



Appendix 2: Financial strategy



GREAT LAKE TAUPŌ
Taupō District Council

**Taupō District Council's
Long-term Plan 2024-34**

Introduction: Achieving the balance

This financial strategy clearly outlines the financial vision and priorities for the next 10 years. It aims to ensure we are achieving an appropriate balance between the needs of our community, responsible management of our assets, and financial sustainability over the long term. It provides guidance for Council's financial decisions and a means to monitor the financial performance of Council.

The budget for this Long-term Plan has been developed to give effect to the priorities as agreed by Council. Council has also indicated a commitment to maintaining current level of services, meeting legislative requirements, looking after our assets, and provisioning for the expected growth of the district.

These priorities have meant that operating budgets required to deliver our wide range of services have been largely maintained, there has been an increase in the renewals and maintenance budgets for our critical infrastructure, and continued investment in required growth-related assets. Operational efficiencies and discretionary project cuts have been required to ensure these priorities will be achieved and to mitigate the non-controllable budget increases. Further budgetary cuts would compromise these priorities.

Projected growth has increased from our last Long-term Plan, which has been highlighted by both the financial and infrastructure strategies, as a key driver of increased demand and subsequently increased pressure on our critical infrastructure and services. This increased demand is forecast to continue over the entire 10 years of this plan.

Along with the increasing demand on services, Council is facing additional challenges being driven by changes to central government policy and legislative requirements, with a particular emphasis on Council's water and wastewater services. Along with priorities mentioned above, the stronger regulatory approach of New Zealand's new water regulator has been reflected in Council's capital works programme. This has driven increased investment in Council's water and wastewater services over the 10-year period, with larger increases required in the first few years.

On top of growth, and the increasing investment required in our critical infrastructure assets, Council's asset base has continued to increase due to prolonged periods of inflation. This in turn results in increased costs to maintain these assets throughout the 10-year period and a requirement to increase funding to cover the increased depreciation and replacement costs, to ensure the cost of using these assets is covered by current ratepayers, and not burdened onto future generations.

This Financial Strategy has been adapted to respond to the challenges outlined, along with financial sustainability considerations, including the impact on rates and debt, to achieve the right balance.

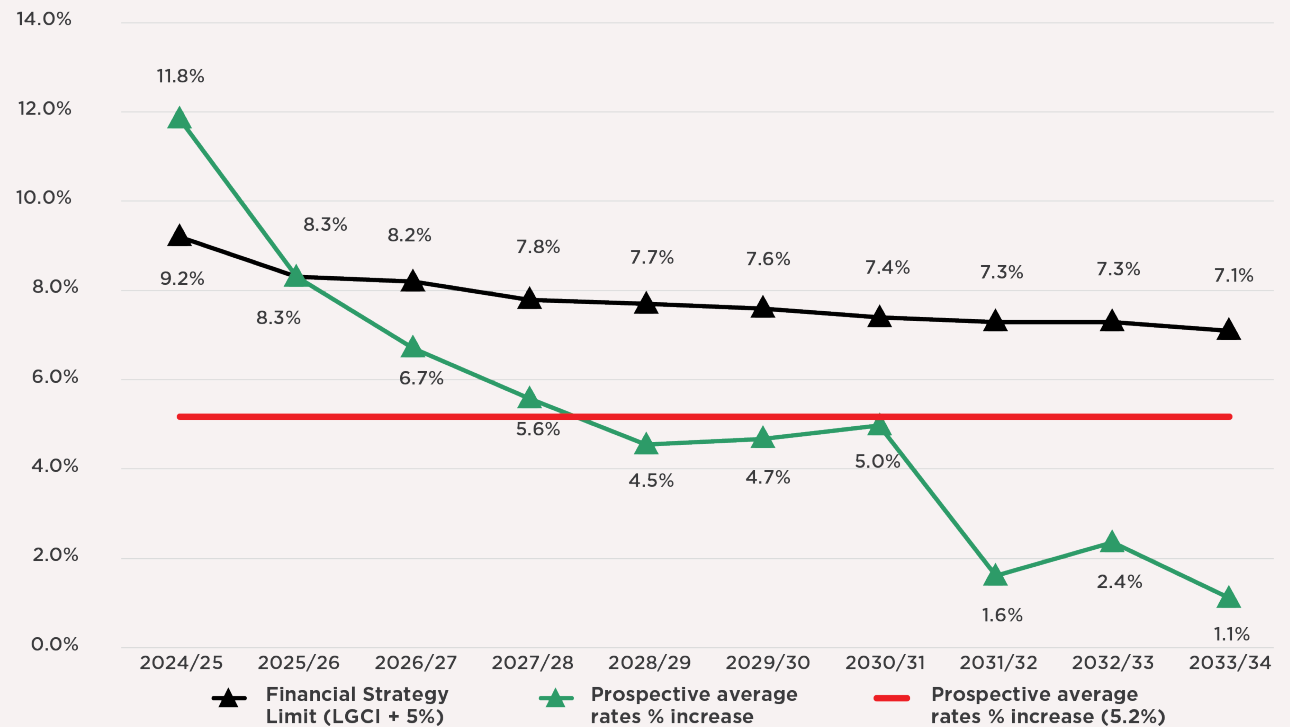
Rates

Council is forecasting average rates increases for existing ratepayers of 5.2 percent across the 10-year period. Recent inflationary pressures, non-controllable cost increases, and increased interest costs have put considerable pressure on rates, particularly in the short-term.

Council have also increased its rates affordability benchmark from Local Government Cost Index (LGCI) + 2.5 percent to LGCI + 5 percent, considering past performance challenges due to LGCI being a forward-looking projection, whereas Council cost increases often occur subsequently to inflationary increases. For most years in this 10-year period, Council is projecting to be well below its self-imposed benchmark. Average rates increases are for existing ratepayers only (after removing forecast growth in rateable properties).

Council recognises that although these short-term rates increases are fundamentally outside of Council's control without compromising key priorities, they are also likely to be challenging for the community. Council have recognised this by not adjusting the benchmark for the two years but instead showing these two years as a short-term breach to the affordability limit.

AVERAGE RATES INCREASES (TO EXISTING RATEPAYERS)



Increased costs for Council's water services have meant that rates increases are proportionally higher for residential ratepayers who have the ability to connect to Council's water and wastewater services. This has been partially mitigated by a proposed differential increase for electricity generators, utilities, and networks. This differential change is being proposed to ensure all industrial/commercial ratepayers pay rates on the same basis, but also in response to Council's consideration of the affordability of rates for the community, for which the proportionally larger increases in residential rates in recent times was a factor.

Availability of alternative funding streams, such as external funding, is considered more challenging than previous Long-term Plans and therefore Council will see an increased reliance on rates revenue during this 10-year period. This is reflective in Council's rates (income) affordability increasing, with Council becoming closer to the benchmark of rates not exceeding 80 percent of total operating revenue being in later years of its Long-term Plan.

Council have proposed increases to its fees and charges, to better reflect increased costs over the past three years. Without these increases, Council would not meet revenue and financing policy funding principles and Council would need to either intentionally breach these principles or amend them to suit current user pays ratios. This would further increase Council's reliance on rates revenue.

Council believes that the breach in rates (income) affordability, that total rates revenue must not exceed 80 percent of operating revenues, is substantially outside of its control considering the substantial increases already applied to fees and charges.

If Council does not receive the assumed external funding streams in this Long-term Plan, such as New Zealand Transport Agency Waka Kotahi subsidies, it will need to reassess the appropriateness of its capital programme and/or specific projects.

Council will also continue to prioritise opportunities to grow its sources of third party funding for capital projects. Council will achieve this through relationships with funding agencies, government departments, and community groups. Council will also continue to advocate Central Government for alternative funding sources, through its own means and through its involvement with sector partners like Local Government New Zealand and Taituarā.



Debt

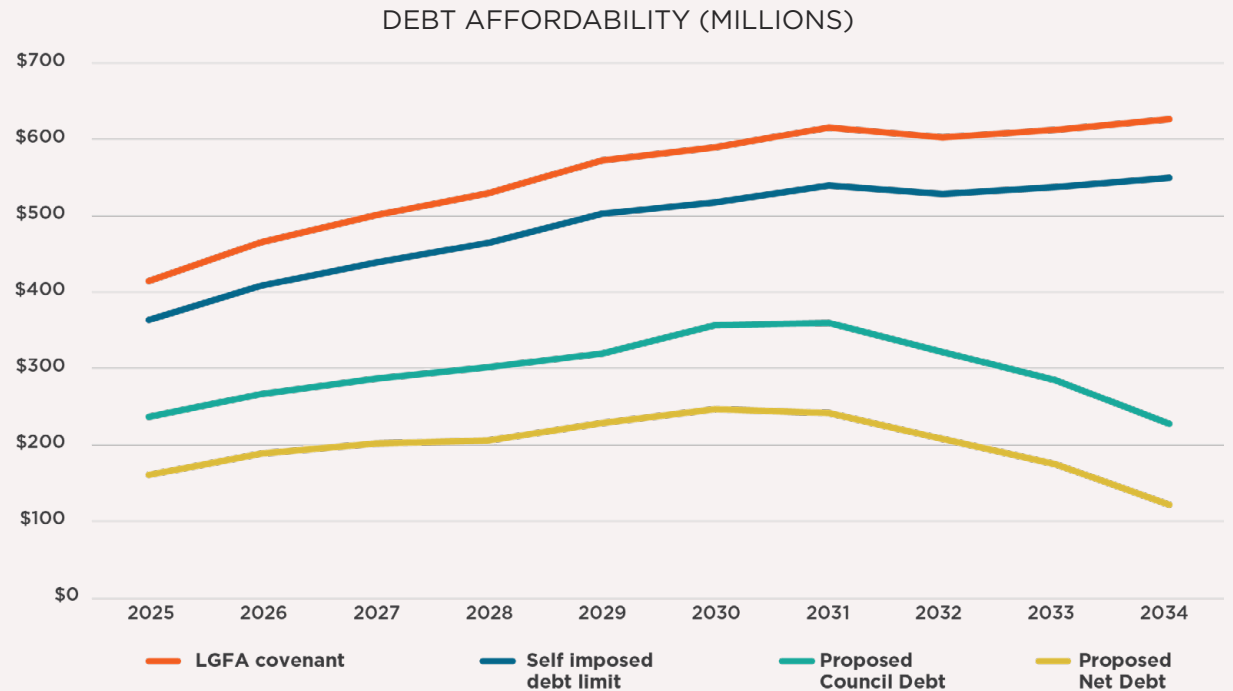
Achieving the balance between debt sustainability and affordability over the long term and Council’s priorities of maintaining current level of services, meeting legislative requirements, looking after our assets, and provisioning for the expected growth, has been challenging for this 10-year period.

Council has managed to maintain debt sustainability and affordability by minimising pressure on debt through voluntary repayments on Council loans, depreciation reserve top-ups, and rationalisation of Council’s discretionary capital projects.

Council has increased its self-imposed debt limit from 225 percent to 250 percent of gross external debt to revenue for this Financial Strategy, recognising the increase in growth during this 10-year period. Due to the forecasted growth projections, Council will be required to carry more debt going forward with increasing capital investment required to provision for this growth.

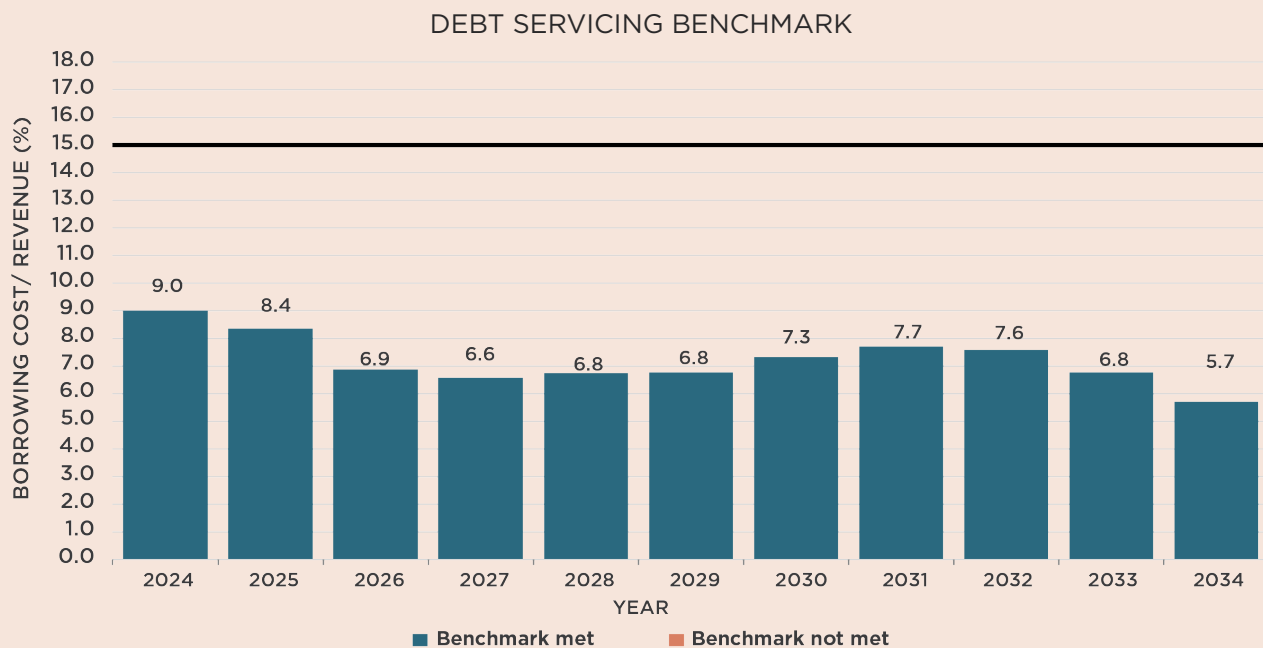
Through this financial strategy, Council also recognises the importance of debt headroom as a key part of planning for unexpected events and changes.

Despite the increased pressure on Council’s debt and significant increases during this Long-term Plan, it remains at prudent levels. The new limit is well below debt covenants that are set by the New Zealand Local Government Funding Agency (LGFA), and Council remain comfortably below the increased limit.



Maintaining a low cost of financing is key for this financial strategy and Council aims to achieve this by obtaining high-quality treasury advice and achieving a positive outcome during Council annual credit rating process. Council’s credit rating is currently AA+ (negative watch) and Council endeavours to maintain a credit rating of at least AA during this 10-year period, to ensure the lowest possible lending margins.

Due to Council’s increased growth projections, Council is allowed to increase its debt servicing benchmark to borrowing costs to be below 15 percent of revenue (from 10 percent), as per Local Government (Financial Reporting and Prudence) Regulations 2014. In the context of the old benchmark, higher projected interest rates and higher growth was putting pressure on this ratio (due to the revenue calculation excluding growth revenue, such as development contributions), however, Council comfortably sits inside the benchmark for high-growth councils.



Policy on giving security for borrowing

The Council normally secures its borrowings against rates income. The Council has a Debenture Trust Deed that provides the mechanism for lenders to have a charge over its rates income.

The Council may provide security over specific assets. This is limited to where:

- There is a direct relationship between the debt and the purchase or construction of the asset, which it funds (e.g. project finance).
- Council considers a charge over physical assets to be appropriate.
- Any pledging of physical assets must comply with the terms and conditions contained within the security arrangement.
- For further information on Council’s approach to borrowing, refer to the Liability Management Policy (part of the Treasury Management Policy).



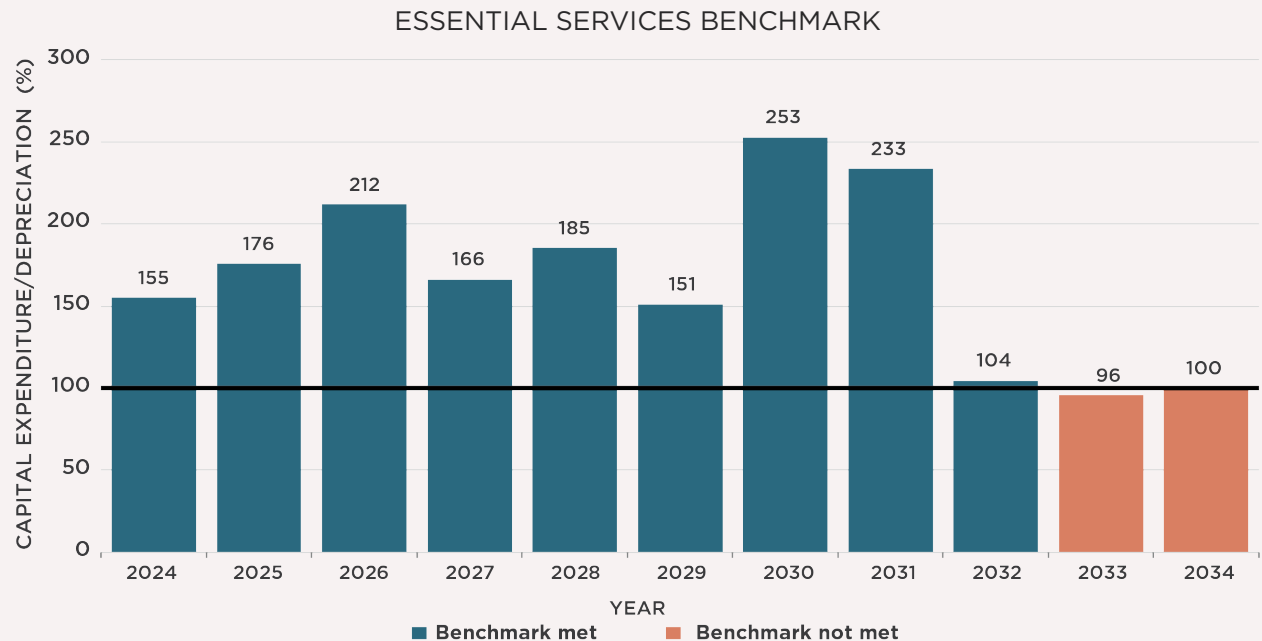
Council services and infrastructure

Council is planning on maintaining current level of services during this 10-year period and this has been reflected in its largely stable operating budgets which are required to deliver the wide range of Council services. This meant that operational efficiencies and discretionary project cuts have been required to ensure a maintained level of service, and to offset several substantial non-controllable increases (such as interest rates, power, and insurance). Further budgetary cuts would compromise these priorities.

Council will continue to fund 100 percent of depreciation of its assets over the asset's lifecycle. The depreciation funded is council's share only (for example excludes NZ Transport Agency funding) and is based on what is expected to be replaced. This methodology is used to achieve intergenerational equity; to ensure the consumption or wearing out of the assets used each year, is paid for by the ratepayers who are using the assets, and not by future generations.

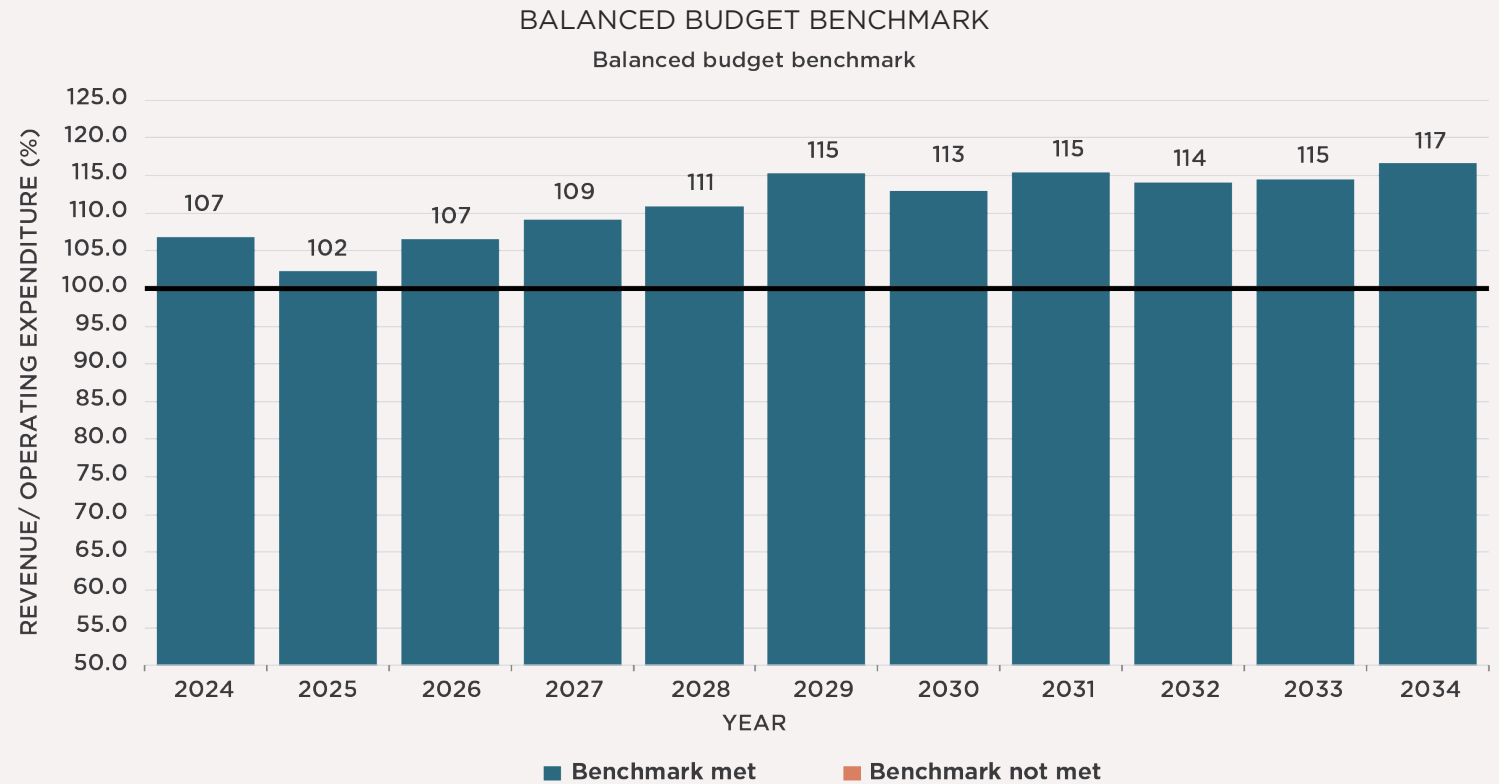
This strategy has been strained in recent years due to prolonged periods of high inflation impacting on replacement costs and maintenance costs of the entire asset portfolio, including those that have previously been funded at historic replacement cost / depreciation levels.

Prioritisation of essential infrastructure, such as water services can be seen in the essential services benchmark, which shows Council's planned capital expenditure on network services as a proportion of expected depreciation on network services. This shows that planned capital expenditure on network services is significantly greater than the benchmark at the first year of the 10-year period. The later years show a breach due to these essential services being prioritised for earlier in the plan.



Increases to Council's capital and operational maintenance and renewal budgets for Council's critical infrastructure have been reflected in budgets over this 10-year period.

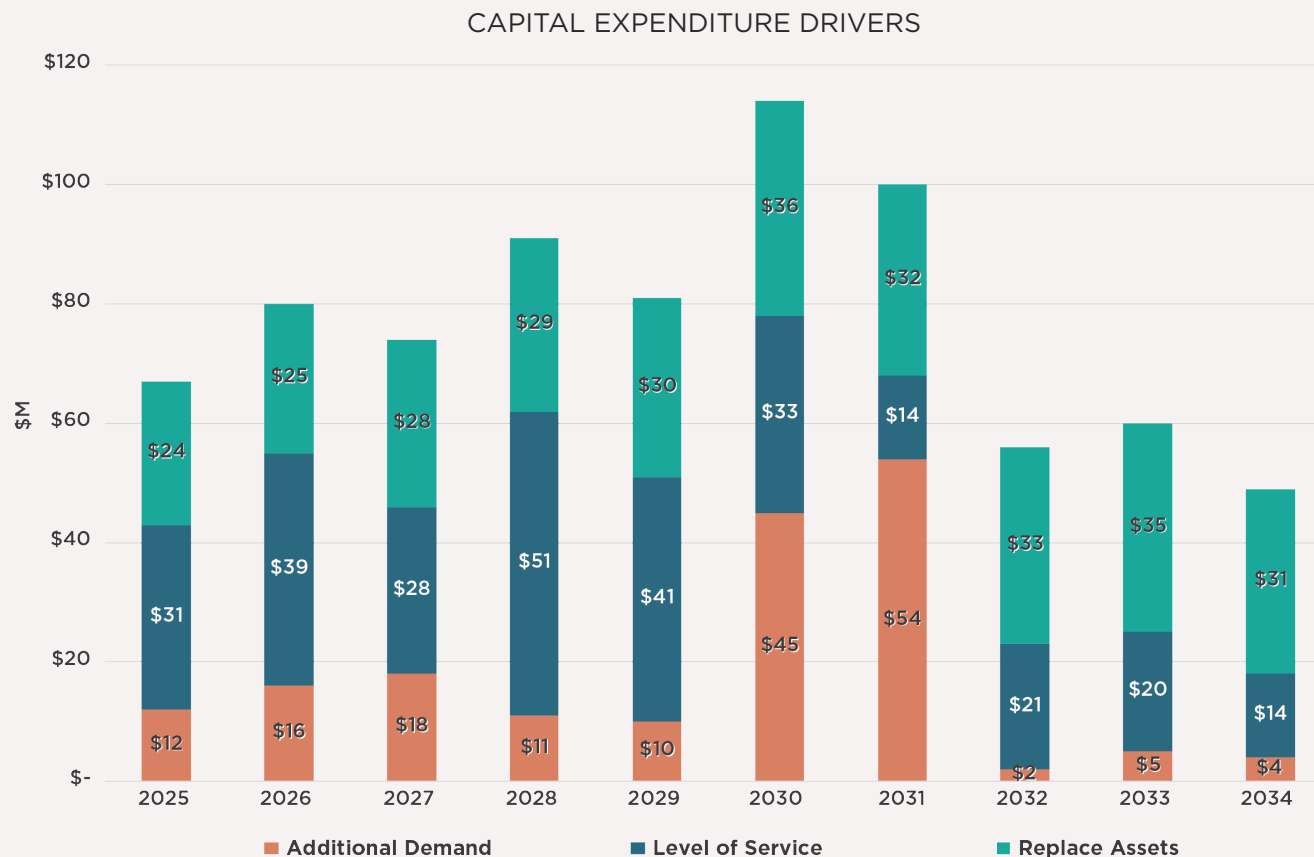
This 10-year period, Council have prioritised topping up negative reserve balances with rates funding in latter years, to ensure no further pressure is put on future generations for the eventual replacement of its assets. This can be seen in Council's balanced budget benchmark which shows Council's planned revenue as a proportion of planned operating expenses. Council meets the balanced budget benchmark if its planned revenue equals or is greater than its planned operating expenses. Council meets this benchmark easily for the 10 years of the plan due to the prioritisation of this funding.



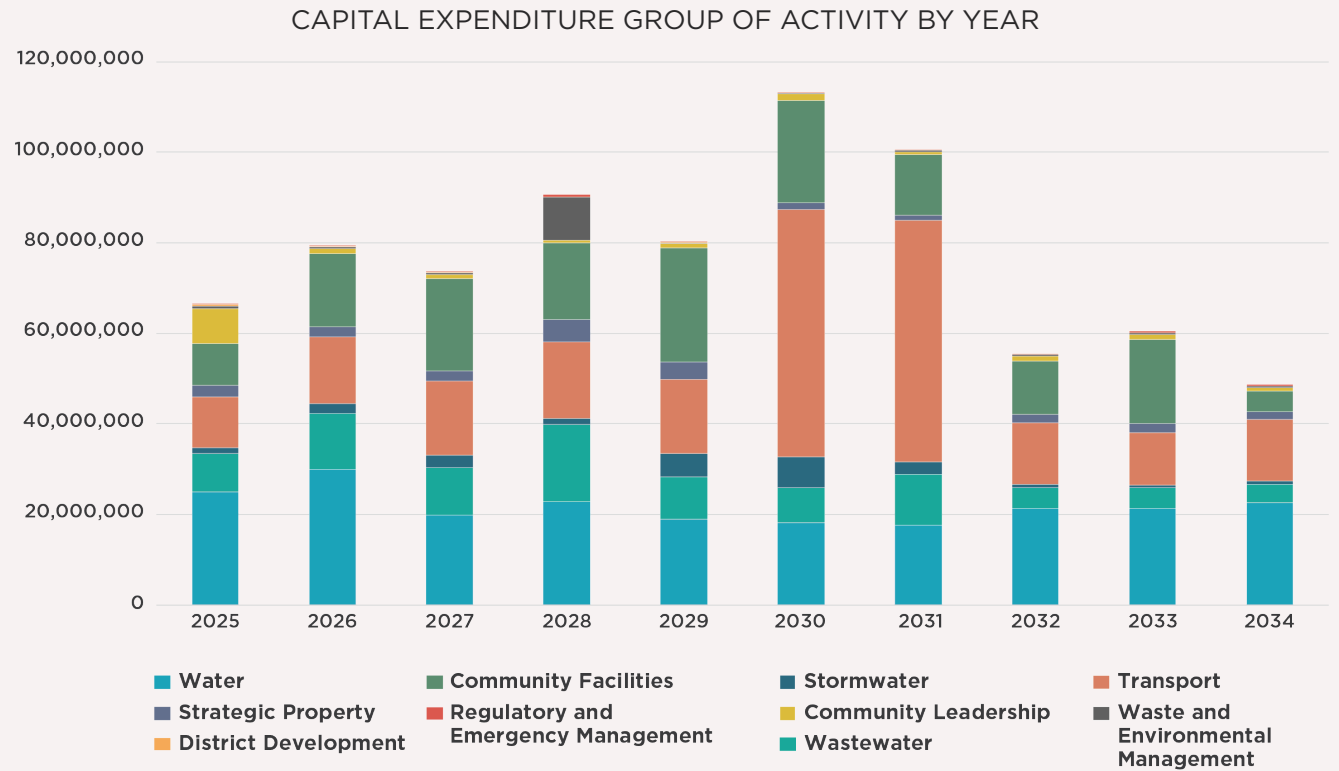
Council has not delivered its entire planned capital works programme in recent years, which has been partially caused by limited resources being available to deliver these projects, with competing infrastructure demands throughout both central and local government. As a result, Council has ensured a deliverability lens has been placed over the programme for this Long-term Plan and believe the programme itself is deliverable, when comparing past performance.

Unfortunately, Council did not anticipate the volume of carry forward of 2023-24 number of project delays from 2023-24 when developing its Long-term Plan; and council officers are going to review this programme further in light of likely increases from carry forward of 2023-24 year capital projects. Any smoothing and/or changes will be reflected in the final Long-Term Plan document.

The average yearly capital programme budget in this Long-term Plan is \$81 million. The following graph shows amounts being driven by additional demand/growth, level of service, and replacement of existing assets. The capital programme has been spread to cater for growth, required improvements (eg water regulatory projects), and affordability.



It is clear in this Financial Strategy that water services are a significant driver for both rates and debt pressures and these pressures have been felt across the sector. These increased pressures, along with new legislation from Central Government's Local Water Done Well Plan, will require Council to review options for its three waters services delivery during this 10-year period, however any impact from this is unknown at this time. Careful assessment of any proposed options needs to be considered by Council, iwi, and the community.



Growth

Council will continue to use development contributions and development agreements to fund the growth proportion of new assets required to cater for the growth in our community. Operational increases are covered by increases in rateable properties, and growth is appropriately excluded from our rates increases affordability benchmark.

This methodology ensures an equitable funding split for the cost of new assets and that growth pays for growth. Despite this principle, Council is generally required to fund its growth upfront, due to the long life of its infrastructure. This puts pressure on Council’s debt, and influences Council’s budgets and infrastructure priorities.

Council is projecting significant increases in its population this 10-year period, as shown in population projections.

TABLE 1 – POPULATION PROJECTIONS BY COMMUNITY CATCHMENT

	2025	2030	2035	2040	2045	2050	2055	2060
Taupō Township	28,000	30,000	32,000	35,000	38,000	41,000	44,000	48,000
Tūrangi	4,000	4,000	4,000	4,000	4,000	5,000	5,000	5,000
Marotiri	3,000	3,000	3,000	3,000	3,000	3,000	3,000	3,000
Mapara	2,000	3,000	3,000	4,000	4,000	5,000	5,000	6,000
Lake Taupō Bays	2,000	2,000	2,000	2,000	3,000	3,000	3,000	4,000
Northern rural	4,000	4,000	4,000	4,000	4,000	4,000	5,000	5,000
Eastern rural	400	400	400	400	500	500	500	500
TOTAL	43,400	46,400	48,400	52,400	56,500	61,500	65,500	71,500

Council’s growth is one of Council’s key significant assumptions and has been projected using the medium-growth scenario in Council’s in-house model. With any growth model, there is risk that growth is higher or lower than projected and/or in different locations than projected.

Should growth be lower than forecast, revenue budgets for rates, building consents, resource consents and development contributions may not be met and this will put further pressure on debt. Should growth be in different locations than projected, this will change Council’s priorities for its capital budgets.

To mitigate this risk, Council will review growth assumptions annually and if there are any disparities Council would need to reconsider the appropriateness of the capital programme.



Unexpected events and changes

Ensuring financial sustainability over the long-term is a key part of ensuring Council is adequately planning for unexpected events and changes. Maintaining sufficient debt headroom and prudent management of Council's investments are key considerations of its financial sustainability.

Council also maintains a disaster recovery reserve as another element of planning for unexpected events, such as natural disasters. Council currently contributes \$350,000 per annum to this reserve. Over the first three years of this strategy, the contribution will increase until it reaches \$600,000 per annum in the 2026/27 financial year in recognition of the importance of adequate planning for unexpected events and the increases in these events in recent history.

Unexpected events are not limited to physical events and unexpected changes can also impact Council's debt and Council recognises the importance of maintaining sufficient debt headroom to allow for these types of changes too. An upcoming example is the change to public sector accounting standards (IPSAS 43) which will likely have an impact on lease liability recognition, increasing Council's reported debt.

Increases to financial benchmarks and ratios in this financial strategy have also been changed based on projected growth, and those projections could change in the future requiring benchmarks to change back. With the benchmarks increased due to growth (debt affordability and servicing), Council is still sitting comfortably within old limits based on lower growth for the entire 10-year period of this financial strategy.

Investments

Council has significant financial investments in its financial investment activity and Council's primary objective when investing is the protection of its investment capital and that a prudent approach to risk / return is always applied. Council will act effectively and appropriately to:

- Protect the Council's investments.
- Ensure the investments benefit the Council's ratepayers.
- Maintain a prudent level of liquidity and flexibility to meet both planned and unforeseen cash requirements.

One of Council's significant investments is the Taupō Electricity Limited (TEL) Fund which was established after Taupō Electricity Limited (TEL) and Taupō Generation Limited (TGL) were sold in 1995.

Council used the assets of the TEL Fund to create a community fund, which aims to produce revenue that could be used to fund community projects, after first inflation-proofing the fund. This fund is also used as self-insurance for underground assets, so Council avoids significant insurance premiums on these assets. In the event of a natural disaster, Central Government would fund 60 percent of underground assets with Council being required to fund the rest from the TEL fund.

During recent years, the TEL fund has not kept up with inflation due to the economic environment, with low liquid asset returns and high inflation. Therefore, no income has been dedicated to community projects during this Long-Term Plan, while the fund returns to the past value (in present day measures). Our target for this financial strategy is to increase the value of the TEL fund from \$68 million to \$124 million.

The TEL fund is now managed by an external investment manager, which has been set up to achieve the original outcomes in a

financially prudent manner. This is governed and measured by a Statement of Investment Policies and Objectives (SIPO), and it is proposed in this strategy that the SIPO be maintained as the overarching performance measurement for this fund. The budgeted rate of return is 6.01 percent.

The TEL fund has additional benefits to our community as the liquidity that the fund offers enhances Council's Standard and Poor's credit rating, keeping lending costs as low as possible.

The Council also maintains investments outside of the TEL fund, which include cash, and a small amount of equity investments and other minor shareholdings. The principal reason for holding an equity investment is to achieve efficiency and community value, rather than for a financial return, and appropriately we do not have any financial targets for these. Current equity shareholding includes the Taupō Airport Authority, the New Zealand Local Government Funding Agency Limited, and the New Zealand Local Government Insurance Corporation Limited.

The Council seeks to achieve an acceptable rate of return on all its investments consistent with the nature of the investment. Council will achieve all its treasury objectives, as maintained in Council's Treasury Management Policy. The budgeted rate of returns for other cash is 5.1 percent

Taupō District Council also holds other asset investments. These comprise commercial, industrial and residential land investments, forestry investments, commercial and semi-commercial property, including community housing and camping grounds.

In this 10-year period, Council is also planning to invest in developing its property to achieve housing outcomes and a financial return to Council. This has been planned in a financially-prudent manner with the dual targets of having no impact on rates and limited pressure on Council's debt - to become self-funding this 10-year period.