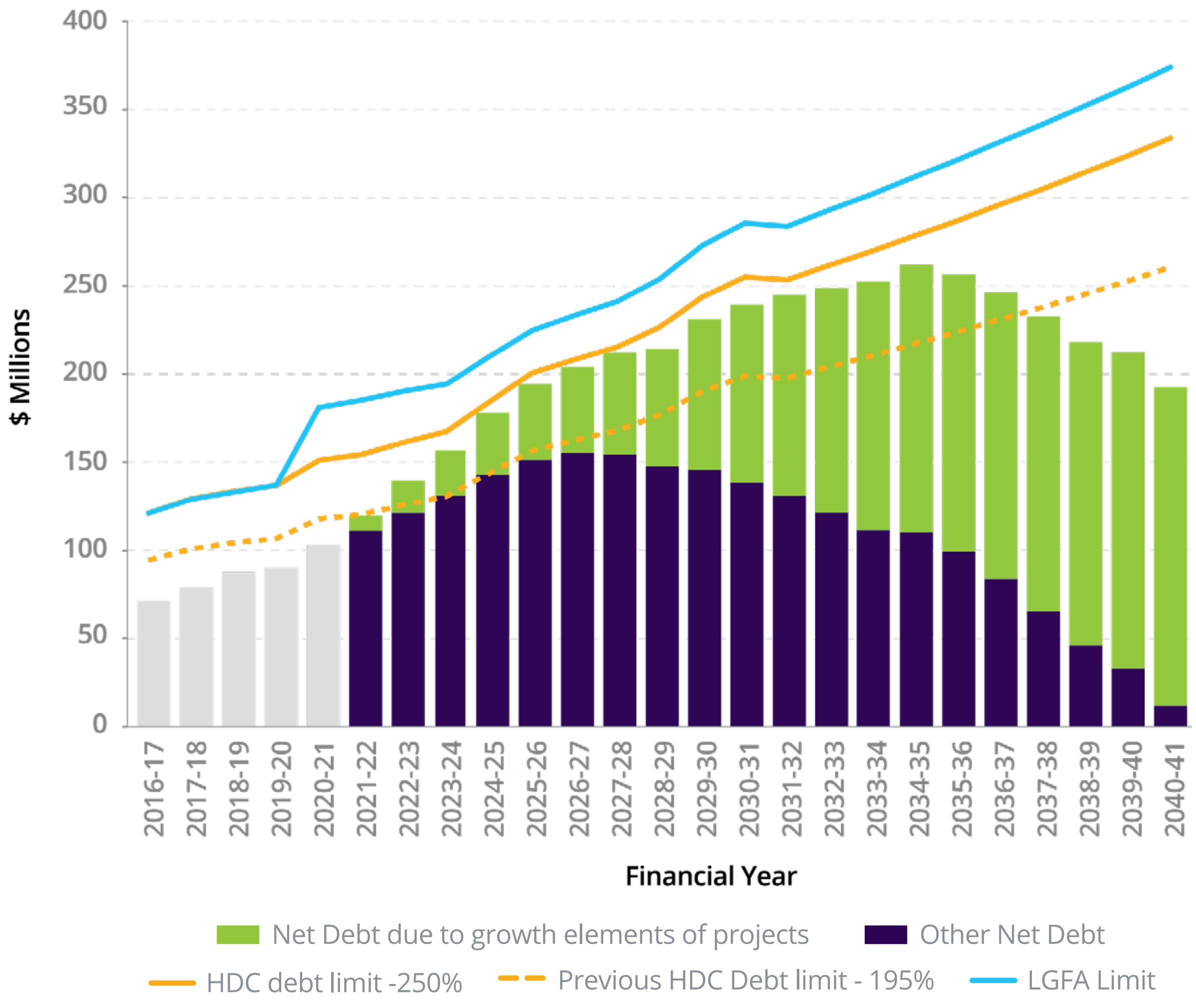
Debt

Council uses debt (loans) to fund the cost of providing new infrastructure for growth and increases to levels of service, to ensure future generations pay their fair portion of the cost of the new assets which they will use.

Throughout the 20 year plan we are planning to spend approximately $410m to continue maintaining existing assets and to ensure our infrastructure and community assets are able to service the extra 11,000 dwellings we are expecting to be constructed in the district over the next 20 years. This renewal capital programme will be fully funded by rates and subsidies from NZTA. Of the total growth and upgrade programme of $552m, $95m is assumed to be funded from development contributions.

Council's net debt is predicted to peak at $262m in 2035. For the LTP 2021-41, Council is proposing to increase its debt limit from 195% to 250% to provide sufficient room to fund growth projects. Figure 3 shows that a significant portion of Council's debt requirements are projects that maintain existing assets, however, to also fund the projects needed to support such a fast growing community additional debt is required. Increasing the debt limit to 250% is considered to be prudent as there is still sufficient headroom with the debt limit imposed by the LGFA (who Council borrows money from) and provides a sufficient buffer to access additional

Figure 3. Net Debt



funds if required in the event of an emergency such as a natural disaster.

In the past, Council has used debt to fund some of the renewals of assets and to keep rates affordable. This is unsustainable and resulted in above average debt and an unbalanced budget. This is proposed to be addressed through this 20 year plan by increasing rates to fund renewals.

Council is also committed to exploring other sources of revenue, such as external grants, to pay for infrastructure needed to meet the needs of the growing community. Council has had recent success in receiving Central Government Funding for investment in delivering infrastructure for the Tara-Ika growth area, the Foxton River Loop and for the 3 Waters network.

How we plan to fund Tara-Ika Infrastructure

Tara-Ika is a 420ha block of land to the east of Levin. It is privately owned by a number of different parties and has been identified as a key growth area for the Horowhenua District. Council has been working with these landowners and has produced a Master Plan to guide development in this area. This Master Plan will enable the development of approximately 2,500 houses (at a range of different section sizes), a small commercial area, new parks and reserves, and education opportunities. This is now the subject of a District Plan Change (Proposed Plan Change 4) which seeks to change the zoning of the land to allow development to occur.

Provision of key public infrastructure to accelerate development of the Tara-Ika Growth Area is assumed to be delivered and funded externally and will not be funded by Council debt. This means the assets created from the development will be vested with Council on completion in 2025/26. The total value of the project is $38m (uninflated). It includes the construction of lead-infrastructure for the Tara-Ika growth area including roading, reserves, wastewater, stormwater and water. Council has received a Government grant of $12.55m for the project, and if the project is not able to be delivered and funded externally, it would be funded by an interest free Government loan ($12.55m), and Council co-funding ($14.5m inflated). However, Council does not currently have room in the debt profile for the government loan and the co-funding portion of the project, while completing the rest of the proposed capital programme. If the project is not able to be funded externally, Council will reprioritise the timing of the capital programme to ensure our projected borrowings remain within the limit of 250% of operating income while completing this project as a priority. This would mean an additional $27m of borrowing would be required and $19m of capital upgrades would need to be moved from the first seven years of the plan to years 2036 to 2041. This cost would be funded over time by development contributions, if Council decides to reintroduce them. This would not impact current levels of service, but could delay the implementation of improvements to levels of service by seven years. It is not proposed that renewals would be impacted.

LGFA

The LGFA is the Agency where Council sources the bulk of its loan funding.

Council has maintained an A+ credit rating with Standard and Poors every year since first being rated in 2015.

This credit rating enables the LGFA limit to be set at 300% of Council's operating income for the 2020/21 and 2021/22 years, reducing to 280% in year 2025/26 and remaining at 280%.

Gaining a credit rating has also helped to reduce Council's interest rates on new borrowings since May 2015.

Limit – Debt

The net debt to revenue ratio will be within the maximum of 250% of Council's operating income as calculated for LGFA covenant disclosures.

Rates

Council remains committed to a long-term programme of increasing income to:

1. **Increase rates funding of asset renewals expenditure.**
2. **Pay for operational expenses.**
3. **Maintain a balanced operating budget.**

In recent years, a key aspect of Council's Financial Strategy has been increasing rates to move from the partial loan funding of renewals to rate funding of renewals, with an aim of fully rates funding renewals and achieving a balanced budget.

Rates funding renewals ensures that current generations contribute to the asset replacement as they use the asset. This has led to above inflation rate increases since the 2013/14 financial year, apart from in 2020/21, when Council decided on a 1.83% decrease to the total rates income collected in response to the Covid-19 pandemic. This rates decrease for the 2020/21 year (compared to the 5.54% increase projected in the LTP 2018-38) means Council's rates income is currently lower than anticipated, this is contributing to the need for higher rates increases in the short term to catch up.

However, in order to keep rates increases below 7.5% in the first 3 years, Council is proposing to continue to loan fund some asset renewals for the first few years of the plan.

Between 2025 and 2028 we also need to keep rates at between 5 and 6% for a further 4 years to increase rates funding of asset renewals and reach the goal of fully funding renewals by rates by the end of the 20 year plan.

A key benefit of growth is that the rates income increase needed each year is split between a greater number of ratepayers, decreasing the impact on the community (Figure 4).

Council's long-term aim is to have rate increases (net of growth) close to the level of inflation (Local Government Cost Index (LGCI)) plus 2%. This is proposed to be achieved in the 2028/29 financial year. Council is committed to getting the most value out of every dollar spent, while achieving the right balance between progress and affordability.

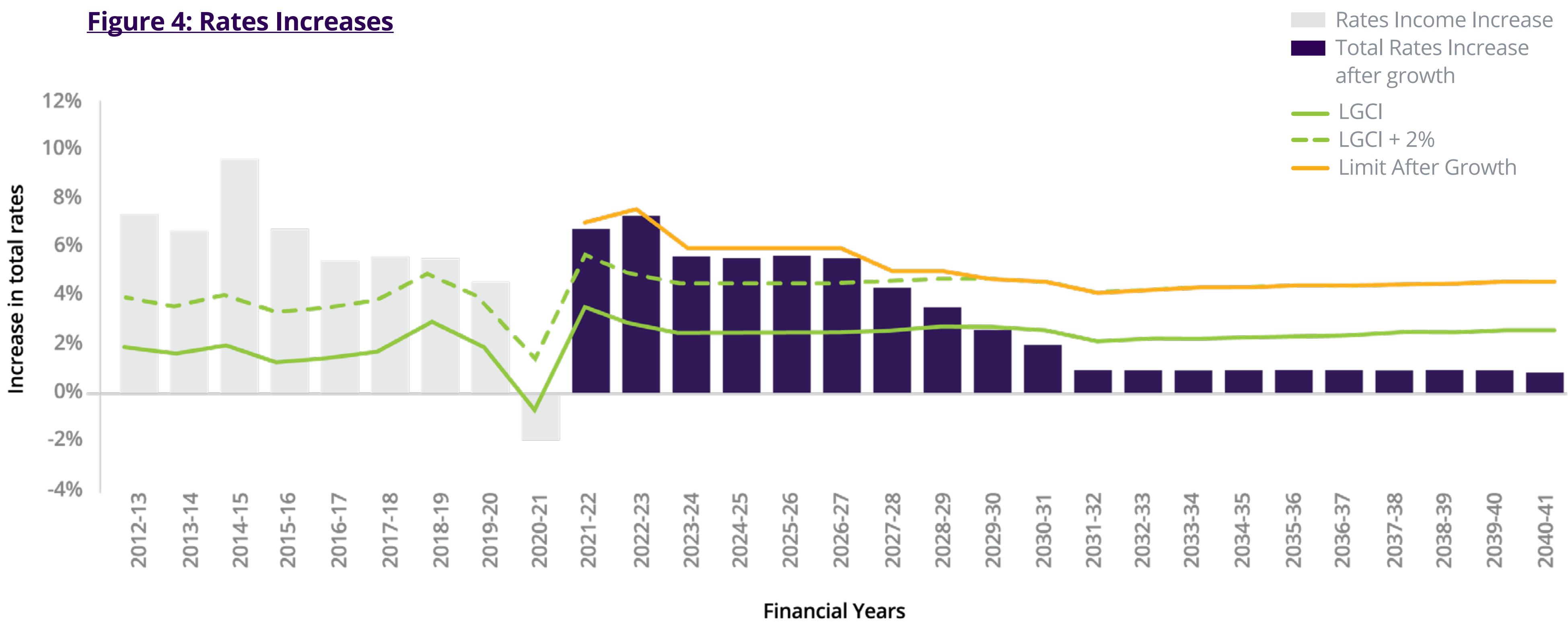
LGCI

The LGCI is the inflation index relating to local government (as opposed to the Consumer Price Index (CPI) which measures inflation for households).

Local government inflation differs from household inflation mainly due to the greater influence of petroleum inflation on local government than individual households.

The Society of Local Government Managers (SOLGM) has commissioned Business and Economic Research Limited (BERL) to forecast inflation/price changes for 2021-2041for local authorities as a basis on which to prepare their forecast LTP financial information. These forecasts are used within Council's Significant Forecasting Assumptions outlining inflation over the 20 years of the LTP

Figure 4: Rates Increases



Note: Neither the CPI or LGCI provide forecasts past 2030/31. The LGCI trend-line was simulated from 2030/31 based on the previous 10-years of data.

Table 1: Rates Increases

	2021/22	2022/23	2023/24	2024/25	2025/26	2026/27	2027/28	2028/29	2029/30	2030/31	2031+
Rates Increase (after growth)	6.7%	7.3%	5.6%	5.5%	5.7%	5.5%	4.3%	3.6%	2.6%	2.0%	1.0% *(Average)*
Rates Limit (after growth)	7.0%	7.5%	6.0%	6.0%	6.0%	6.0%	4.6%	4.7%	4.7%	4.6%	4.4% *(Average)*

Note: penalties and remissions are not included in the above. Individual household rates may be higher or lower than the above percentage increases.

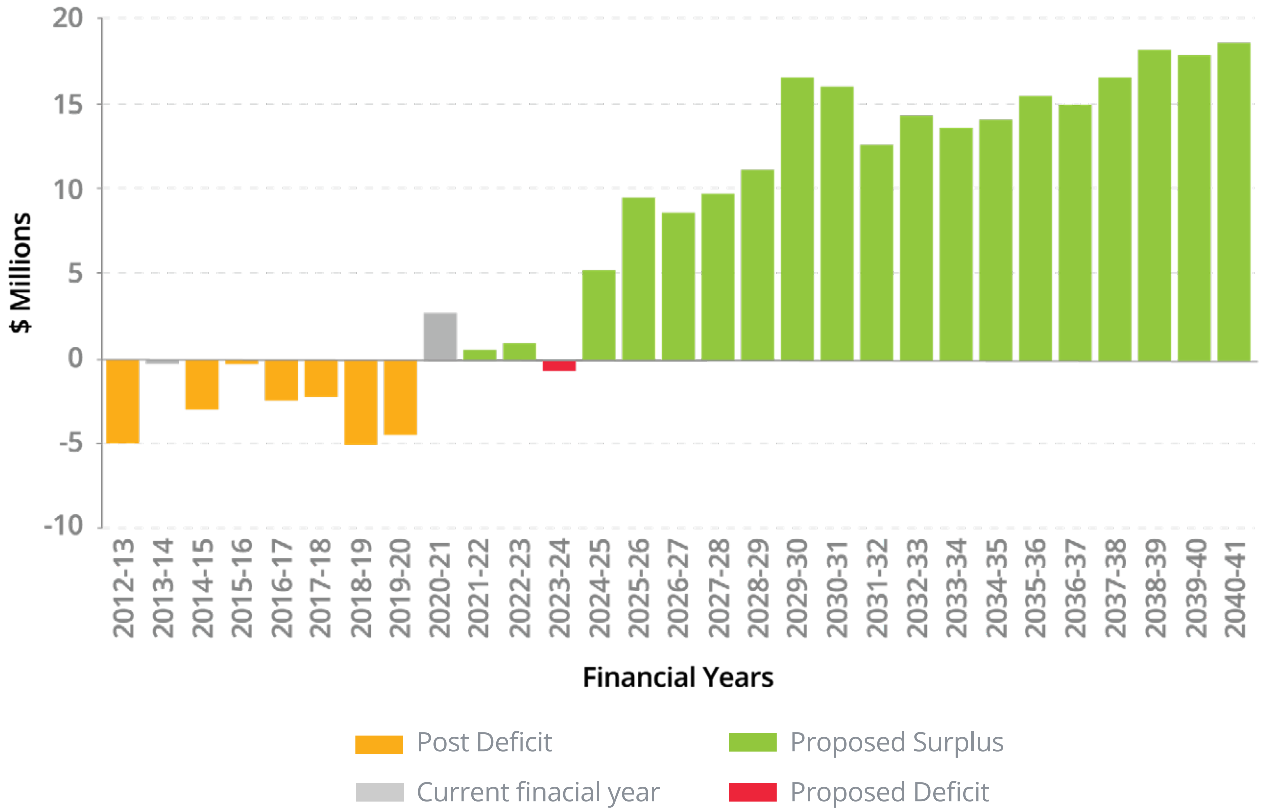
Balancing the budget

Balancing the budget means Council's income is equal to or more than operational expenses.

Council has a history of budget deficits, largely resulting from partial loan funding of the asset renewal programme as outlined in the section related to rates. For this 20 year plan we are planning to balance the budget in all years, apart from a small deficit in 2023/24, however, in order to keep the rate increases affordable in the first 3 years Council is proposing to loan fund some asset renewals. The following 5 year period still has above inflation increases to increase rates funding of asset renewals necessary to keep the loan portfolio sustainable in the long-term. This also has the consequence of increasing surpluses in all years from 2024/25 onwards.

Operating in surplus means we will be able to pay-off more capital project loans (debt) used previously to fund renewals. This has also been helped by the NZTA Funding Assistance Rate (subsidy) on Land Transport increasing from an initial assumption of 60% to 62% reducing to 60% in 2023/24.

Figure 5: Benchmark Operating Surplus/Deficit



It is still Council's intention to increase fees and charges by inflation as a source of income. Although no increases were made in the 2020/21 year to help the local economy recover from the Covid-19 pandemic.

The balanced budget measure is calculated by measuring incomes less expenses but excluding income from development contributions, vested assets, asset revaluation gains/ losses and other non-operating income and expenses.

Policy on Securities

In order to borrow money, Council has to offer our lenders some security.

In general, councils secure debt by giving the lender the ability to raise a rate (i.e. rate you more) to repay the loan. Council uses the LGFA as a source of loans and uses rates as security for all borrowings from the LGFA. Using rates as security helps Council take out loans with low interest rates.

Investments

Council holds investments in companies, commercial property and cash.

Investment in Companies

Council is an equity holder in three companies (listed in Table 2). Council does not hold these equity interests to receive a financial return. The reason for holding the share is strategic, to foster efficiencies and positive outcomes in reducing costs. Council holds an investment in Civic Financial Services Limited. Before 1 March 2017 it was known as the New Zealand Local Government Insurance Corporation Ltd and traded under the name of Civic Assurance, however, the company no longer offers insurance products. Council's initial reason for investing, to foster a competitive insurance market, no longer applies. Recently the Company sold its Wellington building and paid out a special dividend to shareholders.

Investment in Property

Council owns a mix of properties both core, relating to Council's primary services (e.g. drainage and sewage) and non-core, pertaining to non-traditional services (e.g. commercial buildings and motor camps). Council has been implementing a programme of asset sales of non-core property following an evaluation of the property portfolio in accordance with Council's Property Strategy.

This programme of sale of non-core property assets will be continued, with the aim of Council owning and maintaining only core property by 2028.

There is a risk that the sale of assets will not occur in the assumed timeframe due to unforeseen property markets.

Table 2: Council Shareholdings

Company	Shareholding	Principal reason for investment	Budgeted Return
Manawatū-Whanganui Local Authority Shared Services Ltd	$16,000 (14.29%)	Efficient cost effective back office functions	nil
New Zealand Local Government Funding Agency	$100,000 (0.4%)	Cost effective borrowing	$6,000 pa
Civic Financial Services Ltd	$104,000 (1.0%)	Historically for risk management, and ensuring a competitive insurance market	nil

Cash investments

Council has surplus cash from operations from time to time. Surplus cash is invested for short periods of time (30 to 90 days) to maximise returns from these funds.

Council's practice is to use surplus cash to minimise external debt. It is prudent to hold some cash to ensure short- term liquidity. Council generally holds approximately $10m to $11m in cash. Cash is supplemented by the use of a committed banking facility of $10m that enables Council to raise short-term borrowings in the event of a natural disaster when Council would need access to funds quickly to provide relief.

Council recently increased cash reserves to reduce the liquidity risk (i.e. to reduce the risk of not covering our short-term debt).

Other investments

As part of borrowing from the LGFA, the Council is required to invest in financial bonds at 2.5% of the borrowing from the LGFA. Council will receive interest and full repayment of these "borrower's notes" upon repayment of the loan to which they relate. Interest is calculated to cover the cost of funds.

Insurance

Council has full insurance cover through the MW LASS insurance procurement project.

Council currently insures all Water, Wastewater and Stormwater assets as well as Council's operational assets (plant and equipment) and buildings. Land Transport (Roads and Footpaths) assets are uninsured.

A key assumption is that Central Government will contribute towards the replacement of Land Transport assets following a qualifying natural disaster event. This assistance would be provided at the Council's current Funding Assistance Rate (FAR), which will be 62% in 2021/22, 61% in 2022/23 and 60% in 2023/24. For the portion of cumulative claims of the total costs of emergency works that exceed 10% of the Council's approved maintenance programme for the year, Central Government would provide funding at the normal FAR plus an additional 20%. Council will loan fund the difference

Another key assumption with any disaster recovery is that Central Government will contribute 60% of the funding to reinstate infrastructural assets following a significant natural disaster. Council's 40% share is insured for disaster recovery through the Local Authority Protection Programme (LAPP). LAPP is a mutual self-insurance arrangement with other local government entities to insure underground infrastructure against disaster damage similar in nature to Christchurch's earthquake.

Council is reviewing its membership of LAPP due to the continued withdrawal of member councils in recent years. This increases Councils risk of LAPP not being able to cover insurance claims in the long-term. If Council decided to leave LAPP, it will replace this form of mutual insurance with normal insurance subject to affordable premiums and excess. Normal insurance for operational assets and buildings is sourced through the Manawatū-Whanganui Local Authority Shared Services (MW LASS) procurement in conjunction with our regional partners.

Central Government is reviewing their commitment to cover 60% of any disaster reinstatement whereby they will withdraw from this arrangement in all but catastrophic events. However, the Government has not made any definitive decisions as yet. Council has, therefore, assumed the status quo in the interim. Council believes it will have sufficient capacity to borrow to cover the costs of any emergency within the new 250% of income debt limit and well within the LGFA limit of 300% (decreasing to 280%).

Horowhenua
DISTRICT COUNCIL

enquiries@horowhenua.govt.nz
horowhenua.govt.nz
06 366 0999
Private Bag 4002, Levin 5540
126 Oxford St, Levin 5510
HorowhenuaDC