Selwyn
DISTRICT COUNCIL

Financial Strategy

2024-34

Introduction

The financial strategy guides the way the Council makes decisions over income, expenditure, borrowing and investments.

It helps explain how we plan to balance the books and summarises the implications of these plans for ratepayers (i.e. making transparent the overall effects of our proposals for funding and expenditure on our services, rates, debt levels and investments). In doing so it links the decisions the Council makes on what services to provide and how they will be paid for.

The objectives of the financial strategy are to:

- provide funding for the continuing transformation of the district.
- keep rates at reasonable levels, whilst allowing them to rise sufficiently to allow for improved community facilities and essential infrastructure to meet the needs of the community.
- use borrowing to spread the cost of new facilities and infrastructure between current and future ratepayers (intergenerational equity); and
- keep the Council in good financial health so that future generations benefit in the same way that the current generation has done.

Our starting point

The Council is in a sound financial position after a decade of rapid population and business growth. Recent years' financial results have been positive, net borrowing is low and we retain a range of investments.

Although this growth is very positive for the district, and certainly results in an increase in the number of ratepayers, it does put ever increasing pressure on our water and wastewater systems, roads and community facilities. Responding to this pressure requires substantial investment in these areas and will continue to do so.

The major financial challenge for the Council, ratepayers and developers over the next 10 years is funding of this expenditure.

As at June 2023 the Council had:

- Net assets of $2.9 billion
- Gross borrowing of $115.2 million
- Equity and property investments of $257 million
- Expenditure of $166 million delivering services
- Rates income of $85 million
- The impact of Covid-19 continues to present challenges with cost escalation being seen in a number of areas and giving rise to cost-of-living challenges. The global economy has significantly changed, altering trends such as migration, employment, tourism, and ways of working. Rapidly shifting global markets, industries and economic structures are impacting business structures and viability. Economies are responding to higher-than-average interest rates, inflation, and a cost-of-living crisis, with many countries now in recession.

Our strategy

Our strategy has been prepared taking into account the Council's starting financial position, plus the factors that we expect to have a significant impact on our position over the next 10 years.
These include:

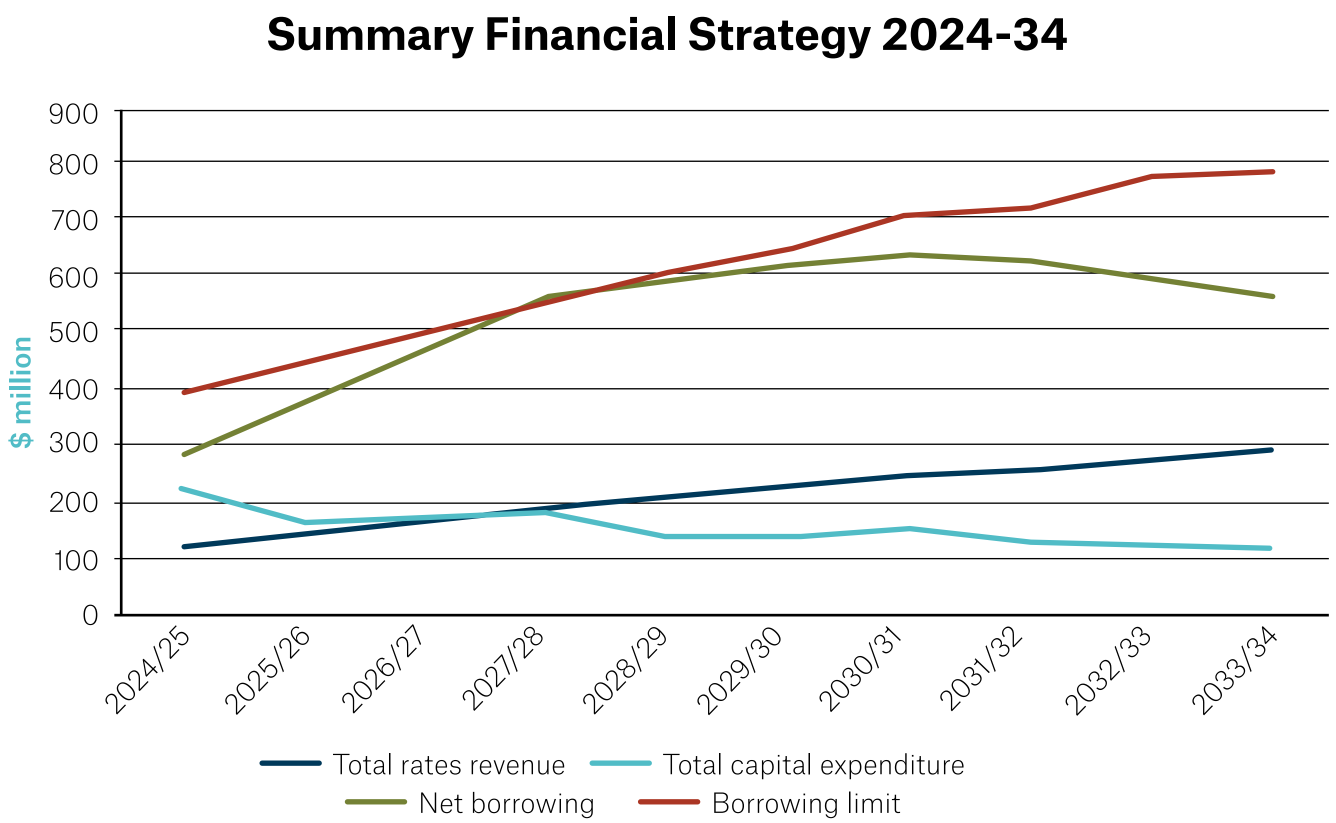
- population growth, changing land use and the associated infrastructure requirements;
- inflation;
- changes to services; and
- the funding of renewals and depreciation.

There is more information on how these factors have influenced the strategy in the appendix.
Our strategy is to keep the Council in good financial health and rates at a reasonable level.

The chart below shows how the substantial level of capital investment over the next few years will result in an increase in the level of borrowing, and how increasing rates revenue will allow the borrowing to be kept under control so that it starts to reduce towards the end of the period. Rates revenue goes up due to both more ratepayers and rate increases, but increases are kept at reasonable levels.

Council is in the early stages of developing a Strategic Investment Strategy (which will be subject to the Council's significance and engagement policy).

The key focus of this will be re-defining what we class as a strategic asset and having a clear set of criteria around future investment/s. This will also include reviewing our existing asset base for divestment opportunities.



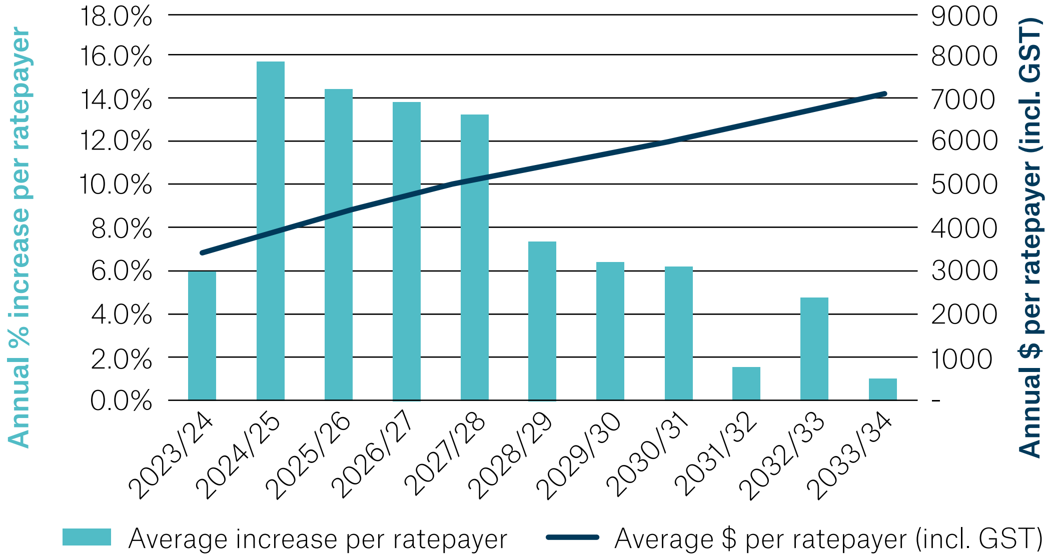
Rates

The total rates ratepayers pay is made up of a mix of general rates (approximately 40%) and targeted rates (approximately 60).

We are forecasting an average total rate increase per ratepayer of 8.5% per year over the next 10 years. We have set a limit that the average rate increase per ratepayer will not exceed 16% in the first four years of the plan and 10% for the remaining six years.

These are average increases per ratepayer and the actual increase for individual ratepayers may exceed these amounts (the number of ratepayers is defined as the number of assessments for the uniform annual general charge.)

The forecast average rate increase per ratepayer and the average rates per ratepayer is set out in the chart below.



General Rate

The activities funded by the general rate include:

- land transport (mainly roading);
- community services;
- development and growth services;
- democracy;
- cemeteries, public toilets, civil defence, community development; and
- a contribution towards swimming pools.

Increasing general cost pressures in particular in maintaining, enhancing and building a safe road network and town centre improvements, means the general rate will need to increase.

The amount of the general rate that individual ratepayers pay is based on the capital value of their property plus a uniform annual general charge. The Council has sought to minimise increases in the level of the general rate by using borrowing to fund expenditure that will deliver community benefits over a number of years (i.e. road improvements).

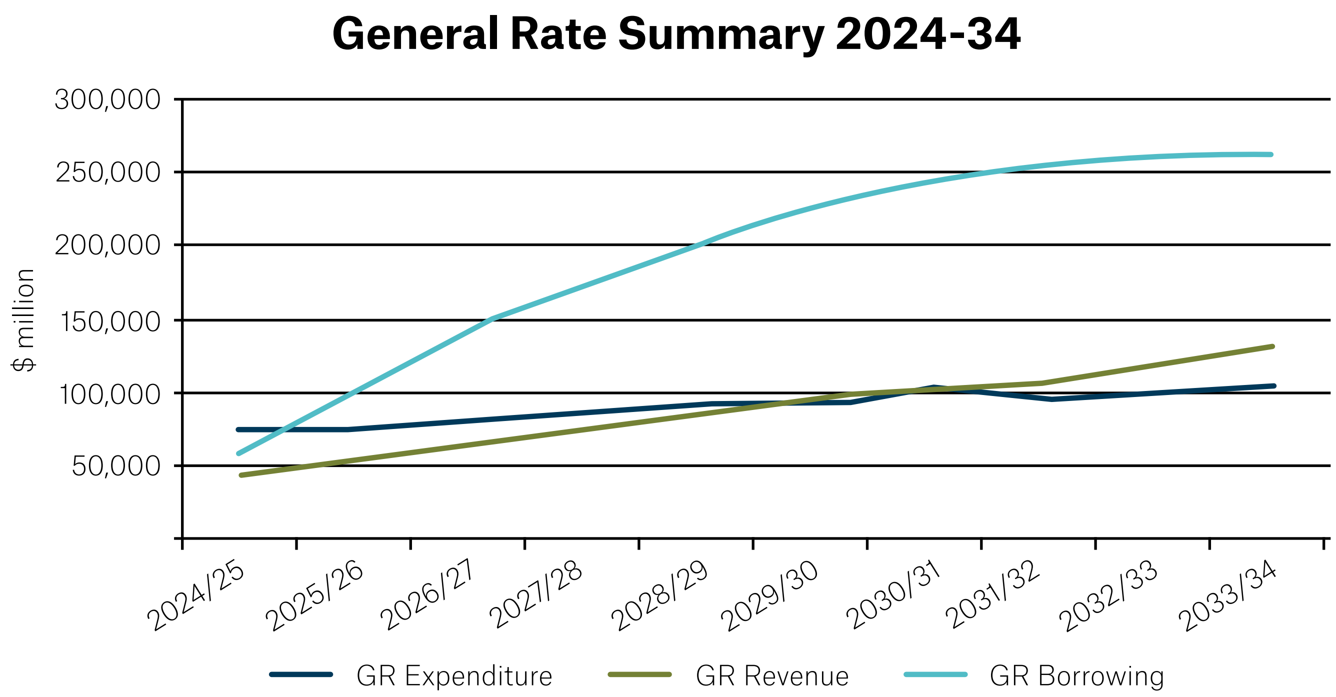
We consider this is a fair approach as future ratepayers share some of the costs incurred that they will enjoy the benefits of. The level of borrowing needs to be sustainable in the longer term as will build interest costs that add to the amount that needs to be funded by rates and builds up borrowing that will need to be repaid.

The Council's approach is to increase the general rate and use general rate funded borrowing in a way that balances the needs of current and future ratepayers, and limits borrowing to a financially sustainable level. The chart below illustrates general rate expenditure over the next 10 years and how it will be funded through a mix of general rates and borrowings.

It shows how borrowings are used to fund a portion of expenditure that creates longer-term benefits. Therefore, allowing the cost impact on the ratepayer through general rate increases to be spread similar to how the community will benefit. Repayment of borrowing can happen when general rate revenue (the red line) exceeds general rate expenditurem (the blue line).

Average annual general rate increases of 12%, plus forecast growth in the rating base, are needed to achieve the objective of being able to reduce general rate borrowing by the end of the 10-year period of the plan.

Without the planned general rate increases the level of borrowing would need to increase further. This would then see future rate payers being faced with a large financial burden and the prospect of significant rate increases. The alternative position is deferral or cancellation of major projects or reducing levels of service to lower expenditure and reduce benefits to the Selwyn community.



Targeted Rates

Targeted rates are used to fund specific activities including:

- water, wastewater, water races, land drainage, stormwater.
- recreation reserves, community centres, libraries, swimming pools.
- Canterbury Museum.
- refuse; and
- the Malvern Community Board.

A self-contained account is maintained for each targeted rate that, over time, is kept in balance (i.e. net expenditure equals targeted rate revenue).

In any one year the account may be in surplus or deficit. The level of the targeted rate is set to achieve a balance over the medium term (5 to 10 years).

Where the activity requires substantial capital expenditure this may be met by borrowing that is repaid over a period of time, typically 20-25 years.

Borrowing

The anticipated rate of population growth and planned service improvements will require continued capital expenditure. This involves a number of large projects including improving road intersections, new community facilities and additional wastewater capacity. The level of capital expenditure will mean that the Council needs to borrow to pay for these costs as they are incurred. These projects represent an investment in the future of the Selwyn district and will be used and enjoyed by both current and future residents. The use of borrowing means that the cost of this investment is met over time by those that benefit.

Interest costs and principal repayments will be met by a mix of the general rate, targeted rates, development contributions, land sales and lease revenue.

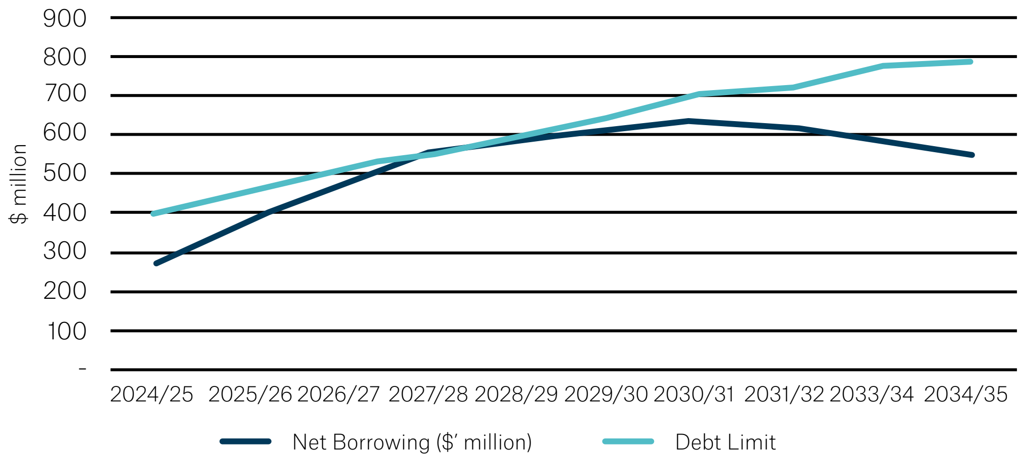
The Council's forecast level of net borrowing for the 10 years of the plan is shown in the chart below. It shows the level of debt compared with the Council's borrowing limit. Net borrowing increases in the early years of the plan but planned increases in revenue means that we can meet our objective of reducing net borrowing by the end of the 10-year period of the plan.

The Council generally does not offer its assets as collateral on borrowing and instead provides security on its borrowing through a Debenture Trust Deed. This provides lenders with a charge over the Council's rates income and means that if the Council defaulted on a loan, the lender would have the ability to set a rate and recover the sums owed. In practice, it is the ability of local authorities to set rates that makes it very unlikely that a local authority will default on its obligations.

Whilst the Financial Strategy looks at the requirements for 10 years, modelling beyond that period is required in the Infrastructure Strategy (30 years) and longer-term financial considerations need to be taken into account.

Borrowing limits

The Council has set the following limits on borrowing. The aim of the limits is to ensure that the level of borrowing is prudent and provides capacity for both future capital expenditure and unexpected events.



Assessment of ability to provide and maintain services within rates increases and borrowing limits

The limits specified in this financial strategy in relation to rates increases and borrowing have been set to ensure that the Council is 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. We also have additional demand for infrastructure due to our population growing significantly.

Net borrowing is defined as total debt less unencumbered financial assets and investments with a maturity of less than 1 year.
Net Interest is defined as the amount equal to all interest and financing costs less interest income for the relevant period.
Rates revenue is defined as the amount equal to the total revenue from any funding mechanism authorised by the Local Government (Rating) Act 2002.
Operating balance is defined as surplus of operating funding taken from the Funding Impact Statement, excluding financing costs and interest revenue.
** The forecast maximum in 2027/28 is projected to exceed the 220% limit set by Council. This is forecast to be within the limit in in the following year and for the remainder of the plan.*
^ This ratio is exceeded in 2024/25 to 2026/27 due to impact of unspent operating project budgets being carried forward and the Council has made the decision to smooth the impact of rates increases on the community. The forecast average across the remainder of the plan is within the limits.

Ratio	Limit	Forecast maximum level during period 2024-34
Net borrowing as a percentage of total revenue	220%	223%*
Net interest as a percentage of total revenue	<10%	9.6%
Net interest as a percentage of rates revenue	<25%	12.9%
Payback ratio (net borrowing/operating balance)	<9 years	20 years^

Investment

The Council has three main types of investments:

Investment	Objective	Target Return	Use of Investment Returns
Property portfolio	To bring jobs and services to the district and to make a financial return.	6.0%	Revenue from commercial property is used to support the general rate requirement over time
Shareholdings: • Orion New Zealand Limited • CORDE Limited • Transwaste (Canterbury) Limited	To secure a long-term financial return through investments that provide both annual dividend revenue and regular capital growth that protects the underlying value of the investment. As such they generally provide a better long-term return than cash investments.	1.5*	Dividend income is used to support the general rate requirement.
Cash	Cash is held in reserve for specific purposes in near risk-free investments and to provide financial security in the form of liquid assets.	5%	Interest revenue is used to support the general rate requirement.

** This is based on the fair value of the Council's shareholding.*

Conclusion

The Council has designed its financial policies to be prudent and fair to current and future ratepayers. Current ratepayers pay for the services they enjoy, including a contribution to the cost of replacing the infrastructure they use. The cost of expanding our infrastructure to allow for new residents is partly paid for by developers. All ratepayers, current and future, pay for the costs involved in improving the quality of services. This approach will maintain the Council's healthy financial position over the next 10 years and provide a sound base for maintaining the well-being of future generations.

Appendix - Supporting information for the Financial Strategy

Key factors that have influenced the financial strategy.

The financial strategy has been prepared taking into account the Council's starting financial position, plus the factors that we expect to have a significant impact on the Council's position over the next 10 years.

These include:

- population growth, changing land use and the associated infrastructure requirements;
- inflation;
- changes to services; and
- the funding of renewals and depreciation.

Population growth, changing land use and infrastructure requirements.

As a fast-growing district, population growth is top on the list of factors that are influencing the Council's finances. It is this growth that leads to the increasing level of operating expenditure and the significant capital expenditure programme of recent years.

We have prepared our 30-year township population growth forecasts for the district using information from Statistics New Zealand and data on recent trends in sub-division development and building activity.

The current population of the district is about 84,000 and the forecast is that it will be around 100,000 by 2034 (the end of the period covered by the LTP). This population growth (near 30%), alongside the associated business growth, will continue the land use change from rural to urban and industrial.

The Council's policy is that developers should pay a fair share of the costs of new infrastructure that is required to serve the growing population. In this way the whole community benefits from the growing population but is not burdened with all of the costs. There is however some risk with this strategy.

If the Council spends money providing infrastructure to allow more houses in the anticipation of future funding from land developers, but the population does not grow as anticipated, then the Council, and ultimately, the ratepayer is left with borrowing that still needs to be repaid. This risk will be monitored over the coming years, with action taken to try to mitigate if the risk materialises, for example by delaying future expenditure if growth slows more than expected.

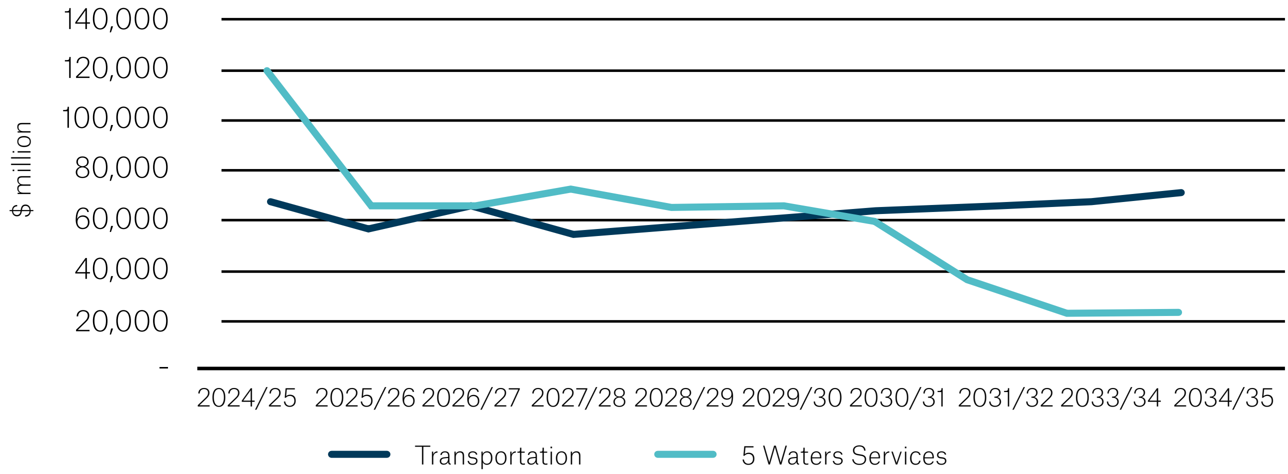
The forecast cost of providing for the growing population over the next 10 years is set out in in the table below.

	2021/22	2022/23	2023/24	2024/25	2025/26	2026/27	2027/28	2028/29	2029/30	2030/31	Total
	$'000	$'000	$'000	$'000	$'000	$'000	$'000	$'000	$'000	$'000	$'000
Community services & facilities	12,404	15,680	15,136	16,632	4,998	6,748	9,672	8,747	5,934	5,295	101,246
Transportation	30,859	36,798	40,229	29,615	30,719	28,082	34,560	37,652	38,011	23,246	329,771
Solid waste management	1,205	-	-	-	-	-	-	-	-	-	1,205
5 waters services	76,338	36,904	27,482	32,160	30,217	25,199	30,206	16,727	6,248	4,645	286,126
Support services	70	-	-	-	-	-	-	-	-	-	70
	120,876	89,382	82,847	78,407	65,934	60,029	74,438	63,126	50,193	33,186	718,418

Note: these additional costs relating to population growth may also result in improved services to the existing population, for example through roading improvements and new or expanded community facilities.

Forecast Network Infrastruture Capital Expenditure 2024-34

Note: The forecast network capital expenditure correlates to the work programme identified in the network infrastructure asset management plans.



Growth expenditure

The capital expenditure relating to growth is to provide additional capacity in the Council's road, footpath, water and wastewater networks, as well as providing additional community facilities.

The funding of growth capital expenditure related to:

- roading will be by a combination of general rates and development contributions.
- water, wastewater will be by development contributions.
- community facilities will be by combination of targeted rates, user charges and reserve development contributions.

Additional maintenance expenditure arising from growth will be largely met by the new ratepayers as they add to the rating base. This means that existing ratepayers will not need to meet all these costs.

Inflation

Everyone faces the impact of inflation, and the Council is no exception. Although the headline consumer price index (CPI) is relatively low at the start of the LTP period, costs faced by local authorities do tend to increase faster than the rate of the CPI. This inevitably means the cost of providing services will increase over the next 10 years and these increases will affect the level of rates. Overall, we estimate that inflation will increase the costs by nearly one third over the next 10 years. As a result, most of the Council's rates and charges will increase due to inflation.

Changes to services

Over the past few years, the Council has put in place a number of improvements to the level of services it provides. This includes the new community facilities and a greater emphasis on community development. The impact of these changes has already largely been reflected in the Council's cost structure and ratepayers' bills. Over the next 10 years the Council is planning the following improvements in the levels of service:

- roading improvements to improve the efficiency and safety of key arterial routes;
- the development of town centres;
- water system upgrades to improve water quality;
- new walking and cycling links between townships;
- expansion of the wastewater system;
- new community facilities including the Prebbleton Community Centre, the Leeston Library and Community Centre; and
- improvements to sporting and recreational facilities in a number of townships.

The improvements are partly related to population growth and will be funded by a mix of targeted, general rate and development contributions.

Renewals and depreciation

Depreciation charges are an accounting measure that represents how much of an asset value has been used up. For example, if a road surface lasts 10 years, the current ratepayers are assumed to have used up one tenth of the value of the road each year.

The annual depreciation charge forms part of the Council's operating expenses for the year.

As the asset has been previously paid for, depreciation is a non-cash expense (just a 'book entry') and does not involve any payments.

Renewal costs are the actual cost of replacing assets at the end of their life. It is the actual cash payment required to replace the old asset.

Over the long term the renewal cost and the depreciation charge for the Council's infrastructure assets (roads, water and wastewater systems) should be similar. But in any one year they can be very different – depreciation is a regular annual operating expense, and the corresponding renewal is an irregular capital cost.

Because many of the Council's assets are relatively new and have been fairly recently paid for by ratepayers through rates and development contributions, it is not fair for the Council to charge the full cost of depreciation to current ratepayers. The Council has therefore adopted a mixed approach to funding the cost of renewing its assets:

- For water, wastewater, stormwater and water races, the average cost of renewal work that will be required over the next 30 years is included in the calculation of the amount of rates required each year. This is because renewal costs are variable year to year and this approach smooths the rates funding required.
- For roading, the estimated cost of actual renewals work is included in the calculation of the amount of rates required each year. This is because renewals costs are less variable and are part funded by the New Zealand Transport Agency.
- For community facilities, the estimated actual cost of renewals is included in the calculation of the amount of rates required each year. This is because most of the large facilities are relatively new, and ratepayers are still funding the initial construction of the facility. The Council intends to move to longer term renewals or depreciation funding in the future once more of the initial construction cost has been paid off.

Assumptions

This financial strategy is based on certain assumptions about the future including that:

- the population of the district will continue to increase;
- capital expenditure will be incurred as planned;
- interest on borrowing will be between 3.9% and 5% (based on current forecasts);
- returns on investments will be in line with expectations, generally 1.5% – 6%;
- price increases (inflation) will be in the range 2-3% per year.
- there is no change in tax rates; and
- there is no major destabilising event locally, nationally or globally.

We know that reality rarely turns out as we expect and the advantage of having a financial strategy is that it seeks to maintain a strong financial position with flexibility to adapt to changing conditions.

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