Financial Strategy

Te Rautaki Pūtea

Managing financial resilience in an uncertain and changing financial landscape

Overview

We are planning for our financial future post a global pandemic that has had a significant effect on both New Zealand and the Southland Region.

We also have a new government that has set out clearly its agenda in terms of economic recovery, regulation review and regional infrastructure influence. Over the past three years we have invested in infrastructure as part of the Governments response to the pandemic and matched their funding through debt, and that is set to continue. There is more investment required as we look to improve the resilience of our flood infrastructure for the region as a whole. There remains some uncertainty as to the economic bounce back particularly in areas where we rely on external funding such as marine fees, interest rates and inflation are having a significant impact on our budgets both now and in what we are forecasting.

A key focus for Council over the next three years will be building the capability of our flood infrastructure team, addressing some long overdue maintenance issues, and planning and designing the infrastructure we need for the region in years 4 and beyond to build greater community resilience to existing and foreseeable threats.

The new Government has signalled that the Resource Management Act review will be put on hold and that the proposals of the previous government will be repealed where necessary or redirected to focus on less regulation and a greater emphasis on economic outcomes. Freshwater management is up for review and our current planning will need to be put on hold until such time as the new direction of government is known.

With uncertainty in some areas there is greater certainty in others, so it is in this environment that we are planning our financial strategy with a focus on providing prudent financial management of our expenditure and funding needs.

Debt funding of long-term infrastructure such as flood protection infrastructure ensures that there is intergenerational equity and that the burden of funding doesn't all fall on current ratepayers. Our funding requirements for future infrastructure needs remains uncertain as we are hopeful that the government's focus on regional infrastructure will see funding come our way. That is why it is important that we build our capability over the next three years, not only to deal with current maintenance issues but to be ready to respond to opportunities for investment beyond which we are planning.

In considering our funding needs Council has realised that the efforts it has made in areas that have traditionally been funded through targeted rates are providing benefits to the region as a whole. We are proposing that our funding sources for river schemes be applied across the region recognising that all ratepayers benefit from the security of lifelines such as roading, power, communications, air travel and emergency services these assets provide now and will need to provide to a greater extent into the future. We are also proposing that for flood infrastructure, biosecurity, and land sustainability our rates be set using capital value rather than land value. This better reflects the economic benefit that our services deliver and ensures that those who have greater investment in capital or derive greater incomes from capital pay a fairer share than they currently do under a land value basis.

Council has a significant investment in South Port NZ Ltd and as with all investments this should be reviewed on a regular basis to ensure it is providing what it is intended to. A key objective for Council is to ensure that Council continues to hold a controlling stake in South Port NZ Ltd and that controlling stake remains above 50%. Maintaining the current level at 66.48% does concentrate Councils investment portfolio heavily into one industry so consequently Council proposes to look to divest some of this shareholding and reposition this equity into similar if not higher performing investments, reducing investment risk and maintaining or enhancing returns.

Finally, Council is also seeking to enhance its financial resilience and proposes doing this in a modest way by increasing its financial reserves. This will in the main be done by reducing the transfers from reserves to fund activities and rating for these instead. In addition, Council is reviewing reserve balances held and their use, as per the new Reserves Policy.

Material Assumptions

We have made assumptions in order to build our Long-term Plan, including the financial and infrastructure strategies. It is possible they will be wrong – which is why financial resilience and flexibility are key to this strategy.

The full list and detail of our assumptions is in the "*Significant Forecasting Assumptions"* section of this Plan. The following summarised material assumptions have a large impact on our financial strategy, particularly in the more financially sensitive first three years:

Table 1: Summary of significant financial strategy assumptions

Assumption	Description	Financial Strategy Impact
Marine Fees	Marine fees income comes primarily from large cruise ships. In 2023/24 we budgeted $2.8m. Cruise ship numbers have increased, we are budgeting for a total of $3.2m in the first three years of this plan.	Cruise ship numbers have increased this year but could settle back to pre-covid levels, resulting in less external income. Income less than budgeted for would reduce our financial resilience.
Fees and Charges	We are taking a closer look at what we do and who benefits. New regulation requires require new charges. Some existing charges are insufficient to cover the cost of the benefit and some existing business is not being charged. Rates are forecast to go up and it is just and equitable that fees and charges do too. We are increasing the budget accordingly.	All income makes a big difference to our balancing of the books, debt levels and financial resilience. Failing to increase fees in line with costs would reduce our income and we would not cover our everyday expenses.
South Port Dividends	We are forecasting the same return as directors declared in 2024 ($4.7M).	The South Port dividend is our single largest source of investment income. The closure of Tiwai is still undecided and the new opportunities that lie ahead, create uncertainty. If dividends received are less than budgeted, this will create a deficit, increase debt and reduce our resilience.
Realisable Investment Income	We have budgeted a realised return of 3%.	We consider we have budgeted conservatively. If we achieve better than expected returns, we will build resilience, lower than expected returns would increase debt. Adjustment can be made in Annual Plans.
Cost Increases	We use a risk lens to best estimate what things will cost in the future. This includes inflation estimates. We have used the Business and Economic Research Limited (BERL) and Local Government Cost Index (LGCI Table 3) as a basis for inflation on the council's basket of goods. Inflation is forecast to reduce; however the same commentary suggests there is significant uncertainty due to global conflicts.	In this strategy inflation higher than our forecasts means less greater everyday costs and less financial resilience.
Flood infrastructure	For the duration of the LTP we have budgeted to receive 75% of funds from Government with the remaining 25% funded by debt.	Significant investment is required which is not possible without government co-funding.

As actual results crystalise, where these assumptions differ, we are protected by having budgeted conservatively and should have the resilience to respond within our forecast financial envelope.

Guiding Financial Principles

We have developed some principles to assist in making informed and consistent choices under the legal framework. The following principles have been developed and applied:

1. We ensure the everyday costs for services to the region are met from everyday income.
2. We ensure that where future ratepayers will use assets created today, they will pay their share through our prudent use of debt.
3. We maintain financial resilience by having funds, debt capacity and insurance sufficient to fund unplanned or unforeseen events.
4. We clearly define service levels and deliver them in an efficient and effective, customer focused manner, providing value for money.
5. We charge on a cost recovery basis where we identify there is a private benefit, and it is efficient to collect.
6. We aim for rates to be affordable and equitable, with increases set to provide certainty to ratepayers.
7. We manage our investment funds and other investments by taking a prudent approach to risk and return.

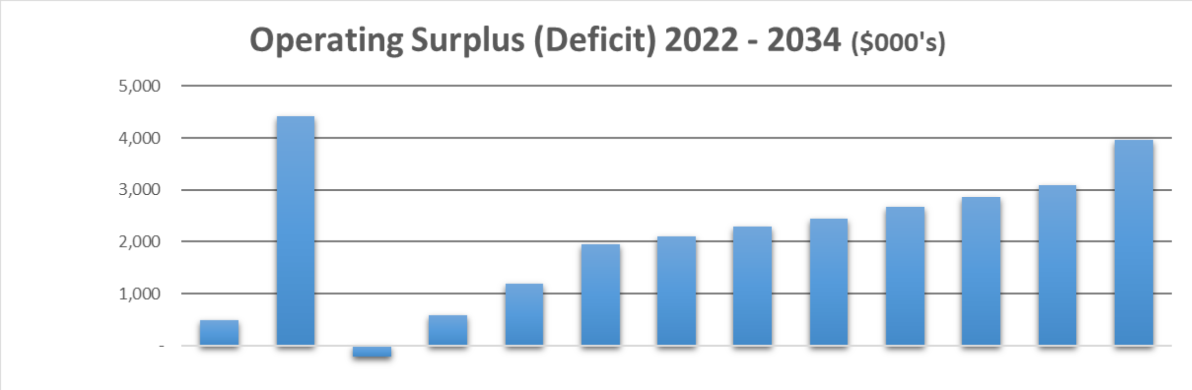
Complying with these principles can be challenging and compromise between principles is often required.

Balancing the Books

Everyday costs should be paid from everyday income. If we can't achieve this, we would need to fund our everyday income to cost deficit from debt or by reducing investments. This means existing ratepayers are not paying for some of the services they are receiving. Using debt or reducing investments to fund everyday costs means that future ratepayers will pay for this with added interest cost (for debt) or with less interest income (on investments). In both cases, our financial resilience will be reduced and there would be an increased financial risk for future communities.

In our last LTP, with Covid on the horizon, we chose to fund everyday costs through debt if needed. While we can still do that, it's no longer our preferred option, we need to rebuild financial resilience. This financial strategy assumes that we pay all our everyday expenses from everyday income and that we borrow only to fund intergenerational assets.

Graph 1: Balancing everyday costs with everyday income



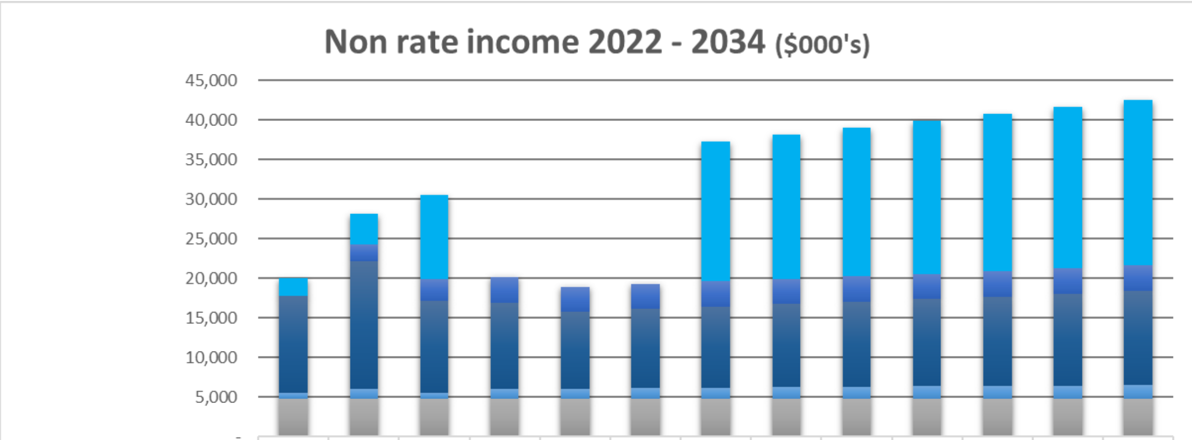
	2022	2023	2024	2025	2026	2027	2028	2029	2030	2031	2032	2033	2034
Surplus (Deficit)	487	4,417	(215)	577	1,193	1,955	2,103	2,286	2,445	2,665	2,865	3,080	3,959

*Excludes one off Government Funded projects.

Non-rates Income (including policy on holding investments and budgeted returns)

Our main non-rates income sources are shown in the following table. Council is taking a more active role in the management of its investments both in the managed fund portfolio and the investment it has in South Port NZ Ltd. Fees and charges have also been reviewed and are budgeted to meet all costs associated with managing the activities they cover.

Graph 2: Material non-rates income



	2022	2023	2024	2025	2026	2027	2028	2029	2030	2031	2032	2033	2034
Capital Grants	2,220	3,862	10,600	-	-	-	17,709	18,221	18,764	19,276	19,819	20,377	20,934
Marine Fee	-	2,192	2,797	3,197	3,197	3,197	3,197	3,197	3,197	3,197	3,197	3,197	3,197
Other Operating Income	12,211	16,056	11,598	10,871	9,679	10,009	10,263	10,518	10,787	11,041	11,311	11,588	11,865
Investment income	847	1,316	806	1,298	1,318	1,375	1,430	1,486	1,543	1,601	1,661	1,721	1,795
Dividends	4,709	4,709	4,709	4,709	4,709	4,709	4,709	4,709	4,709	4,709	4,709	4,709	4,709

Policy on holding investments and budgeted returns

We hold two large investments - our shareholding in South Port NZ Limited and our investment managed fund:

- **Investment in South Port**
  South Port NZ Limited is a public company listed on the NZ Stock Exchange. We are the majority shareholder with 17,441,573 of 26,234,898 shares (66.48%). Our port is a strategic asset and our principal reasons for owning these shares are the economic wellbeing of the region and to provide a financial benefit by using the dividends to reduce the general rate.

  There is a risk that there is a change in operating circumstances and South Port cannot maintain the forecast dividend, reducing the offset against the general rate which would result in higher rates or more debt. With this in mind Council will be reviewing its shareholding in South Port NZ Ltd in order to reduce this risk exposure. Ownership will not drop below holding a controlling interest and any proceeds from divested shares will be reinvested in similar if not greater returning assets. Forecast dividends over the 10-year period of the LTP are based on receiving 27 cents per share. We have not forecast any growth in this return given the uncertainty in what lies ahead. The budget for dividends income is shown in Graph 2 above.

- **Investment in managed funds**
  The principal reason for the investment in the managed fund is to maintain the buying power of funds held for future spending.

  Income is generated from the managed fund and is based on movements in each of a number of portfolios. The portfolios include cash, bonds and equities. The realised income is first used to maintain the value of certain reserves by adding an amount to their end of year balance and then used to reduce the general rate. Unrealised income stays in the managed fund to build our capital investment and resilience. The managed fund is a long-term investment that may have losses for certain periods. Generally, we would not realise these losses and use previously unrealised income to buffer the impact.

  There are two challenges to this approach that need to be considered:

  1. investment market uncertainty means that the actual income earned may vary from the income forecast. This could mean that the proposed surplus/deficit would be higher or lower. A higher return could be capitalised to build resilience or realised to keep rates within our limits;

  2. capital drawdowns from the managed fund have previously been used to reduce rates, by paying for operating costs, responding to disasters or for major projects. We no longer have financial capacity to continue this. Our resilience level is lower than it has been, and our interest returns are also much smaller.

Based on information supplied by our fund managers, and taking into account current performance, realised returns are forecast to be 3% for bonds and equities. The budget for investment income is shown in Graph 2 above.

We also own leasehold land and some other investments.

- **Investment in leasehold land**
  We own leasehold land for flood management purposes. This land represents a significant resource for the benefit of the Southland community. This is operated in a professional manner in a way that supports environmental sustainability. Opportunities to diversify land use to enhance biodiversity, reduce net greenhouse gas emissions, and improve income streams will be investigated.

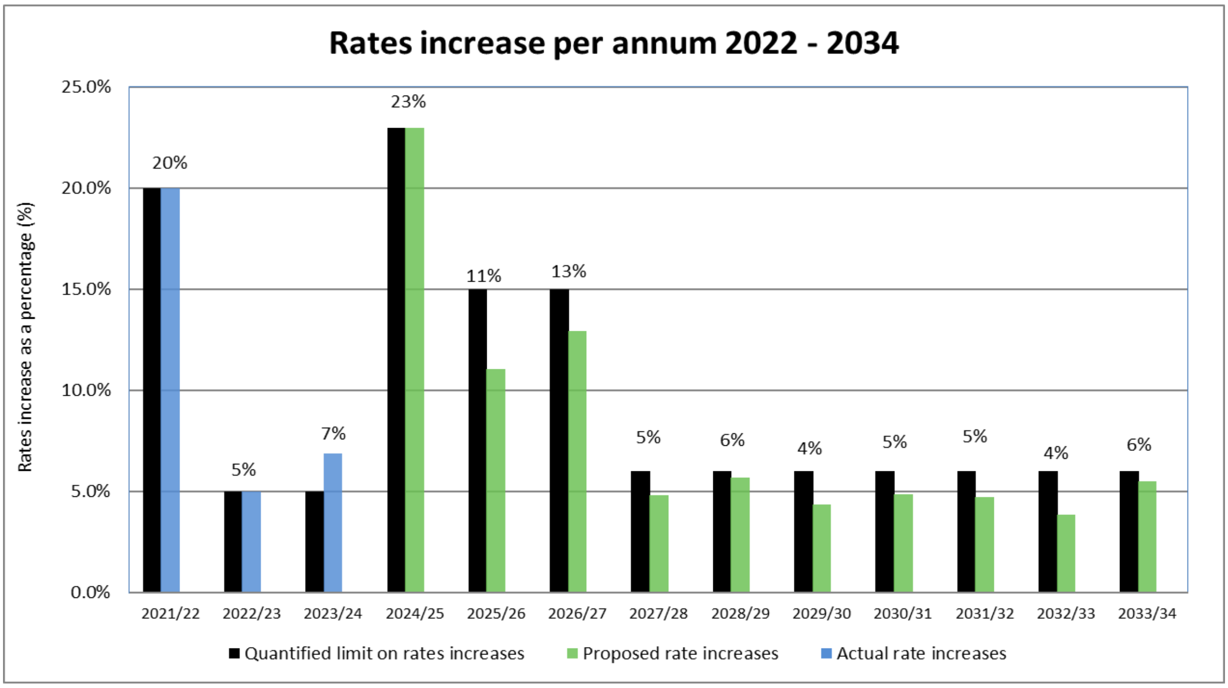
- **Other investments**
  We have a small investment in Regional Software Holdings Ltd, a Council Controlled Organisation with partner shareholders Northland, Taranaki, West Coast, Waikato and Horizons Regional Councils. The company allows for a shared service collaboration to deliver shared software products and services for more efficiently and effectively and with value for money outcomes. We receive no investment return from this shareholding.

  We have a small holding in Southland Regional Development Agency Limited, a Council Controlled Organisation with seven partner shareholders. This investment supports economic and business development, tourism and events. We receive no investment return from this shareholding.

Rates

Limit on rates
Planned increases in total rates income will not exceed 23% in 2024/25 and then not exceed 15% from 2025/27 and then not exceed 7% from 2028/34.

Graph 3: Rates affordability



NB: Proposed average rates increases are within the quantified limit (maximum) outlined above

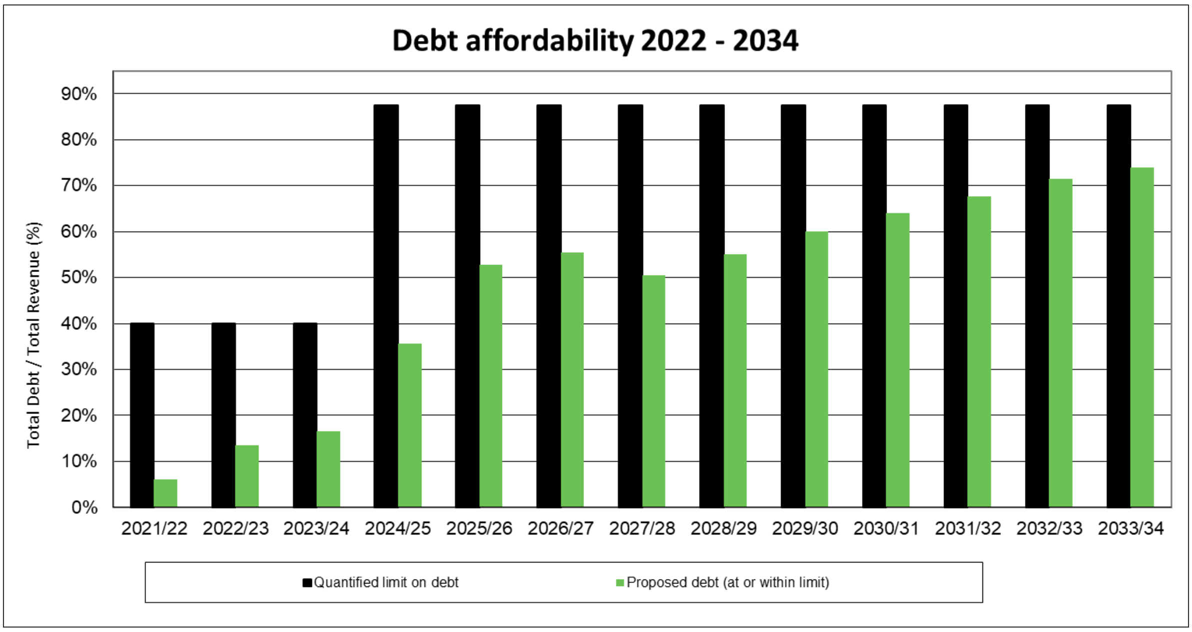
After reviewing our budgets, making inflation adjustments to maintain service levels, investing in flood infrastructure be more resilient, we assessed our options for rates increases.

It is financially prudent to seek rate increases to fund our operational costs. As per our guiding principles, it is important that everyday expenses are paid for by everyday income. It is not prudent to continue to budget for operating deficits. Our reserves available to fund operating deficits have been run down.
We are recommending rates increases across the ten years sufficient to allow us to provide the level of service expected by ratepayers while maintaining sufficient financial reserves to help fund adverse weather events.

Debt

Limit on debt
Our external debt will not exceed 87.5% of total income, which is 50% of the LGFA maximum of 175%.

Graph 4: Debt affordability



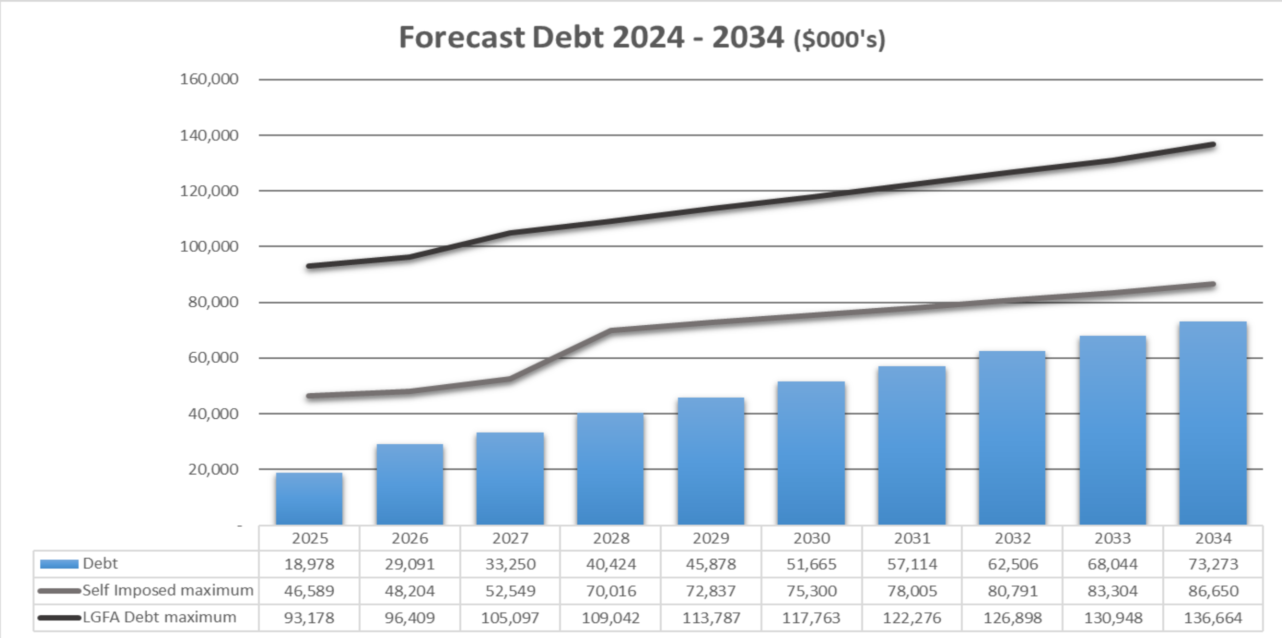
We are budgeting for new debt to fund additional flood infrastructure. We plan to take a holistic approach to our debt management meaning we will manage debt in one basket and allocate to cost centres where necessary. Debt management will be guided by market conditions and the principle of intergenerational equity taking into account the life of the asset borrowed for.

This is a change in strategy from our traditional approach. The amount of planned external debt (what we have borrowed from the Local Government Funding Agency or bank) is modest, given our size and income.

We are budgeting external debt to be approximately 75% of total income as shown in Graph 4. Our total debt will peak at $73 million in 2034 as shown in Graph 5.

The Local Government Funding Agency (LGFA), local government's primary lender, will lend us funds dependent on our existing net debt (external debt less liquid investments) and income. They will lend an amount equal to 175% of total income, or up to $137 million in 2034.

Graph 5: Budgeted debt levels



	2025	2026	2027	2028	2029	2030	2031	2032	2033	2034
Debt	18,978	29,091	33,250	40,424	45,878	51,665	57,114	62,506	68,044	73,273
Self Imposed maximum	46,589	48,204	52,549	70,016	72,837	75,300	78,005	80,791	83,304	86,650
LGFA Debt maximum	93,178	96,409	105,097	109,042	113,787	117,763	122,276	126,898	130,948	136,664

Resilience (including significant factors affecting our ability to maintain service levels)

Building and maintaining financial resilience is prudent. We live in a region that is prone to flooding and is in close proximity to the Alpine Fault. Disruption to our normal day to day activities can therefore occur at any time. We need to provide financial resilience while at the same time taking care to manage today's financial requirements.

We are responsible for ensuring the organisation can respond to unplanned events from small to very large events. As the regional centre of Civil Defence Emergency Management, we must be physically and financially operational from the start of an event.

Our financial resilience is strong based on consideration of the following three matters:

Resilience fund	Explanation	Estimated value
Liquid financial assets	We hold specific funds (reserves) for responding to events like flooding. Additionally, we have reserve funds (such as catchment reserves) that provide financial resilience in those activities. In a major event, all liquid funds could be repurposed to rebuild the region as long-term priorities change.	$9M
Debt capacity	The LGFA will lend up to 175% of our net debt to income. Our peak forecast debt is $73M in 2034 below the LGFA maximum of $137M.	$137M
Insurance	Council has insurance for business recovery and for losses to assets. The National Emergency Management Agency will fund costs of Council's operational response to an emergency and will contribute to asset reinstatement.	Not quantifiable.

The combination of these three items builds a level of resilience that will allow us to continue to operate in the event of a large emergency. We have shown that in smaller emergencies, responding and recovering from events, and maintaining business as usual is able to be successfully achieved.

Capital Expenditure

On the back of the previous Government's Climate Resilience funding, Council proposes further investment into its core infrastructure being flood control assets. The LTP provides for initial investment in building capability which will be used to develop the long-term capital investment required to improve existing and to build new flood infrastructure.

Other assets, (plant, vehicles, property and equipment) will be renewed at end of life or in response to potential Government climate change initiatives. These investments will be funded from depreciation held in reserves for this purpose and are not material to this strategy.

Changes on Population and Land Use (the capital and operating costs for providing for those changes)

We are not forecasting significant population change over the next ten years. The most noticeable changes in population are an ageing population and increasing diversity. Land use in the region continues to evolve and change with the potential for resulting environmental impacts. Impacts of land use include effects on biodiversity and water availability and quality. Our Significant Forecasting Assumptions provide more detail for each of these assumptions.

Policy on Securities

To borrow from either the LGFA or the bank we must offer security, just like residents do with their mortgage. Like most councils, debt is secured against rates income.

Lenders like this as security and it helps keep our interest rates low. Giving rates income as security means that our lenders can make us charge ratepayers more to repay debt. That is why it is important to keep our debt at a sustainable level.

We may also offer other security, including physical assets, in certain circumstances. The full policy on giving securities can be found in the Treasury Policy on our website.