2024-34 Long-Term Plan

Financial Management

Council Workshop

11 May 2023

Workshop Purpose and Outline

- Financial review process
- Overview of the key matters relating to financial management under the Local Government Act 2002
- What's proposed for LTP 2024/34
- Independent review
- Next steps

Financial Review Process

- Series of workshops planned
  - May: Overview legislative requirements (today)
  - June: Overview of current funding
    - including ORC rates, RC rates

    Review FS / RFP – identify changes to consider
  - July: Independent report back on RFP

    Determine rationale for change and options to consider / model
  - Sept: Review options / modelling

    Determine preferred options for Draft AP
  - Oct: Draft FS and RFP
- Includes independent review – being undertaken together with BOP/WRC

Local Government Act 2002

- Five obligations for financial management:
  1. Prudence – s.101(1), (2)
  2. Following a two-step funding process – s.101(3)
  3. Adopt Financial and Infrastructure strategies – s.101A, s.101B
  4. Adopt a set of funding and financial policies – s.102
  5. Balance the budget – s.100

1. Prudence

- Sections 101(1) and (2) of the LGA set out that:
  1. A local authority must manage its revenues, expenses, assets, liabilities, investments, and general financial dealings prudently and in a manner that promotes the current and future interests of the community.
  2. A local authority must make adequate and effective provision in its long-term plan, and its annual plan (where applicable) to meet the expenditure needs of the local authority identified in that long-term plan and annual plan.

- All financial dealings are subject to, and must demonstrate prudence
- Act doesn’t define prudence
- Requires consideration of both current and future
- Considerations could include:
  - Assumptions – population growth, land use, climate change, economy, legislation, specific events
  - Activity / asset management plans – life of the assets
  - Current levels of service and performance – maintaining vs increasing
  - Affordability – ability to pay (vs willingness to pay)
  - Surpluses / deficits (and reasons for them)
  - Individuals vs groups vs whole community
  - Provision for contingencies / emergencies

Benchmarks

- Local Government (Financial Reporting and Prudence) Regulations 2014
- Requires reporting against seven fiscal benchmarks
  - Rates
  - Debt
  - Balanced Budget
  - Essential Services
  - Debt Servicing
  - Operations Control*
  - Debt Control*

  ** Annual Report only*
- Benchmarks are indicators only, not caps or statutory limits

Benchmarks – LTP 2021-31 p65-66

Prudence Disclosures

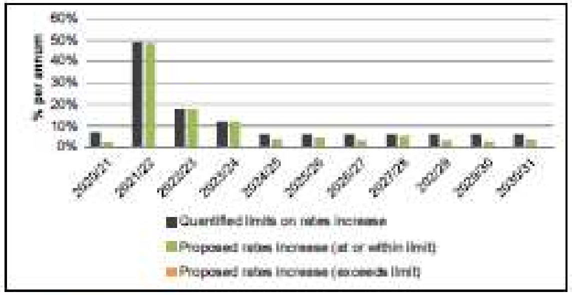
The purpose of this statement is to disclose Council's planned financial performance in relation to various benchmarks to enable the assessment of whether Council is prudently managing its revenues, expenses, assets, liabilities, and general financial dealings.

Council is required to include this statement in its Long-term Plan in accordance with the Local Government (Financial Reporting and Prudence) Regulations 2014 (the regulations). Refer to the regulations for more information, including definitions of some of the terms used in this statement.

Rates (Increases) Affordability

The following graph compares Council's planned rates increases with a quantified limit on rates increases contained in the financial strategy included in this Long-term Plan.

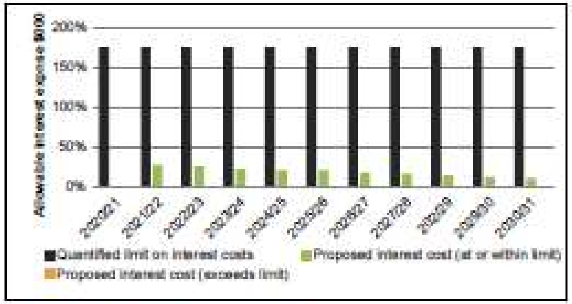
The quantified limit is 49% for 2021/22, 18% for 2022/23, 12% for 2023/24 and subsequently 6% in 2024/25 to 2030/31.



Debt Affordability

Council meets the debt affordability benchmark if its planned borrowing is within each quantified limit on borrowing.

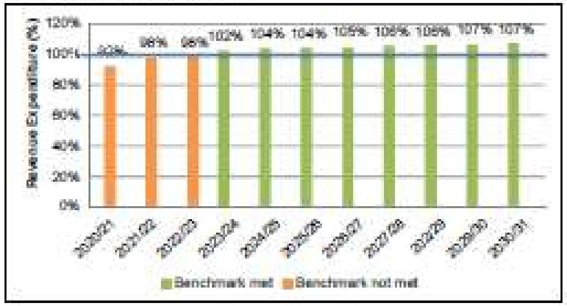
The following graph compares Council's planned debt with a quantified limit on borrowing contained in the financial strategy included in this Long-term Plan. The quantified limit is that debt cannot exceed 175% of the total revenue.



Balanced Budget Benchmark

The following graph displays Council's planned revenue (excluding financial contributions, vested assets, gains on derivative financial instruments, and revaluations of property, plant, or equipment) as a proportion of planned operating expenses (excluding losses on derivative financial instruments and revaluation of property, plant, or equipment).

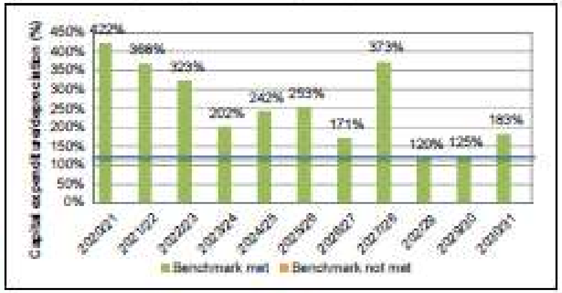
Council meets the balanced budget benchmark if its planned revenue equals or is greater than its planned operating expenses.



Essential Services Benchmark

The following graph displays Council's planned capital expenditure on network services as a proportion of expected depreciation on network services. Council's network services comprise flood protection and control works.

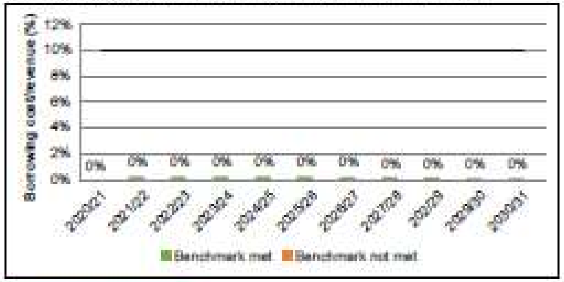
Council meets the essential services benchmark if its planned capital expenditure on network services equals or is greater than expected depreciation on network services.



Debt Services Benchmark

The following graph displays Council's planned borrowing costs as a proportion of planned revenue (excluding financial contributions, vested assets, gains on derivative financial instruments, and revaluations of property, plant or equipment).

Because Statistics New Zealand projects Otago's population will grow more slowly that the national population is projected to grow, it meets the debt servicing benchmark if its planned borrowing costs are equal to or less than 10% of its planned revenue.



2. Two-step Process

- Sections 101 of the LGA sets out that:

   3. The funding needs of the local authority must be met from those sources that the local authority determines to be appropriate, following consideration of,—
      a) in relation to each activity to be funded,—
         i. the community outcomes to which the activity primarily contributes; and
         ii. the distribution of benefits between the community as a whole, any identifiable part of the community, and individuals; and
         iii. the period in or over which those benefits are expected to occur; and
         iv. the extent to which the actions or inaction of particular individuals or a group contribute to the need to undertake the activity; and
         v. the costs and benefits, including consequences for transparency and accountability, of funding the activity distinctly from other activities; and
      b) the overall impact of any allocation of liability for revenue needs on the current and future social, economic, environmental, and cultural well-being of the community.

Step One

- Fund activities from sources “determined appropriate”
- Must “consider” 5 factors (not “include”)
- There’s no weightings for the 5 considerations
- Done at activity level (not groups of activities)
- Considerations cover inherent funding principles
  - Distribution of benefits – public/private good or user pays principle
  - Period of benefits – intergenerational equity principle
  - Contributing action / inaction – exacerbator pays principle

- ORC mainly uses a benefit based approach:
  - Whole community = general rate
  - Defined groups = targeted rate
  - Individuals = user pays
    - Some activities use a mix of the three
  - Immediate / current year = general rate
  - Ongoing / long term = targeted rate (smoothed through reserves)
- Exacerbators are often hard to determine and rate
  - Do use it ie. Alex flood scheme, some parts of other schemes, enforcement
  - Act states “action or inaction”

Step Two

- Considers the overall results of step one
- ORC considers:
  - Overall level of rates – average rates and average increases
  - Rates comparison to other regional councils
  - Use of differentials and uniform rates (UAGC)
  - Use of investment income (to offset general rates)

3. Financial Strategy

- Section 101A of the LGA sets out that:
  1. A local authority must have a Financial Strategy.
  2. The purpose of the Financial Strategy is to:
     a) facilitate prudent financial management by the local authority by providing a guide for the local authority to consider proposals for funding and expenditure against; and
     b) provide a context for consultation on the local authority’s proposals for funding and expenditure by making transparent the overall effects of those proposals on the local authority’s services, rates, debt, and investments

- The financial strategy presents the financial vision and consequences of the LTP
- Explains “how the work is paid for”
- It provides:
  - an overall direction and desired end point for the financial status of Council, and
  - a summary of the financial issues and consequences arising from the policy and service delivery decisions elsewhere in the LTP, and how those issues and consequences will be managed.
- “What we are going to do” is explained through activity planning and the infrastructure strategy

3. Financial Strategy Content

- Section 101A of the LGA sets out:

3. That the Financial Strategy must include:

    a) The factors that are expected to have a significant impact on the strategy including

        i. the capital and operating costs of providing for expected changes in population and land use

        ii. capital expenditure necessary to maintain levels of service on roads and footpaths, flood protection, and flood control works

        iii. any other significant factor that affects your ability to maintain existing levels of service and to meet additional demands for services

    b) quantified limits on rates increases and debt and an explanation of what impact these may have on your local authority’s ability to maintain current levels of service and meet additional demands for services, within the limits

    c) any policies that your local authority has for giving security for its borrowing. If your local authority is a member of the Local Government Funding Agency, you should check that your existing policies are not inconsistent with the requirements applying to members of that agency

    d) a statement that sets out your objectives for holding and managing financial investments and equity securities and its quantified targets for returns on those investments and equity securities.

- Have to include that mandatory information but more information than that is required to tell the financial story
- A lot of the detail in the Financial Strategy can't be completed until the underlying LTP information is completed
- Key assumptions of the strategy can be set before the core LTP is built ie use of debt, investment returns, capital repayment
- Last LTP story was based around growth…funding an increasing work program and the impact and recovery from Covid-19
  - External debt was proposed to replace internal debt, Port dividends increased (from $10M to $13M in year 1 and $20M in year 10) and rates increased significantly across the 3 years (48%, 18% and 12%)
  - Current FS (and RFP) are based on 4 key financial principles – prudence, fairness, value for money and transparency
- This LTP the financial strategy / story is likely to be focused more on delivery and sustainability

4. Funding and Finance Policies

- Sections 102 sets out that:

  2. A local authority must adopt the funding and financial policies:

     a) revenue and financing policy

     b) a liability management policy

     c) an investment policy

     d) a policy on development contributions or financial contributions

     e) a policy on the remission and postponement of rates on Māori freehold land

     f) a local boards funding policy (unitary / districts only)

  3. A local authority may adopt either or both of the following policies:

     a) a rates remission policy

     b) a rates postponement policy

Revenue & Financing Policy

- Only policy required to be included in LTP / audited
- Can be amended at any time but significant changes that trigger an LTP amendment would also need to be audited
- First step in the rate-setting process – followed by the funding impact statement and rates resolution
- Applies the two-step process
- Must be adopted before adoption of the LTP
- ORC combines (b) and (c) in a treasury management policy (this is allowed and common in the sector)
- (e) must also support the principles of the Te Ture Whenua Māori Act 1993 – will need to review current against this

- Section 103 sets out that the RFP:

1. Must state Council's policies for funding operating expenses and capital expenditure from…
2. The following permitted sources:
   a) General rates – including valuation system, differential rating and uniform annual general charges
   b) Targeted rates
   (ba) Lump sum contributions – n/a
   c) Fees and charges
   d) Interest and dividends from investments
   e) Borrowings
   f) Proceeds from assets sales
   g) Development contributions – n/a
   h) Financial contributions under the RMA 1991
   i) Grants and subsidies
   (ia) Regional fuel taxes under the LTMA 2003 – n/a
   j) Any other source
3. Shows how Council complies with s.101(3) – the two step funding process

5. Balancing the Budget

- Section 100 the LGA sets out that:
  1. A local authority must ensure that each year’s projected operating revenues are set at a level sufficient to meet that year’s projected operating expenses.
  2. Despite subsection (1), a local authority may set projected operating revenues at a different level from that required by that subsection, if the local authority resolves that it is financially prudent to do so, having regard to:
     a) the estimated expenses of achieving and maintaining the predicted levels of service provision set out in the long-term plan, including the estimated expenses associated with maintaining the service capacity and integrity of assets throughout their useful life; and
     b) the projected revenue available to fund the estimated expenses associated with maintaining the service capacity and integrity of assets throughout their useful life; and
     c) the equitable allocation of responsibility for funding the provision and maintenance of assets and facilities throughout their useful life, and
     d) the funding and financial policies adopted under section 102.

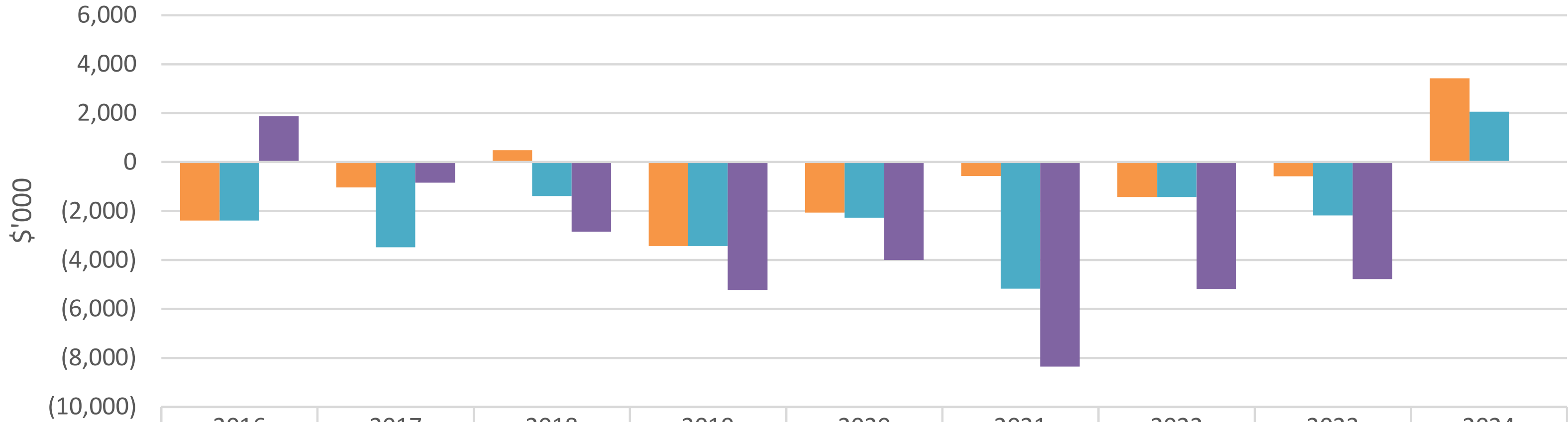
- Section 100 calculation is slightly different than the benchmark one ie vested assets and property revaluations are in s.100 but excluded in benchmark
- Requirement is “sufficient” (not equal to or greater than)
- Implies a small surplus is prudent (but that may not be the case)
- Applies to Council as a whole (rather than to separate activities)
- Test applies annually – surplus in one year doesn’t automatically offset another
- Section 100(2) allows an for an unbalanced budgeted providing Council resolves it’s financial prudent and considers the matters in clauses s.100(2) a-d

Deficit History

- Raised by Council's auditors in 2020-21 Audit
- Discussed in paper to A&R Sep-2022
- Deficit issue:
  - Large LTP year 1 deficits, reducing over LTP years 2 and 3 to usually a surplus position in years 4-10
  - AP years 2 and 3 have been rebudgeted to larger deficits than in LTP
  - Subsequent LTP's restart the process with new large / reducing deficits in year 4 which was intended to return to surplus
  - Additional actual deficits are occurring through unbudgeted decisions or unforeseen events outside the planning cycle

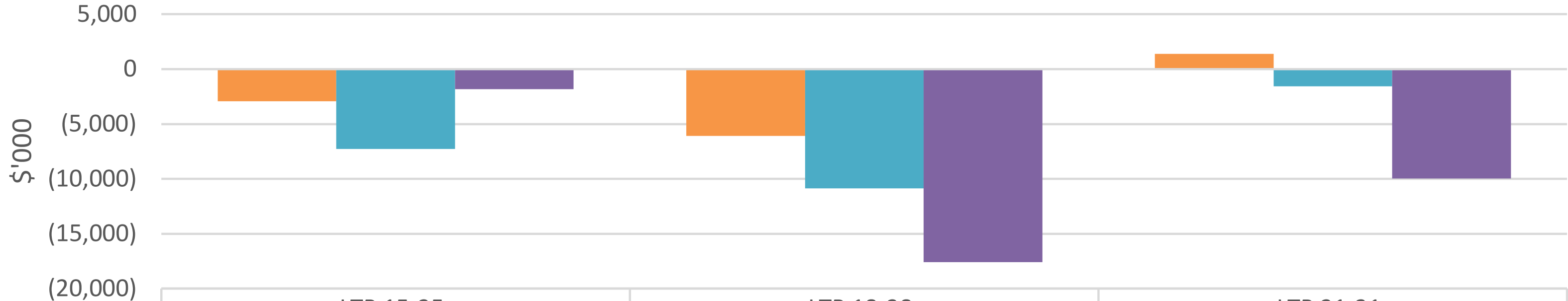
Graphs from A&R paper (with 2022-24 added)

Operating Surplus / (Deficit)



	2016	2017	2018	2019	2020	2021	2022	2023	2024
LTP	(2,383)	(1,035)	488	(3,430)	(2,070)	(571)	(1,433)	(583)	3,419
Budget	(2,383)	(3,482)	(1,393)	(3,430)	(2,275)	(5,168)	(1,433)	(2,186)	2,053
Actual	1,869	(841)	(2,849)	(5,218)	(4,006)	(8,354)	(5,189)	(4,786)	0

Operating Surplus / (Deficit) - LTP 3 Years



	LTP 15-25 2016-18	LTP 18-28 2019-21	LTP 21-31 2022-24
LTP	(2,930)	(6,071)	1,403
Budget	(7,258)	(10,873)	(1,566)
Actual	(1,821)	(17,578)	(9,975)

Notes:

- 2023 Actual is Forecast = deficit $2.6M greater than budget
- 2024 Budget is Draft AP
- Surpluses reflect gain on property sales

Proposed for LTP 2024/34

- Wider first principles approach as multiple rates will be reviewed
  - Strategy led rather than legislation led (important but don’t want this to constrain thinking)
  - Legislation tends to lead to a benefits/exacerbator focus, strategy focus aims to bring balance with outcomes / wellbeings
  - Focus is still on flood and drainage schemes and transport (areas with large reserve deficits and forecast expenditure)
- Things to be considered:
  - What we’re funding – increased LOS / cost in last LTP
  - Who owns the assets – schemes vs ORC vs not ORC (divestment)
  - Capital repayment period / depreciation
  - Benefit allocation – technical (zone based) vs integrated

Independent Review

- Engaged Morrison Low in collaboration with BOP/WRC
- Provide a case for change incorporating:
  - Review of all regional councils RFP’s
  - Case studies of RFP’s have influenced investment decisions
- Develop draft objectives / outcomes that consider community outcomes / wellbeings that can be used to inform the RFP
- Provide a draft methodology for applying s.101(3) a and b
- Provide advice on the impacts of the Te Ture Whenua Māori Act 1993

Next Steps

- June – review current funding, identify changes
- July – independent report
  - Determine rationale for change and options for further analysis / modelling
- Sep – report back with analysis / modelling
  - Determine preferred options and timing
  - Change could be incorporated:
    - In the LTP and consulted on in early 2024 ie “big bang” amendment to the RFP
    - Staggered over the a period of years ie break up and amend parts of the RFP over the LTP consultation and subsequent AP’s
- Oct – draft FS and RFP

End…Questions