Financial Strategy

Policy status:	Draft
Review due:	30 June 2024
Legal reference:	Local Government Act 2002 Section 101A Schedule 10, Part 1, Section 9

Purpose of the Financial Strategy

The Financial Strategy sets out how the Council plans to finance its overall operations for the next ten years, and the impact on rates, debt, and levels of service. The Strategy guides the Council's funding decisions and, along with the Infrastructure Strategy, informs the capital and operational spending for the Long-Term Plan 2021-2031.

Executive Summary

The Council plans to improve the overall condition of its essential assets, such as roads, footpaths, water supplies, and wastewater systems. We will also focus on ensuring that the services we provide are appropriate for a community of our size, fit for purpose, and comply with legislation.

In doing so, affordability is our greatest challenge, and we are committed to ensuring that rates are the last option as a funding source. User pays, external funding, and debt will be sourced wherever these are more appropriate.

We are extremely fortunate that our asset renewal profile is relatively flat for at least the next ten years (and potentially the next 30 years), especially for water, wastewater, and stormwater assets, largely due to the significant rebuild work that has been completed following the 2016 earthquake. Over $40 million has been spent since 2016 on remedial work to roads, bridges, three-water assets, the harbour, and other facilities owned by the Council.

Further assistance has come through the national three-waters reform process, whereby the Department of Internal Affairs has granted $1.92 million to the Council, enabling us to quickly undertake projects that will enhance asset capacity, resilience and public health outcomes.

Significant asset deficiencies do however remain, especially in the condition of local roads, which have had a low level of service pre-quake due to a 'do minimum' approach in the interests of rates affordability. This Financial Strategy aims to enable the catchup of deferred roading renewal work, as well as improving our overall services, while at the same time remaining within our self-imposed limits on rates and debt.

The Financial Strategy has the following overall financial boundaries:

- External borrowings are capped at $15 million,
- Our annual loan interest expense will be no more than 10% of total revenue,
- Rates increases are capped at no more than 7% in year one, 6% in year two, and 5% thereafter,
- Rates income does not exceed $10 million per annum in years 1-5, and is controlled by the 5% limit on rates increases per year thereafter.

Introduction

We begin the 2021-2031 chapter of our story amid the COVID-19 global pandemic. With New Zealand managing frequent small outbreaks of community transmission at the time of writing, which are keeping the country in a constant state of nervous tension, compared to the rest of the world we are enjoying almost total freedom of movement.

As of April 2021, the effects on New Zealand's GDP has been less than forecast and major sporting, cultural and music events are continuing to be successfully hosted. As a result of its national pandemic strategy and unity of approach, New Zealand is perceived internationally as a leader in terms of the pandemic response, and a destination of choice, especially once borders reopen unrestricted.

However, behind this "success" has been an unexpected and substantial rise in house prices, and an almost complete loss of the international tourism market in New Zealand (worth $...billion annually). This latter aspect has the country, especially those areas where international tourism is a major contributor to the local economy, at a potential tipping point.

For Kaikōura, COVID-19 comes on top of the effects of the 2016 Kaikōura earthquake. With access initially restricted to the District, the summer season 2019/20 saw Kaikōura's visitor numbers return to pre-quake levels for the first time. Due to the pandemic New Zealand entered lockdown in March 2020. With international visitors absent, the 2020/21 summer tourism season was well supported by domestic travellers, but the absence of international visitors, especially at "shoulder seasons" is strongly felt.

Businesses have altered their operations to best adapt, but despite this there has been the closure of several local businesses, and jobs lost (or hours, and incomes, reduced) since the pandemic hit. As of April 2021, the continuing impact on the local economy in 2021 and 2022 remains uncertain. NZ Tourism forecasts suggest the recovery of international visitor numbers is still at least a year away, and will take several years to recover fully, as vaccines are rolled out and confidence slowly returns for travellers.

Despite the effects of the pandemic, the local economy seems poised to move forward and local businesses continue to attempt to weather the loss of international visitors in anticipation of a strong recovery. There are substantial new developments in the wings (not least of which is the new Sudima Hotel).

Notwithstanding this, the Council acknowledges the effects to date on the local economy, likely to continue in the immediate future. The 2021 winter and potential for a still reduced 2021/22 summer is likely to test the resilience of local businesses to their limit.

Whilst the impact of the pandemic on the Council's own revenue and operations income has not been substantial, the Council took steps in 2020 to assist ratepayers' potential financial challenges. This included a reduction of the proposed 10% rates increase for 2020/21 as part of the earthquake recovery, to 4%, including a reduction in the Council's staff numbers of nearly 20%.

Purpose

Section 101A of the Local Government Act (2002) states:

101A Financial strategy

(1) A local authority must, as part of its long-term plan, prepare and adopt a financial strategy for all of the consecutive financial years covered by the long-term plan.

(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.

This Financial Strategy is a cornerstone to the Council achieving its goal of providing quality services without placing unnecessary burden on ratepayers. It outlines the key financial parameters and limits that the Council will operate within. This Strategy focuses on moderating rates increases, including making best use of debt as a funding tool where this is appropriate.

It is the Council's view that this financial strategy is prudent and sustainable. In putting this strategy together, the Council had to face facts that we simply cannot afford to do everything we want to, and had to prioritise which projects are important, and which to leave out for at least another decade. Underlying this strategy is the Council's view that the level of staffing and expenditure is such that Council services and compliance will be delivered on a no-frills basis.

The Financial Strategy is strongly influenced by its associated Infrastructure Strategy 2021-2031, and is best described as an enhanced status quo.

Infrastructure Strategy

The Infrastructure Strategy 2021-2031 highlights several key factors that influence this Financial Strategy.

Firstly, since the 2016 earthquake close to $1 billion has been spent to repair or renew sections of State Highway roads, bridges and rail networks in the District. Over $40 million has been spent on similar remedial works to roads, three-waters assets, and other facilities owned by the Council. These rebuild projects have been very helpful in that the assets that suffered the most damage were those that were most fragile in terms of their age or other deficiency. Almost all of our asset renewals that would have been required within the next 20-30 years have, effectively, already been replaced.

Secondly, even prior to the earthquake the Council had the foresight to increase the capacity of its essential assets, such as water reservoirs, wastewater pump stations and treatment ponds, to accommodate a peak population of up to 10,000 people. As a result, there are no growth-related capital projects requiring ratepayer funding for at least the next ten years.

The only major cost identified in the Infrastructure Strategy is a backlog in road renewals and, with loan servicing costs extremely low, this LTP provides for most of the backlog to be addressed over the next five years, funded by loan.

Financial & Corporate Sustainability Review

In 2018, the government, through the Department of Internal Affairs, initiated a review into the long term financial and corporate sustainability of the Kaikōura District Council, largely seeking assurance of the capacity and capabilities of the Council given the substantial government funding assistance that was needed following the devastating Kaikōura earthquake.

As the review progressed through 2019, the focus was on the principles of retaining local governance for the Kaikōura district, but that services could be provided through other Councils using a new shared service model. The review (known as FCS) concluded that the Council was not sustainable in its current form, due in large part because of the projected net debt forecast by the reviewers for the Council. The review suggested that up to $10 million was required to invest in developing new IT systems and database platforms that could then be easily integrated into the systems of other Councils so that they could provide shared services to the district.

Prior to any detailed discussions with other Councils, and with COVID-19 impacting the world at this time, the potential funding the government had considered might be available for Kaikoura was reprioritised to COVID relief packages. The review project completed in 2020, with a revised focus on the completion of internal projects to increase capabilities and improve processes.

By the end of 2020, the Council's financial performance and position had become clearer, with the rebuild projects virtually all completed and on budget, debt at much lower levels than forecast and the Council as an organisation having strengthened its internal capabilities.

The substantial work undertaken to put together the draft Long-Term Plan 2021-31 has shown, for the first time since the Kaikōura earthquake, the long-term infrastructure requirements and financial projections of Council. Other than the identified backlog of roading expenditure, the infrastructure renewal profiles over the period are such that it may be over 30 years before any significant renewal projects are required. This is due in no small part to the post-quake financial assistance of the government, and the Council's successful delivery of the infrastructure rebuild programme. The resulting rates and debt requirements are far from those envisaged through the FCS project.

The Council now considers that the Kaikōura District Council is financially sustainable for the foreseeable future, and that our debt levels, the condition of our core assets, and our knowledge about those assets actually puts the district in the best position it has been in for some time. The Council's corporate sustainability will remain challenging to maintain, with the level of staffing and expenditure such that Council services and compliance will be delivered on a no-frills basis.

Principles

The Financial Strategy has been based on the following foundation principles:

1. Council's activities are affordable for the community, and fit for purpose
2. Debt (both external and internal) is used as a funding tool where this is appropriate, and surplus cash is either used to repay debt, to invest in activities that generate a return, or to lessen overall costs to ratepayers
3. Users meet the cost of services when the benefits of those services are available to be enjoyed by an identifiable group of users (the user pays principle)
4. Rates are the last option as a revenue stream

Strategic goals

This Financial Strategy aims to plan for our community to be in the position by 2031, where:

- Our services and activities meet legislative standards as a minimum
- Our assets are well-managed and maintained, with the backlog of renewal expenditure addressed within the 10-year period
- Our levels of service meet the expectations of our communities
- Our internal processes are efficient and effective
- The projects identified in our Infrastructure Strategy have been completed
- Our total debt is no more than $15 million
- Our annual loan interest expense is no more than 10% of total revenue
- Airport and harbour activities are self-funding (if not income generating)
- Our investment assets provide an acceptable return, or have been sold

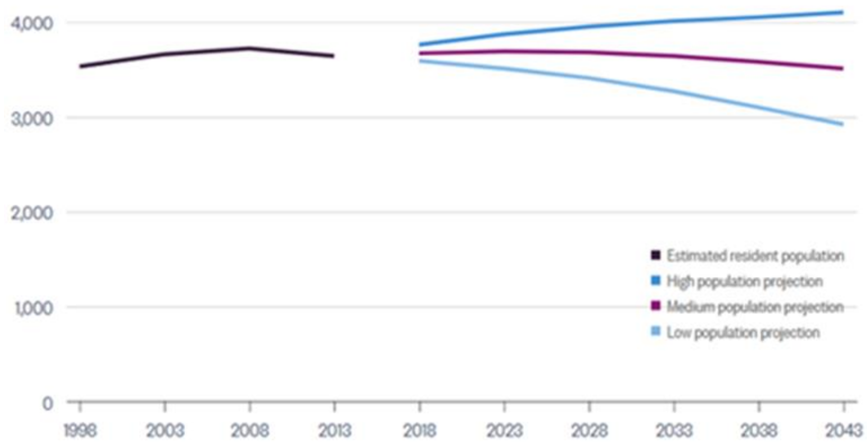
Context and strategic issues

The purpose of the Financial Strategy is to enable the Council to plan for anticipated future changes to our district's population and land uses, noting our context in terms of climate change and natural hazards, and other contextual issues. This Strategy will guide the Council's future funding decisions, and along with the Infrastructure Strategy, informs the capital and operational spending for the Long-Term Plan 2021-2031.

We have planned for ongoing renewal of our assets and to respond to anticipated demographic trends in our Infrastructure Strategy, whilst at the same time remaining within the rates and debt limits set out in this Financial Strategy.

Changes in population

Statistics NZ has released its population growth projections, per the graph below. These projections include a range from low to high. The Council has assumed that the average growth of permanent resident population in the district will not exceed 1.0% per annum. The Statistics NZ medium projection for resident population is a decrease at an average rate of around 0.4% per annum. This trend is however so weak that even relatively modest changes in a broad range of factors influencing growth could cause significant deviation from it.



Source: Statistics New Zealand population growth projections (Kaikōura)

While a population decrease has occurred following departure of the NCTIR workforce now that the earthquake rebuild projects are completed, the low projection from Statistics NZ reducing our population to less than 3,000 by 2043 seems rather pessimistic. It is conceivable that a major commercial activity and/or growth in tourism post-pandemic, could kick-start another wave of population growth, and there is clear evidence of business investment in the district – such as the Sudima Hotel under construction, developer enquiry about light industrial parks and expansion of residential subdivisions, proposed affordable housing developments, and other activity.

We also anticipate the demographics within our resident population to change over time. Our demographic statistics show we have an aging population, and we are likely to see people living longer, and living relatively active lives for much longer than before. For as long as there is no aged care specialist facility in Kaikōura, we expect that those with higher needs will by necessity have to move to another district.

A trend that may further compound our changing demographic is the high and apparently increasing proportion of dwellings within the district that are not permanently occupied, the majority of which are holiday homes. The most recent census indicates this proportion to be just over 32%, having risen by 4% over the preceding 5 years.

In summary, we do not expect there to be very much change in the number of usually resident population in the 2021-2031 period of this LTP, but there will almost certainly be changes to our demographic profiles.

The cost of providing for changes in population

With resident population growth expected to remain relatively static over the next ten years, we do not expect any significant increased demand for essential infrastructure such as roads, water supplies and wastewater networks. This is especially true given the pre-earthquake capacity of our key infrastructure, combined with the extent of the earthquake rebuild of the Council's essential assets, with the wastewater treatment plant, water and wastewater pipe infrastructure, water sources and storage facilities having been substantially renewed and, in some cases, rebuilt with more capacity and more resilience than before. This essential infrastructure will meet population growth demands for the foreseeable future, and no growth-related costs are anticipated within the 2021-2031 period.

Instead, our ageing population raises concerns about rates affordability, particularly amongst those with lower, fixed incomes such as pensions. An older population is also likely to increase demand for better quality pedestrian pathways, and potentially more passive recreational activities and alternative modes of transport. This LTP also provides for additional spend on footpaths, to improve accessibility and eliminate trip hazards, and only a very small portion of this has been deemed to be attributable to growth. Also, to enable therapeutic physical activity and low-impact exercise for an ageing population, the new swimming pool will be open for the summer of 2021/2022.

Natural hazards & emergency events

The Kaikōura district, like much of New Zealand, is subject to natural hazards. The November 2016 earthquake reminded us all that the Kaikōura district is a tectonically active zone. The quake itself exposed 105km of fault rupture within the district and resulted in new faults being identified. There were several positive effects which resulted from the earthquake. For example, the Kaikōura Peninsula rose over one metre in uplift, with greater uplift elsewhere in the district, eliminating the need for beach renourishment and protection work in the medium term. Other positives include the science and research which followed, which enabled the Council to obtain up to date information about our natural hazards.

Post-earthquake we have more detailed information about the active faults within our district, and this has allowed for the identification of fault avoidance and awareness overlays. Our understanding of liquefication has improved and we can now meet the Ministry of Business Employment and Innovation (MBIE) guidance, 'Planning and engineering guidance for potentially liquefaction prone land'. New LiDAR information has allowed for more accurate modelling of potential flooding. Research undertaken by GNS science supported by the Endeavour Fund has allowed areas subject to potential debris inundations (landsides and debris flows) to be identified.

To ensure the future development of our community is more resilient, Council planning staff are currently using the new natural hazards information to progress a natural hazards plan change for the Kaikōura District Plan.

The cost of providing for natural hazards & emergency events

Much of the costs involved with gathering information on our natural hazards has already been done, in so far as fault lines, liquefaction, debris flows and flood modelling. As discussed above, the cost of beach renourishment and coastal protection has been eliminated from Council budgets for the foreseeable future.

The Council has established a Roading Emergency Work fund that may be called on immediately following a flood or similar event that damages local roads and bridges, and while the fund is relatively small (maintained at approximately $200k annually), it is assumed that emergency subsidies would be available from Waka Kotahi (NZTA) to offset some of the repair costs, as well as other Council sources of funding.

The Council has already introduced the Earthquake Levy, a targeted rate at a set dollar amount per rateable property, which is used to repay earthquake-related loans in the first instance, and then once those loans are repaid, the Levy will start to build an Emergency Events reserve fund.

The opportunity cost of creating fiscal buffers (or emergency reserves) can be significant, because building buffers implies forgoing other rates funded expenditure geared toward better levels of service and spend on asset resilience. Therefore, rather than relying solely on emergency cash reserves, Waka Kotahi (NZTA), and ultimately the earthquake levy, the Council keeps at least $2 million in borrowing headroom, by having pre-approved borrowing facilities with the Local Government Funding Agency (LGFA) and/or the Bank of New Zealand (BNZ) that are always at least $2 million more than is actually borrowed. This means at least $2 million is available at short notice for any kind of emergency or unforeseen event.

Climate change

The Council has a moral and a legal responsibility to incorporate Climate Change response into its day-to-day business and decision making. It is important that the Council aligns its activities to reduce carbon emissions across all its areas of influence and creates the conditions for a low-carbon economy that is smart and innovative, and can meet or exceed the targets set within the Climate Change Response (Zero Carbon) Amendment Act 2019.

The Council has long been a supporter of greenhouse gas reduction, through various initiatives such as solar-powered streetlights in low density areas, our past benchmarking achievements in the Earthcheck programme, and more recently our installation of electric vehicle fast-charger in the West End.

We are fortunate that the Council does not have any activities or services that are linked to high carbon emission, such as use of coal or fossil fuels for heating. We do, however, own a landfill, which produces greenhouse gasses. The Council is therefore legally obliged to purchase carbon credit and surrender them to the Government through the Emissions Trading Scheme (the ETS).

The cost of providing for climate change

The ETS aims to encourage people and businesses to reduce greenhouse gas emissions, by creating a financial incentive – that is, a cost per emission unit (or per metric tonne of carbon dioxide produced). Unfortunately for the Council, other than through public education, we have little influence over the extent to which individuals consume products and the resulting waste that is created and landfilled. At current levels of solid waste being landfilled, the annual cost in carbon units to the Council – and ultimately to the ratepayer – is expected to be around $80,000 per year until such time as the landfill is capped and our district's waste is transferred to Canterbury or Marlborough. Even then, those costs will not disappear but will be included in any charges we pay to transfer our waste to those landfills.

Changes in land use

Commercial and industrial activity

The Kaikōura Sudima Hotel is under construction and plans to open for the summer of 2021/22. This 120-room waterfront hotel includes conference facilities, a bar and restaurant, and is a welcome addition to the accommodations on offer for visitors. The hotel facilities will open up opportunities to attract a new conferences and events market for Kaikōura.

The Council has been granted $10.88 million from the Provincial Growth Fund (PGF) – up to $9.88M to develop Wakatu Quay, and up to $1M for a feasibility study on how South Bay Harbour could be developed. The vision for Wakatu Quay is to create a vibrant mixed-use space with cultural, tourism and community aspects incorporated in its design. Exactly what will be developed has been subject to a separate consultation process with the community and has entered the design concept phase. The project itself is being managed by the Kaikōura Marine Development Governance Group, which is functioning independently from the Council. Whatever the final design, the intention is that this will be an iconic facility that enhances economic development, creates sustainable jobs, and boosts social inclusion.

The potential for a light industrial park has once again been presented to the Council by an experienced developer, based near the corner of State Highway One and the Kaikōura Inland Rd. This idea has been discussed with the Council before, but this time the developer is progressing negotiations forward, and is more public about the proposal, with interest already for businesses wanting to be part of the development.

Rural land use

Agricultural activities, particularly dairying, but also the potential for vineyards and urban sprawl, can have a large impact on resources (especially water) and impact the size and volume of traffic on our local roads. We anticipate that the bulk of the major changes to land uses in the rural area (dairy conversion and subdivision) has already largely occurred, and there are likely to be only relatively minor change to our rural areas within the next ten years.

The cost of providing for changes in land use

The cost of changes in land use will be met by the developer/landowner, particularly for any future commercial, industrial and residential developments. The Council has removed the threshold that had been in place in the Development Contributions Policy, meaning that every additional housing equivalent unit (HEU) will now be required to contribute to the cost of upgrading infrastructure (previously only developments of ten HEU or more would be liable for contributions). However, as a result of the successful earthquake rebuild and the limited growth infrastructure being required in the next ten years, the dollar value of the contributions themselves have dropped substantially.

The Kaikōura District Plan is the document that deals with land use zones and the restrictions or other control measures that apply to those zones. The Plan will be subject to an ongoing review of its chapters, starting with a review of the natural hazards chapter, and progressing over the next ten years. This rolling review will be funded by loans to help ease the burden on ratepayers.

Primary purpose for capital projects

The Council is required under the LGA to identify whether a capital project is intended to provide for growth or increased demand, to improve a level of service, or to renew existing assets. Only one (primary) purpose is to be selected regardless of whether the project could fit more than one of these definitions.

These definitions might be difficult to apply in practical terms, and so to clarify, an example of a capital project to meet the demands of growth might be construction of a new water reservoir, where more storage of water is required due to an increase in population. A project that is an increase to a level of service might be a new water treatment system to improve the quality of drinking water. Renewal of assets is easier to define, as it is the replacement of existing assets up to their as-new condition. The following two pages classify the Council's capital projects into these categories as required by the LGA.

Providing for growth and increased demand

As discussed in this Financial Strategy, the Council does not foresee any increased demand placed on its essential services attributable to growth that is not already provided for within the design capacity of its essential assets. Only two projects have been labelled related to growth; the Wakatu Quay development, which is PGF funded, and a sealed road extension from Scarborough Street to the new swimming pool to be funded by development contributions.

Improving levels of service

The Council's Infrastructure Strategy highlights projects that will assist to deliver the expectations of current levels of service, and these are listed in more detail in that Strategy.

The government three-water stimulus packages that have been distributed nationwide following the COVID-19 outbreaks have enabled the Council to undertake $1.88 million worth of key projects to improve our three-waters (drinking water supplies, wastewater and stormwater) systems, including treatment, storage, and monitoring upgrades.

These projects commenced in the 2020/2021 financial year, but there remains $1.2 million worth of work planned to be completed by 31 March 2022.

The cost of providing for improvements to levels of service

Group of activities	2021/2022 (,000s)	2022/2023 (,000s)	2023/2024 (,000s)	2024 to 2031 (,000s)
Capital projects to develop new or improve existing assets				
Roading				
Water supplies	-	-	-	-
Sewerage services	-	-	-	-
Stormwater	-	-	-	-
Refuse & recycling	-	-	-	-
Facilities	-	-	-	-
Other assets	-	-	-	-
New Operating Costs				
Roading	-	-	-	-
Water supplies	-	-	-	-
Sewerage services	-	-	-	-
Stormwater	-	-	-	-
Refuse & recycling	-	-	-	-
Facilities	-	-	-	-
Other assets	-	-	-	-
Funding sources				
New loans	-	-	-	-
Reserves	-	-	-	-
Grants & subsidies	-	-	-	-
Rates	-	-	-	-

Maintaining existing levels of service

The Council proposes to spend over $12.5 million in roading capital work including $4.6 million in the next 5-6 years to address a backlog of reseals and sublayer rehabilitation, and the budget for unsealed road metaling has been increased, from $65k to $180k per annum, to renew those roads to an appropriate standard. The Infrastructure Strategy notes that inadequate road renewals between 2010 and 2019 have created backlog, including a risk that adverse weather conditions could cause road surface failures. It is the Council's preference that the accumulated backlog be addressed within the first five years of this LTP (approximately $2.6 million), which carries with it a moderate risk of road surface failure, but that this is able to be mitigated by the prioritisation of renewed sections of road. These projects will be funded by NZTA subsidies in the first instance, with the balance of the reseals backlog funded by loans, and the remainder funded by rates. The result is a significant increase in loans, and the roading rate.

Following the 2016 earthquake, much of our essential three-waters infrastructure has been rebuilt, leaving the Council in the enviable position of having a very low renewal profile for the next ten years. The only major renewal project that has been identified is the replacement of approximately 9km of asbestos cement (AC) main in the Kaikōura township that is currently theoretically near the end of its useful life. At this juncture there is little evidence of increased maintenance due to breaks or leaks, nor is there evidence of any other short-term risk. It is the Council's preference to progressively renew these AC mains over a 15-year period, basing priority on condition assessments and recent repair history.

Another significant renewal project is the replacement of the Waiau-Toa/Clarence River bridge, formerly known as the Glen Alton bridge, which failed during the 2016 earthquake, resulting in a loss of all-weather access for around 15 people in the Clarence Valley. The only solution that Waka Kotahi (NZTA) has agreed to fund is construction of a new bridge downstream with an engineered ford over the old river channel and associated work to protect connecting roads. This $12 million project is to be 95% funded by Waka Kotahi, but while this solution is favoured it remains uncertain. The project is reflected in the LTP budgets but at the time of writing, some issues remain unresolved.

The cost of renewal and replacement of existing assets

Group of activities	2021/2022 (,000s)	2022/2023 (,000s)	2023/2024 (,000s)	2024 to 2031 (,000s)
Capital projects to renew or replace existing assets				
Roading				
Water supplies	-	-	-	-
Sewerage services	-	-	-	-
Stormwater	-	-	-	-
Refuse & recycling	-	-	-	-
Facilities	-	-	-	-
Other assets	-	-	-	-
New Operating Costs				
Roading	-	-	-	-
Water supplies	-	-	-	-
Sewerage services	-	-	-	-
Stormwater	-	-	-	-
Refuse & recycling	-	-	-	-
Facilities	-	-	-	-
Other assets	-	-	-	-
Funding sources				
New loans	-	-	-	-
Reserves	-	-	-	-
Grants & subsidies	-	-	-	-
Rates	-	-	-	-

Limits on rates and debt

The Local Government Act requires the Council to set quantified limits on rates, rate increases, and borrowing. These caps are useful for agreeing with the community the boundaries to the Council's financial envelope and provides some certainty on rates and debt levels.

This Financial Strategy has been developed in the context of the Council's recovery and rebuild phases from the 2016 earthquake. The Three-Year Plan 2018-2021 provided for rates increases of 14% for 2019, 14% for 2020, and 10% for 2021 financial years, to enable the rebuild to be completed and to step up into our new normal. When the COVID-19 pandemic hit in early 2020, the Council heavily moderated the rates increase down to 4.0% for 2021 (instead of the planned 10%).

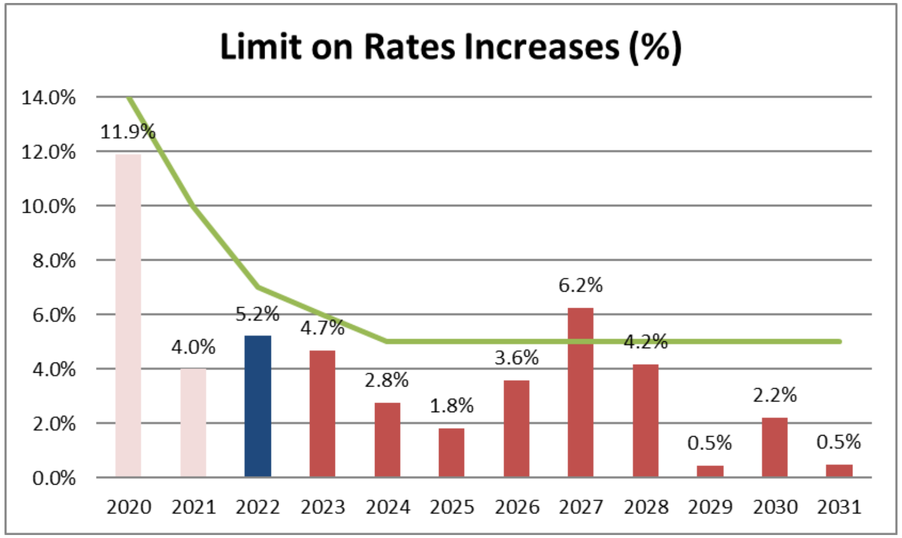
With the roading backlog to be addressed, and the Council's commitment to a full review of the District Plan, both commencing in 2021/2022, and with the level of staffing and Council expenditure such that Council services and compliance will be delivered on a no-frills basis, it is in this context that the Council has set its limits on rates and debt for 2022-2031.

Limit on rates increases

The Council has capped its annual total rates requirement increases to no more than 7% for the 2022 and 2023 financial years, and no more than 5% in each year for 2024 to 2031.

The 2022 rates increase has been impacted by several factors;

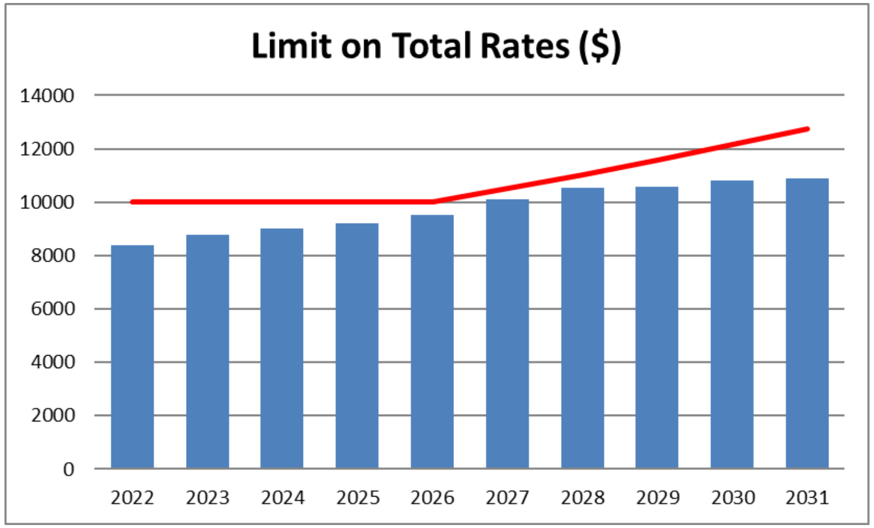
- So as to offset the rates requirement in the 2020/2021 financial year when the district first faced the COVID-19 economic shock, the Council delayed some costs and used special funds or loans instead of relying on rates. Those costs can't be delayed any longer, some of those special funds are now depleted, and the cost of loan interest and principal now need to be met.
- The Council wishes to address a long-standing under-investment in roading maintenance, and this involves significant increases in the roading rate.
- The changes to solid waste services include a new rubbish collection service and provision of bins to support that new service, plus an increase in costs from the Council's contractor. These costs are rate funded.

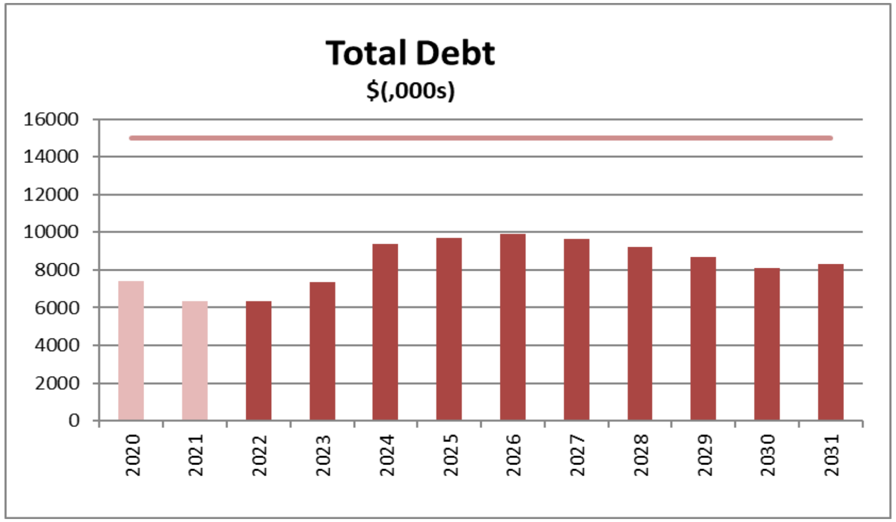


Limit on total rates

Whereas the above graph depicts our limit on rates increases (as an annual percentage) the following graph shows that rates will be no more than $10 million in the first five years of the Long-Term Plan (financial years 2022 to 2026).

From the 2027 financial year, the limit on rates increases as a percentage (above graph) translates into a total dollar value of rates the Council proposes to collect each year over the years 2027 to 2031.





Limit on total debt

The Council has set a self-imposed limit on our total borrowings of $15 million in today's dollars. At this level, forecast interest expenses would remain less than 10% of total revenue even if interest rates rose to 8% (which at this juncture seems extremely unlikely).

The Local Government Funding Agency (LGFA) stipulates its financial covenants, for example one LGFA covenant is that net debt as a percentage of total revenue should not exceed 175%. If the Council were to exceed that covenant limit, it is likely that the cost of borrowing would increase significantly, and that the LGFA may even refuse to lend funds. The Council has self-imposed caps that are more stringent than those of LGFA, and as a result of this, net debt as a percentage of total revenue is well under the LGFA covenant and is less than 90% for all years.

Total borrowings (or debt) increase year on year from 2022 to 2024, where the Council is borrowing to deal with the backlog of roading reseals and pavement rehabilitation, as well as the District Plan rolling chapter reviews. Borrowing reaches a peak in 2024/2025 with loans raised for landfill closure and reconfiguration of the Scarborough Street site as a transfer station.

The above graph shows that borrowing will be well-within the Council's self-imposed limit and highlights the extent of borrowing headroom that is available for emergency events.

Asset sales

The Council aims to sell properties that are not part of the Council's normal business operations and that do not generate a return to the community. Properties that might be considered for sale include closed roads, esplanade reserves and unused/unoccupied land. Once sold, the proceeds from sale will be used at the Council's full discretion, which might be to offset the rates requirement, to repay debt, or be set aside for future asset purchases.

The Council is also considering demolishing the former Council offices at 34 Esplanade and selling the land, which will be a matter for public consultation regarding options for the existing building. This building has been identified by several community groups as an ideal location for arts, culture, small business start-ups and other ideas, however none of these groups have suggested there would be a market rental paid to the Council by any potential tenants, in the context of the substantial costs to bring the building up to standard. This means that, despite the social/cultural value of the ideas put forward, the building would remain a financial burden to the community and require rates input.

Securities for borrowing

Like any other borrower, the Council has to offer lenders some security, and like other Councils, we secure our debt against our rates income. The Council has a debenture trust deed that provides the mechanism for lenders to have security over our rates income. The Council raises its loans with the LGFA and has lending facilities with the BNZ for short-term requirements and/or swaps. It also has two suspensory loans with Housing Corporation NZ, which are secured by the property at 95 Torquay Street (the pensioner flats). Those loans will only need to be repaid if the Council ever sells the flats.

Managing our investments

Equity securities and trusts

The Council controls the appointment of trustees of the Kaikōura Enhancement Trust (KET), which in turn owns 100% of the shares of Innovative Waste Kaikōura Ltd (IWK). Both are therefore Council-Controlled Organisations (CCO's).

KET is a charitable trust established for the purpose of progressing environmental projects and accessing external funds to achieve that goal. It partly satisfied its charitable purposes through holding shares in IWK.

IWK has entered into contracts with the Council to manage the landfill and resource recovery operations, deliver recycling services, provide public toilet cleaning services, and deliver three-waters services within the district.

The Council has a minor shareholding in Civic Financial Services Ltd (trading as Civic Assurance), these shares are not tradeable, and Civic has withdrawn from the insurance market which had been a significant source of trading revenue, and now focuses on Super Easy and Super Easy Kiwi Saver superannuation schemes.

From time to time as opportunities arise, the Council may consider future equity investments if they fulfil strategic, economic, and financial objectives. Any purchase or disposal of equity investments requires Council approval by resolution.

Financial investments

The Council manages its cash, borrowings, financial investments and instruments as part of an integrated treasury function, and as part of our day to day working capital management. We will monitor the progress of our capital projects and other approved projects, and only borrow what is required to fund them if we need to. So as to minimise external borrowing, we will often offset funds in hand and borrowing requirements internally between different funds or special reserves where those funds are not currently required. This reduces overall borrowing, and in turn minimises the level of financial investments, particularly as reserve funds are no longer held in cash. This means the Council will only borrow as cashflows require, reducing loan servicing costs and thereby benefitting ratepayers.

Commercial properties

The Council owns land, buildings, and the wharf at Wakatu Quay, which it considers may provide a commercial return once developed. Funds from the Provincial Growth Fund of up to $9.88 million will be used to create a new commercial/public space, with plans currently underway as to what this might look like. The Council expects that, as a minimum, the new development will not only function in such a way that it supports its own operations and capital programme, but also provide a return to the Council and lessen the dependency on rates.

Forestry

The Council owns 11.5% of the Marlborough Regional Forestry joint venture (MRF), with the Marlborough District Council owning the balance 88.5%.

Historically the Council's forestry assets provided reasonably substantial cash inflows in those years where logging was undertaken. Due to the nature of forestry (trees must be mature, and ideally, timber prices should be good), there may be several years of cash outflows between the years of logging. MRF has entered a six-year period where trees are not mature enough for viable logging, and so the Council is now contributing to the cost of forestry operations until logging recommences (from 2021 to 2026).

Further, the Council plans to harvest the South Bay pine forest during 2021/22 but any net yield from logging will likely be lost in the cost of surrendering carbon credits. The harvest is being done to free up the area for alternate recreational uses and provide ocean views for the Ocean Ridge subdivision, rather than to generate revenue.

For the above reasons, the target return on investment for forestry is zero until 2027. It is intended that surpluses from forestry be used to cover forest operations in the first instance and may then be held in special funds for future strategic purposes (which may include purchasing other investments, reducing total debt, or used to offset general rate requirements).

We also own a small pine forest at South Bay, although this is a popular recreation area for the community rather than a commercially viable plantation. The Council has resolved to cut these trees down.

Targeted return on investments and trusts

Our investments	Objectives	Annual targeted net return
Innovative Waste Kaikōura Ltd (IWK)	Efficiently manage landfill and recycling facilities and deliver three-waters and other services under contract.	IWK will be operated on a break-even basis, no dividend will be paid. Costs will be minimised in the Council contracts.
Kaikōura Enhancement Trust (KET)	Source external funding to deliver or progress environmental projects	KET is a not-for-profit charitable trust.
Civic Assurance	Financial services including superannuation schemes	Civic has withdrawn from the insurance market, dividends are unlikely to be paid
Financial investments	Treasury management	Borrowing costs are minimised
Commercial properties	Optimise value and return, while providing social, cultural, economic and environmental benefits to the community	Commercial property will provide a financial return to Council, as well as providing benefits to the community and/or local economy.
Forestry	Generate cash surpluses after having covered all costs associated with the activity, to be used to reduce the Council's rates requirement or any other purpose at the discretion of the Council	Capital distributions are paid to KDC once logging commences (anticipated from 2027 onward)

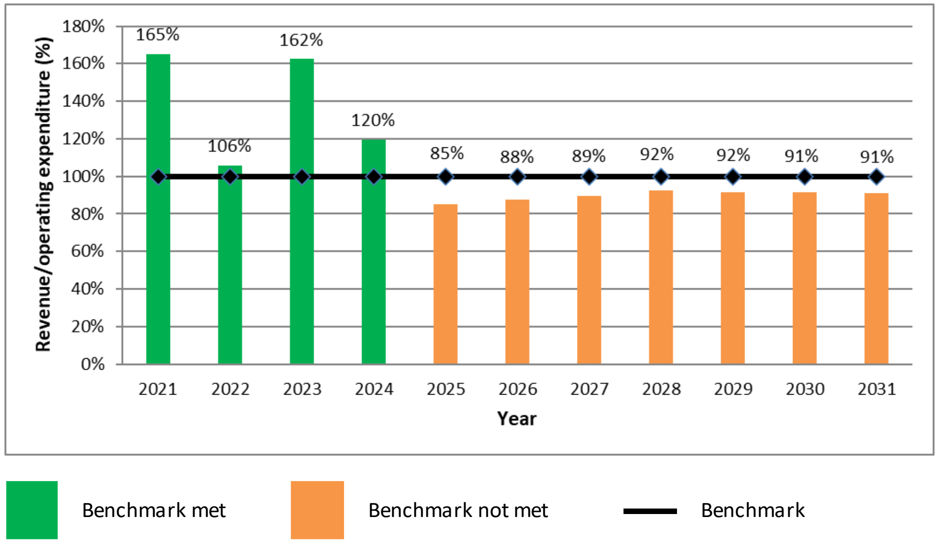
Balanced budget

Having a balanced budget means having sufficient operating revenue to cover operating expenses. Depreciation is an operating expense, although it has no cash impact. The Council takes the view that it will not fully fund depreciation.

Instead, the Council considers that when assets do need to be replaced, we will seek alternative sources of funding such as grants or subsidies in the first instance or raise loans if no other funds are available. Rates may be used to fund the net cost of renewals on an ongoing basis provided the annual renewal cost is equal to or less than the annual depreciation for that asset category.

The result of this strategy is that it is possible – and even likely – that the Council will not cover all operating expenses in every year of the Long-Term Plan due to our conscious decision not to fully fund depreciation.

Balanced budget benchmark



The first three years of the Long-Term Plan, years 2022 to 2024, show a net surplus due to the significant subsidies the Council will receive from Waka Kotahi (NZTA), to construct the Waiau-Toa (Clarence) River bridge. That bridge is expected to cost up to $12 million and will be 95% funded from Waka Kotahi. The subsidies are categorised as revenue to the Council, but the cost of constructing the bridge is a capital project, not an operating cost.

Assumptions

The main assumptions underlying the forecast information, based on predictions from both internal and external sources, are described in full on pages XX to XX in Part Six: Financial Information & Rates chapter of this Long-Term Plan.

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