

Financial strategy – Investing for growth

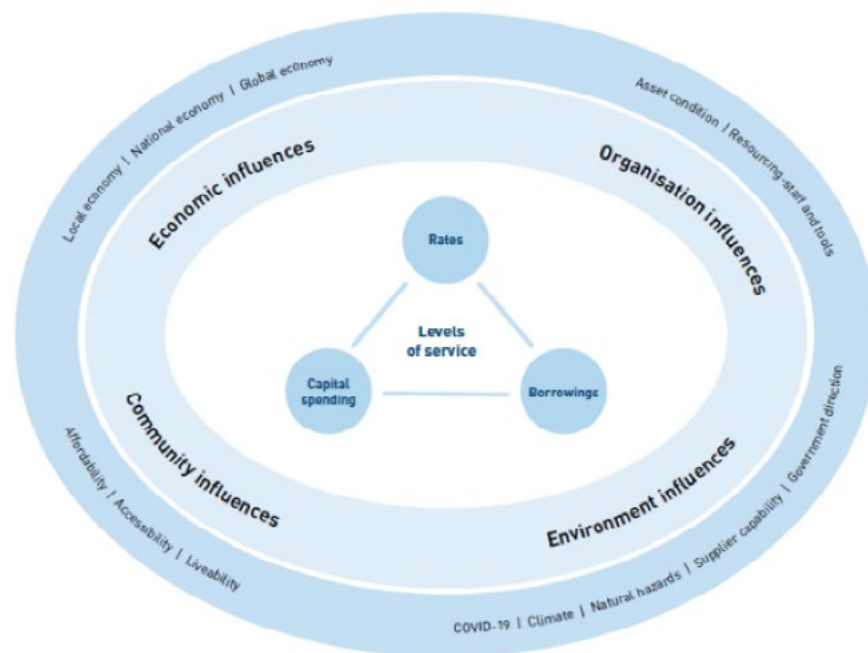
Financial strategy – Investing for growth

Introduction

Our financial strategy sets out the overall financial goals of the Council for the 2021–41 long-term plan. The strategy builds on our current financial position by setting out where we want to be positioned during, and at the end of, the long-term plan period.

Strategic context

The below schematic reflects the range of internal and external factors in the Council's operating environment that impact its financial decision-making. These factors are pushing and pulling us in differing directions, and our challenge is finding a balanced response.



The Council's financial strategy triangle is affected by the three levers: rates, capex and debt. The size of the triangle represents the level of service provided by the Council. A bigger triangle means an increased level of service (or new services). Changing only one lever can be achieved without affecting service levels by allowing the other components to adjust. Changing more than one component means the third lever also has to change, and thus service levels will change too.

Our financial context – where we are now

Against a backdrop of the Covid-19 pandemic and with increasing economic challenges world-wide, Council is on track to complete the main work planned for the first three years of the 2018-38 long-term plan.

Prior to 2015 we had invested in several large capital works, including the Aquatic Centre, and significant three waters' infrastructure. Furthermore, we were not fully funding our depreciation at this time, which led to a rapid growth in debt. From

2015 onwards, a focus emerged on keeping rates increases as affordable as possible.

More recently, we have focussed on positioning the Council to pay down debt faster and enable a capital works programme to strengthen the district’s resilience and accommodate districtwide growth. Accelerating the Council’s debt repayment was to ensure Council had sufficient borrowing capacity to fund a significant underground pipes renewal programme around 2045.

Having once been the fourth most indebted council, our debt has now stabilised and levelled off. This is due to the ‘Green Line Strategy’ that we implemented in the 2018 borrowing down to 200% of revenue by 2023 - in fact, we achieved this by 2021.

So, for the last six years the Council has been running with a ‘rev-limiter’ on its capital works programme. This was done for good reason – as an effective way to get our debt levels down. This has also been helped by relatively low levels of actual growth in the district.

Fiscal discipline has been at the heart of this approach, which has been rewarded with our AA credit rating. The implementation of the Green Line Strategy has also been timely in that it has given us the headroom to effectively respond to Covid-19.

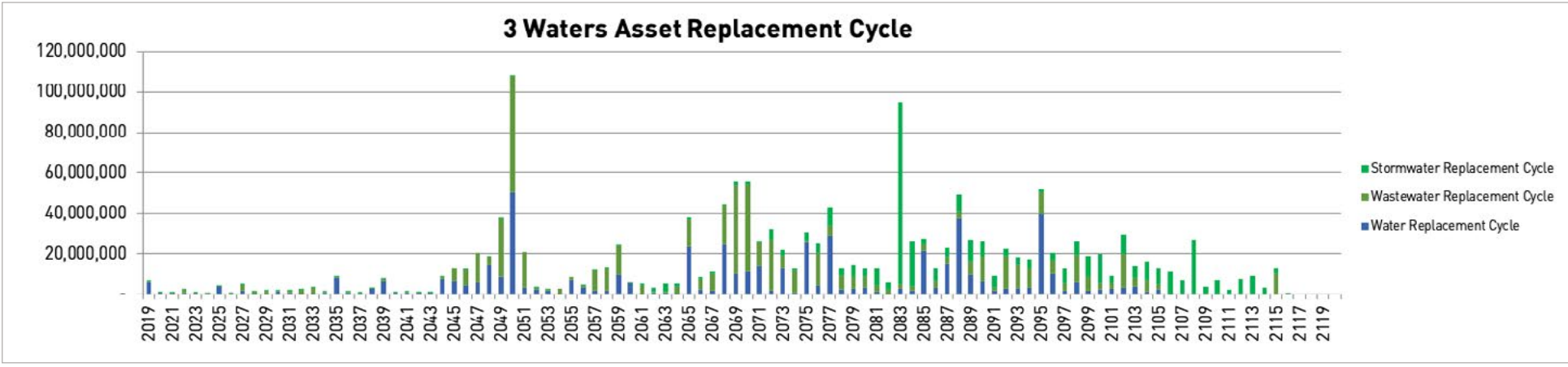
Cost pressures

The Council is exposed to a range of unavoidable cost pressures in its operations, the vast majority of which has to be funded by rates. Our asset values

have been escalating rapidly (through regular re-valuations), leading to increased depreciation costs that we fully fund to allow for future asset renewals. We are also continuing to close the gap on our previously unfunded depreciation costs.

In December 2020 the New Zealand Government, alongside its climate emergency declaration, launched The Carbon Neutral Government Programme, a major new initiative that will require the public sector to achieve carbon neutrality by 2025. This, as well as the Climate Change Commission’s final report on decarbonising the economy, build on and reinforce Council’s 2012 goal of carbon neutrality by 2025.

This growing awareness and acceptance of climate change brings greater urgency on



us all to respond. Climate change impacts are being felt now and will increase within the lifetime of the long-term plan which requires immediate mitigation actions, and will require the Council to make deliberate, evidence-based decisions now as part of a long term, well planned adaptation approach.

Shifting of costs and responsibilities from central government to local government, including proposed changes to the 3-waters and more recently the Resource Management Act (RMA), creates additional pressures for all councils. In addition, there are specific requirements under the Government's 2020 national policy statement on urban development that Council will be implementing and responding to, to ensure we have sufficient development capacity for housing and business needs over the short, medium and long term.

To mitigate against inflation cost pressures, the Council uses a combination of industry-specific cost indices and a composite index called the Local Government Cost Index (LGCI), which is published by BERL in September each year. If we don't adjust our budgets for this index, we would erode the amount we can do for our dollars.

All this means that the Council has had very limited scope in recent years to do new things and has spent a lot of time saying 'no' - as noted in the Organisational Review - and focussing on the basics. A huge amount of effort has been put into 'polishing the apple' even harder, doing more with less. The Council continues to have one of the lowest costs per ratepayer in the country.

What has changed in 2021?

While New Zealand has managed the pandemic better than most, and our district united to provide an effective response, the impacts are still being felt in our community. While more people are working from home and supporting the local economy, smaller businesses especially are vulnerable and another major lockdown would be too much for some of them. The health and wellbeing of our community has also been affected. Underlying issues have been amplified by COVID. We are implementing our Kāpiti Recovery Plan which aims to restore our community wellbeing and regenerate a thriving Kāpiti economy.

Historic low interest rates and the government's programme of quantitative easing means that credit is widely available and at very low rates. In tandem with a

nation-wide under-supply of housing and a lack of demand-side controls, this has fuelled an already heated housing market, leading to increased rents and lower rates of home ownership across the country.

Our district is growing again, and the increasing unaffordability of Wellington, Porirua and Lower Hutt combined with the imminent increase in connectivity from Transmission Gully, plus the Kāpiti lifestyle are all factors contributing to expectations that this growth will accelerate, and that we need to be ready.

How should we respond?

The 2021-41 financial strategy will draw upon many of the elements of the 2018-38 strategy, largely because many of the key challenges such as the prioritised and timely delivery of capital works programmes, climate change and resilience, remain. However, whereas in the past we have been reflecting our current environment, we now need to anticipate our future environment.

We will do this by investing for growth – we know growth is coming and we need to support and advocate for increased housing, and provide a suitable planning framework and the necessary infrastructure to accommodate the

expected growth. We will take advantage of the prevailing financial conditions and mirror the government's approach of providing a stimulus to the economy, creating jobs and opportunities for businesses, both of which will attract and support growth. We will make changes to our District Plan to meet the requirements of the national policy statement on urban development, including where appropriate to zone additional suitable land for housing and enable greater intensification in existing urban areas.

Financial Strategy

The financial strategy is the enabler for the infrastructure strategy which identifies growth, resilience and climate change response as the key areas of focus for the capital expenditure programme. This in turn drives the financial strategy, which balances these infrastructure needs with the management of borrowings and rates impacts on the community.

The Council has adopted a programme of Capex delivery for this long-term plan, which will build upon the foundations of the expected strong growth in the district. All major projects have been and will continue to be assessed and prioritised according to their return and stimulus to the economy.

The Council is progressing a number of major capital works projects such as the East-West link road. The completion of this project is expected to unlock significant private sector development, including the Paraparaumu Office Precinct. This in turn will generate significant retail activity to support business and population growth.

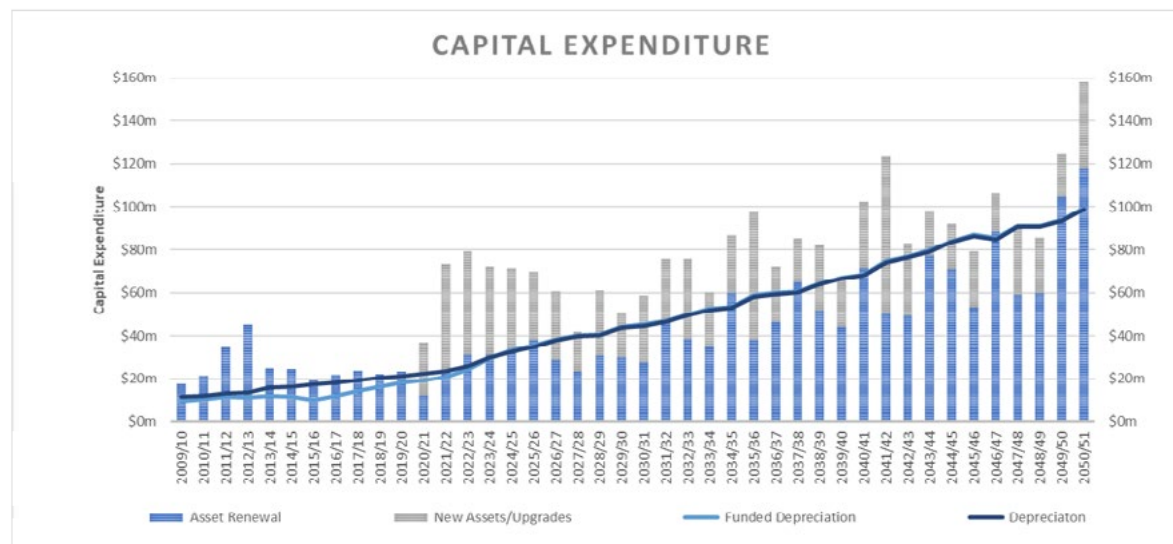
Other major projects to provide stimulus in the first three years of the long-term plan are the:

- town centre projects, to increase vibrancy and attract visitors and investment;

- Waikanae water treatment plant which will increase water safety and resilience;
- Mahara Gallery and Waikanae Library upgrades;
- Paekākāriki seawall which will increase climate resilience; and
- Hautere and Ōtaki wastewater treatment plant upgrades.

As well as providing economic stimulus, these major projects also support infrastructure provision and facilities for a growing population.

The Council's capital expenditure programme totals \$225 million in the first three years of the long-term plan, which



equates to an average of \$75 million in each year. The entire 20 year programme is more than twice as much as the 2018 long-term plan planned. This reflects the many factors influencing our district. We've used the last three years to thoroughly update our asset plans, and we're reflecting both growth, and the advancing need for asset renewals. We've seen elsewhere what happens if you defer renewals for longer than is appropriate; or if you don't understand your asset condition. All of the programmed capex, shown in the below chart, is to maintain existing service levels without improving it.

To ensure the delivery of the significantly increased programme of works, we will use alternative delivery and procurement models, such as alliance partnerships and collaboration with neighbouring councils. This will include longer term procurement models as well as bundling multiple projects into consolidated packages of work.

In addition, the capacity and capability of our project management office is expanding to manage certain key projects and will maintain an overview of the entire capital works programme.

Net borrowings are expected to increase by \$113 million between 2021 and 2024, from \$169 million to \$282 million. From 2026

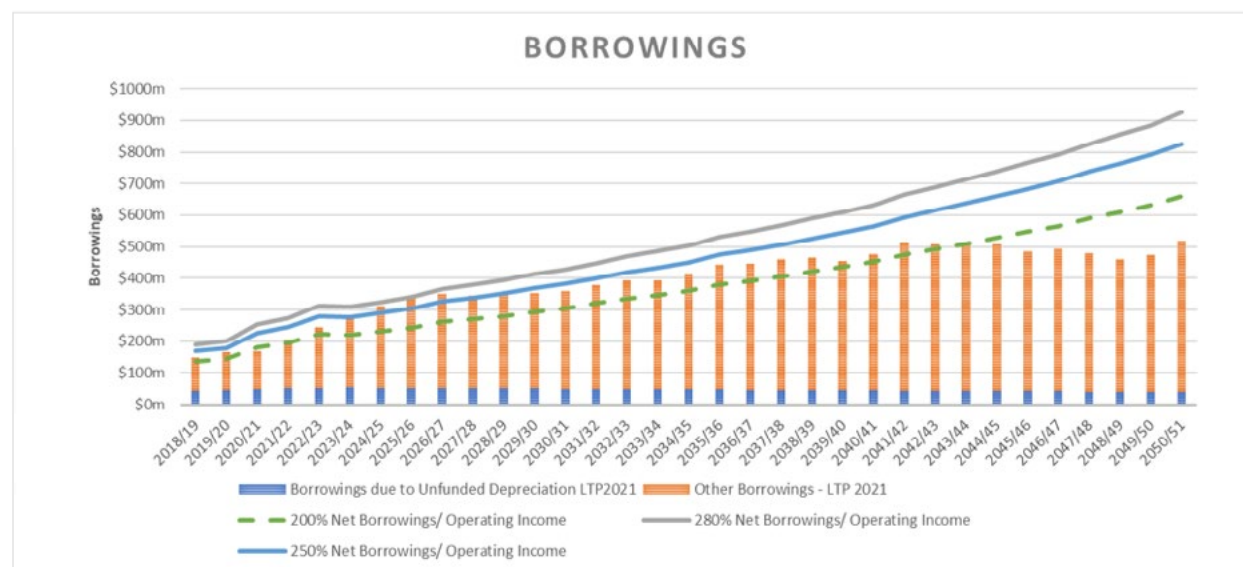
onwards the Council will be prepared to scale back its capex programme so that by the end of the long-term plan we expect to have gradually transitioned back to more of a 'Green Line strategy'.

The rate of transition will be linked to population growth and the increase in the ratepayer base, with the associated rates and development contributions revenues. If growth is higher, the transition to the Green Line can be slower; if growth is lower than anticipated, we will need to slow down our programme more quickly.

Council has recently received advice from Waka Kotahi indicating that there will likely be a shortfall in the amount of funding

provided by them to support the maintenance of the districts transport network, relative to the amount included in the long-term plan, of up to \$3.9 million over the next three years. To date, no detailed information has been provided by Waka Kotahi on where this funding shortfall would sit within the transport activity, and final confirmation on any shortfall will not be provided until August 2021, after adoption of the Council's 2021-41 long-term plan on 24 June 2021.

In developing the future budget requirements for Access and Transport's significant work has been undertaken over the last 12 months by the Council. This



work has involved internal staff resources, external consultants and direct engagement with Waka Kotahi at multiple levels within their organisation. Waka Kotahi funding is based on a three year work programme which is provided as a total level of investment over the period. This allows for funding to be moved between years as long as the projected total over three years remains the same. This flexibility will allow Council to respond to any funding shortfall in year one on the long-term plan with no change to the current level of investment in that first year. If a lower level of investment is approved by Waka Kotahi in August 2021 then Council would need to consider the implications of this through the 2022/2023 Annual Plan process as it relates to year two and three of the long-term plan. There will also be further opportunities to secure increased funding allocation from Waka Kotahi over the next 3 years, as has been the case in previous years.

Council believe under investment in critical infrastructure maintenance and renewals is not sustainable. This position is supported by recent audit advice provided by Waka Kotahi on how this Council is managing its transport activity, where the recommendation was to ensure ongoing future levels of investment needed to

reflect the assets criticality and avoid future underfunding performance risks.

Forecast net borrowings at the beginning of the long-term plan period of \$169 million equate to 187% of operating income. By 2041 (year 20), net borrowings are forecast to be \$476 million or 211% of operating income, and by 2051 (year 30) \$516 million or 156% of operating income – back within the Green Line limit of 200%, as shown in the chart on page 4. This is prudent and will ensure that the Council is still well positioned to manage the major underground renewals around 2045-2050 as well as providing the Council with sufficient borrowing headroom to best respond to future uncertainties and/or opportunities.

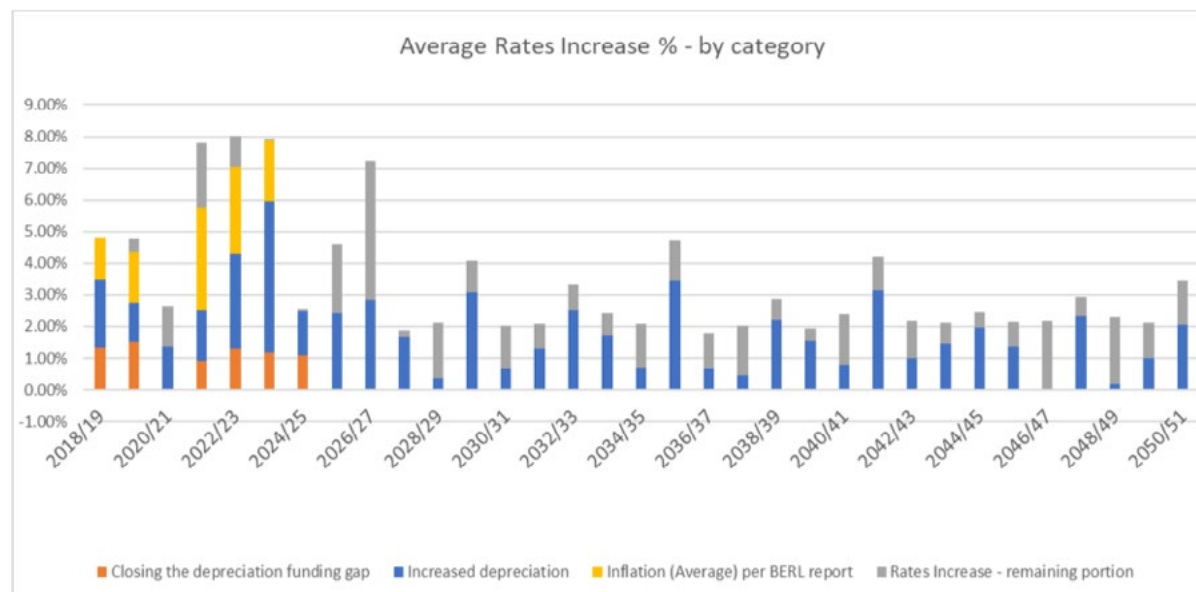
The relative decrease in net debt to revenue, even though net debt has increased is largely due to the expected increase in rates revenue as a result of growth. The population is expected to increase to 85,658 by 2050 - an increase of 30,154 – with the ratepayer base expected to increase by 12,072 from 25,460 to 37,532 over the same period. The average rate of population growth to 2050 used in the Council forecasts is 1.5%, which is reasonable given the long run growth average of 3.2% over the last 47 years, and 1.5% over the last 25 years.

The driver for this long-term plan is for the capital works programme to sustain growth and support resilience – this and the associated debt impacts have been outlined above. After capex and borrowings, rates are the third lever of our financial strategy; the significant changes to capex and borrowings mean that rates have to increase in order to maintain the level of service that we deliver to the community.

According to the 2020 Residents' Opinion Survey, the overall satisfaction with Council remains very high at 80%, and is increasing year on year. The main drivers of satisfaction are the most visible, highly used Council facilities such as libraries and swimming pools, and the condition of outdoor spaces such as cycling, walking, bridle paths, and beach access points.

Accordingly, there are no changes to the existing levels of service and the operating and capital budgets have been set to maintain existing levels, as well as to meet additional demands for services arising from the district's expected growth.

The impact on rates is significant in the first three years of the long-term plan - an increase of 7.79% in year one, 8.0% in year two and 7.9% in year three - however, over



the 20 year term of the long-term plan, rates increases average 3.7% a year.

The above chart shows that, between 2018 and 2024, most of each annual rates increase relates to unavoidable costs such as new depreciation, closing the depreciation funding gap or inflation. The remaining portion is discretionary increases to operational costs, which have been approved by the Council.

The Council is very mindful that rates affordability in the district is still a concern and for many in the community rates is in

excess of 5% of the median household income, which the Council recognises as an indicator of financial hardship. We administer the government's rates rebates and will continue to use our own rates remission tools in a targeted way to improve the affordability for our district.

Furthermore, the review of the rating system has highlighted the undesirable consequences of the 2020 revaluations, with a significant shift of the rates burden to residential as well as a relatively high impact on areas, such as Ōtaki, with the

biggest affordability issues. The Council has made some small changes to mitigate the revaluation impacts, including transitioning some land value rates to capital value.

While the rates increases in the first three years of the long-term plan are higher than in previous years, the chart below shows that the rates increases decrease significantly in the out years of the long-term plan.

Our response represents a significant change in approach for our district, which reflects significant recent events and the current circumstances:

- The recognition that for many years now the Council has been making less go further;
- An unprecedentedly supportive financial environment;
- The need for a post-Covid-19 response by stimulating the economy; and
- Harnessing and enabling the growth that is on the doorstep and waiting to happen.

Long-term plan financial limits

The 2021-41 financial limits are set out in the following tables:

	2021-41 long-term plan			2018-38 long-term plan		
Measure	Lower limit	Preferred limit	Upper limit	Lower limit	Preferred limit	Upper limit
Rates increases	3%	4.50% - 6.90%	9%	2.90%	3.90% - 4.70%	5.50%
Debt	\$Nil	< 250% of total operating income	280% of total operating income	\$Nil	< 200% of total operating income	The lesser of \$200m and 240% of total operating income
Gross CAPEX (deliverability)	\$30m	\$40-60m	\$80m	\$15m	\$25-35m	\$38m

Note: forecast capital expenditure does exceed \$80 million in later years. Forecast expenditure reflects asset age, condition and replacement of existing assets and the need for new assets. The upper limit for gross capex is based on deliverability of work programmes. The forecast capital expenditure programme will be reviewed annually.

Treasury management policy limits:

	2021-41		2018-38	
	Target	Limit	Target	Limit
Net interest expense over total operating income	< 10%	20%	< 10%	20%
Net external debt over total operating income	< 250%	< 280%	< 200%	< 240%

Appendix

Change of land use

In the short-term, the District Plan accommodates growth through current land-use zoning. An urban development plan change in 2022 will look to make changes to better enable increased development. This will include enabling greater heights and densities in suitable existing urban areas (eg town centres and around rapid transit areas), and potentially rezone some land to allow more 'greenfields' residential development. It will also enable development of land that is already included in the District Plan as a 'future urban development'.

In the long-term, however, these changes alone will not be sufficient so further plan changes and additional infrastructure will be required, particularly in order to meet the growth that is predicted to occur during the latter half of this Infrastructure Strategy. The need and focus for this will become clearer once the Council has completed both the latest Housing and Business Development Capacity Assessment and Council's District Growth Strategy is currently under review, with Council promoting an integrated and people-centered approach to urban development.

Security for borrowings

The Council's external borrowings and interest rate risk management instruments will generally be secured through a Debenture Trust Deed. Under a Debenture Trust Deed, the Council's borrowing is secured by a floating charge over all Council rates levied under the Local Government Rating Act. The security offered by the Council ranks equally with other lenders.

In 2020, the shareholders of the Local Government Funding Agency (LGFA) approved amendments to the net debt / total revenue covenant that applies to local authority borrowers with a long-term credit rating of 'A' equivalent or higher. Such borrowers are now required to maintain their net debt / total revenue ratio as follows:

- for the financial year ending 30 June 2020 - no more than 250%;
- for the financial years ending 30 June 2021 and 2022 - no more than 300%; and
- for each of the next four financial years, a decrease of 5% year on year until reaching a limit of 280%, that will apply for the financial year ending 30 June 2026.

This policy has been updated to reflect the 2021-41 long-term plan borrowings target.

Insurance

The Kāpiti Coast District Council, together with Porirua, Hutt City and Upper Hutt City councils (collectively known as the Outer Wellington Shared Services Insurance Group or OWSS) have been purchasing insurance for their respective assets on a combined basis since 2009. This syndicate was necessary to provide the OWSS with scalability to obtain the benefits of accessing wider domestic and off-shore insurers. In July 2016 Greater Wellington Regional Council joined the OWSS to insure their above ground assets through the collective.

The Council has a maximum insurance cover of \$130m for natural catastrophe damage to infrastructure assets with a \$1m deductible per claim per event. The Council has a sum insured value of \$203 million for material damage and business interruption insurance to above ground assets. Losses suffered to above ground assets by natural catastrophe(s) trigger a deductible of 5% of the site sum insured with a \$100,000 deductible per claim per event. Any losses exceeding the \$203m in aggregate will need to be fully funded by the Council.

New Zealand, in particular Wellington, is seen as increasingly risky for underwriters. Insurance capital is increasingly demanding higher returns due to

heightened risk, and premiums continue to increase substantially from year to year. Insurance is only one method of transferring risk and Council is fully

exploring how best to position Council risk mitigation via insurance and value for ratepayers.