Te rautaki ahumoni 2021–31

Finance strategy 2021–31

Introduction and background

We are required to prepare and adopt a financial strategy under section 101 of the Local Government Act 2002. The purpose of the financial strategy is:

- To facilitate prudent financial management by providing a guide to consider proposals for funding and expenditure against; and
- To provide context on our funding and expenditure proposals by making transparent the overall effects of those proposals on the local authority's services, rates, debt, and investments.

The objective of our financial strategy is to take a sustainable approach to service delivery and financial management. This means focusing on ensuring our levels of service and activities are financed and funded to generate and protect community outcomes and promote long-term community well-being.

As we prepare this financial strategy we are in a strong financial position. At 30 June 2020 we had $1,807 million of total assets including $704 million of total liabilities and total external borrowings of $520 million. Further, our long-term credit rating was recently affirmed by Standard and Poors at [AA+]. This is a strong rating only one notch below central government.

From a funding perspective, we have access to a range of revenue sources which enables us to reduce the funding burden on ratepayers as well as ensuring funding is more resilient to unforeseen events. In financial year 2019/20, the income we received from rates and water levies was less than 50 percent of total revenue.

Overview of financial strategy

In planning for the next ten years, our current financial position means we are well positioned to help the region respond to the various challenges it faces.

In particular, the financial strategy has been devised with the intention of ensuring we can support the region as it confronts the economic challenges posed by the COVID-19 pandemic. To do this we are investing in shovel ready projects that will help to stimulate an economic recovery, in addition to providing for environmental protection and supporting the region's transition to a sustainable and low carbon economy. There has also been a strong emphasis on ensuring we are able to maintain a sustainable approach to financial management. To help achieve this we have funded a portion of these projects through reserves to minimise the impact on debt and rates.

There is also an ongoing need to ensure regional infrastructure is 'future proofed' against the impact of climate change and to implement various carbon reduction initiatives. This will help to ensure we can achieve our target of achieving carbon neutrality by 2030.

There are a range of investments within this Long Term Plan that will assist us in achieving these goals.

To the extent this relates to capital expenditure, this will be funded through debt in the first instance.

Infrastructure Strategy provides details of the level and timing of investment needed to operate, replace, renew and upgrade existing facilities and the Financial Strategy outlines the required rating and debt levels to fund these investments. Together the two strategies outline how Greater Wellington intends to balance investment in assets and services with affordability.

The financial strategy further reflects the requirement to make continued investment in supporting regional growth and an ageing demographic. This necessitates substantive infrastructure investment. In-line with this approach we have also reviewed the levels of service we provide to ensure we are delivering the right community outcomes.

Against this backdrop, we are undertaking close to $1 billion of capital expenditure over the course of the Long Term Plan period, including the following key investments:

- Electrification of Metlink buses
- Rail station infrastructure and upgrades
- Continued investment in Let's Get Wellington Moving
- Development of integrates fares and ticketing solution
- RiverLink
- Delivery of major flood protection hazard and management programmes
- Installation and provision of regional-scale environment and climate monitoring sites
- Renewal and upgrade of critical drinking water abstraction, treatment and supply network assets
- Te Marua Water Treatment Plant Capacity Optimisation
- Relocation of Kaitoke main on Silverstream bridge

As these investments provide intergenerational benefits they will be predominantly debt financed. Over ten years we are expecting to borrow $527 million which results in total outstanding borrowings of $1.2 billion by the end of the plan after repayments. Importantly, we remain comfortably within our debt limits throughout the Long Term Plan period.

Consistent with our approach to ensuring a sustainable approach is taken to the region's financial management, the financial strategy also includes rate increases to fund expenditure that benefits the whole region. On average this equates to increases of around $18 million per annum over the Long Term Plan period. Where possible we have sought to minimise rate increases by leveraging various funding levers.

Guiding principles for our financial strategy

Using debt to fund assets that provide intergenerational benefits: Our approach ensures all ratepayers who use an asset contribute towards it. Using debt to fund assets allows us to increase service levels while ensuring the funding burden is shared across generations.

Who should pay based, where possible, on the distribution of benefits: We consider who benefits from an activity when evaluating how to fund it.

Willingness of ratepayers to pay, and affordability: Consideration is given to balancing the need for public facilities and services with consideration of the ratepayers' ability and willingness to pay. This is done by considering economic information about the region. The rates (increase) affordability benchmark has been reviewed, resulting in an additional benchmark showing the change in the quantum to a dollar per average rating unit to reassure ratepayers of the affordability of Greater Wellington regional rates

Prudent financial management and value for money: We aim to practice good financial management through sound decision making and where our actions are well thought through to minimise the risks and appropriately allocate costs to ratepayers now and in the future.

Challenges

COVID-19 global pressures

COVID-19 has, and could, continue to have a significant impact on wellbeing, jobs and business across the region. It is estimated the regional economy will be impacted over the short-term and take at least five years to return to positive growth in GDP and employment. Due to a decrease in employment and household incomes, it may be harder for households to pay rates.

It is expected to impact our funding sources too. This is likely to be through items such as lower patronage on public transport. At the same time, many of our costs remain fixed and our expenditure pre-committed. Despite this, we are committed to facilitating the region's economic recovery, particularly through the funding of shovel ready projects (a number of which feature in central government's infrastructure investment strategy). Our continued investment in services and infrastructure will contribute to the wellbeing of our community and stimulate the region's economy through the procurement of goods and services.

Environmental pressures – including adapting to climate change

The impacts of climate change are affecting communities across the world and is having impacts on aspects of our lives already. The risk to our communities is now too high to ignore, so in 2019, Greater Wellington declared a climate emergency.

To minimise the negative impact of climate change we must continue to ensure we are becoming a more climate resilient region. Climate change may result in increased risk of flooding, landslides, erosion, droughts and coastal hazards across the region and may impact regional services, infrastructure, coastal roads and constrain the water supply. Council has a mandated role to build the resilience of our communities against natural hazards and climate change.

Our financial strategy assumes we have time to plan and prepare response options for most climate change related effects (i.e. rising sea levels). However our ability to deliver planned levels of service to the community may be affected if climate change occurs faster or with greater impact. If this occurs unbudgeted emergency work may need to be carried out.

Additional unbudgeted costs may also be incurred to mitigate impacts, such as improving protection of critical infrastructure or increasing maintenance.

Our low level of debt provides flexibility to respond to any unexpected climate impacts through borrowing for emergency works. In addition, some self-insurance of our underground assets is in place to help provide for emergency work if required. We are ensuring that future assets are of sufficient standard to cater for the predicted effects of climate change.

Greater Wellington also has a role to play in reducing emissions. As a first step towards this, we have adopted a goal of 40 percent reduction in Greater Wellington's net emissions by 2025, and to be carbon neutral (have net zero emissions) as an organisation by 2030 and 'climate positive' (be absorbing more emissions than it is emitting) by 2035.

Our Carbon Neutral 2030 goal is supported by a 10-point action plan, a Carbon Reduction Policy (2020) and a Climate Change Consideration Guide (2020) requiring options for adaptation and mitigation considered for all work, including decision-making.

We have also established the Low Carbon Acceleration Fund, designed to help spur a step change in Greater Wellington's activities to reduce emissions and put it on track to achieve Council's carbon reduction goals, and fund activities or initiatives that reduce net emissions more quickly and/or at a greater scale than otherwise would occur.

Many of the initiatives in the 2021-31 Long Term Plan, such as the electrification of our bus fleet and phasing out grazing from our regional parks, will support this direction.

Population and demographics

Current statistics estimates the region's resident population to come close to 537,000 in 2021. This is an increase of one percent since the 2018-28 Long Term Plan. By 2030, the population is expected to reach 570,000 and 632,000 by 2043, which will increase demand for services and infrastructure and may also impact the region's biodiversity, marine environment and waterways. Greater population density, and the impact it has on climate change, will need to be monitored too.

Managing the impacts of an ageing population will also be a challenge for the region. This may have rates affordability implications and impact the size and value of new dwellings. Ageing will affect demand for services, including public transport, emergency management and housing patterns.

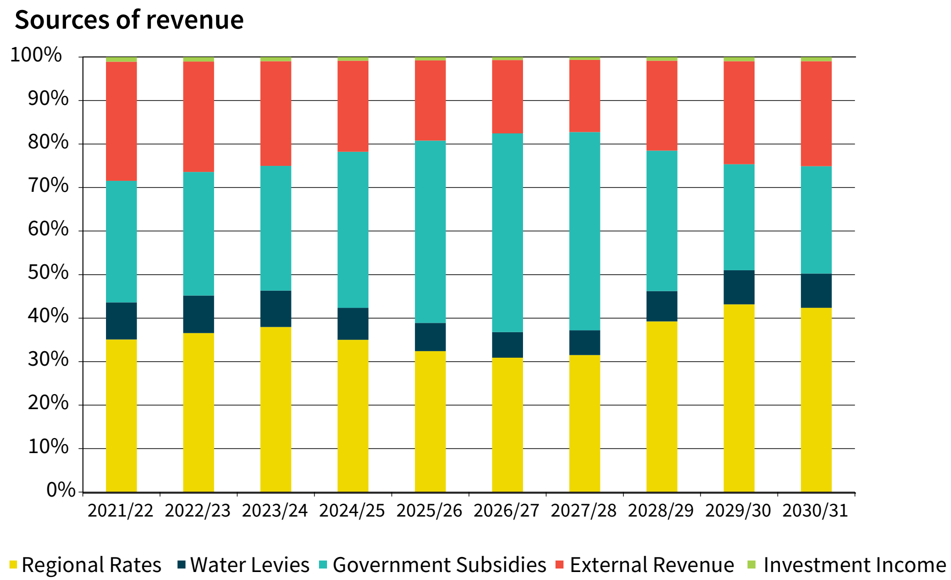
Within the 2021-31 Long Term Plan, we are continuing to address these items by emphasising appropriate infrastructure investment and ensuring our approach to financial management is sustainable.

Funding

We fund activities through a range of sources. The way in which activities are funded is set out in our Revenue and Financing Policy. The key items considered when determining how to fund an activity are:

- The distribution of benefits between the community, any identifiable part of the community and individuals
- The period over which benefits are expected to occur
- The extent to which the actions or inaction of particular individuals or a group contribute to the need to undertake the activity
- The costs and benefits of funding the activity distinctly from other activities
- The overall impact of any allocation of liability for revenue needs on the community
- The most appropriate fees and charges strategy so that adequate funds are recovered to offset operational expenses

Our funding mix over the Long Term Plan period is shown here:



Investments

Investment income is used to reduce general rates and allows ratepayers to realise some of the benefits from the investment portfolio each year. This approach ensures intergenerational equity is maintained.

Investment income consists of direct equity investments in Council controlled Organisations and Council controlled Trading Organisations; investment property; and holdings of financial assets.

Over the term of the 2021-31 Long Term Plan period, we are forecasting $59 million of investment income. The largest contributor is expected to be CentrePort of $38 million.

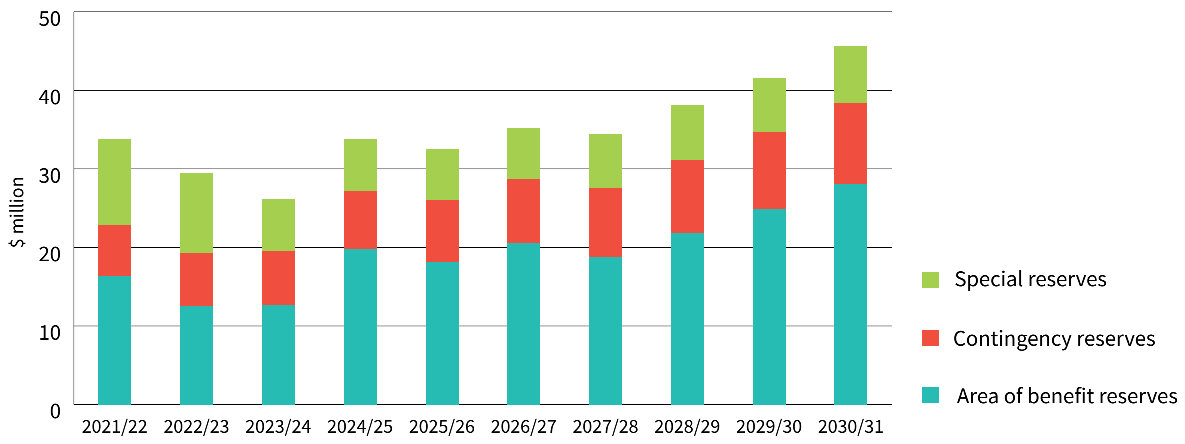
As a responsible public authority, we understand any investments held should be low risk.
Our primary objective when investing is the protection of investment capital and revenue generation. This means we will only invest with counterparties that are of sufficient financial strength, with approved, acceptable creditworthiness ratings.

Reserves

Reserves are generated using surplus funds from prior financial years and are used occasionally to fund expenditure. Maintaining reserves is a prudent form of financial management used to either minimise volatility in capital expenditure or to help protect against the impact of unexpected events. This ensures we can maintain our usual service levels after without putting pressure on debt and rates.

We expect to start the long-term process with $38.9 million worth of financial reserves. We expect to progressively drawdown on our reserves in order to strategically utilise the funds when required and reduce rates impact of our planned capital expenditure. The main drawdowns are expected to be in year 2021/22 and 2022/23 of $6.7million and $5.9 million respectively to fund our public transport modernisation and offset rates increases. After that we expect to build up our financial reserves to reach $45.6 million by 2030/31.

Reserves by type

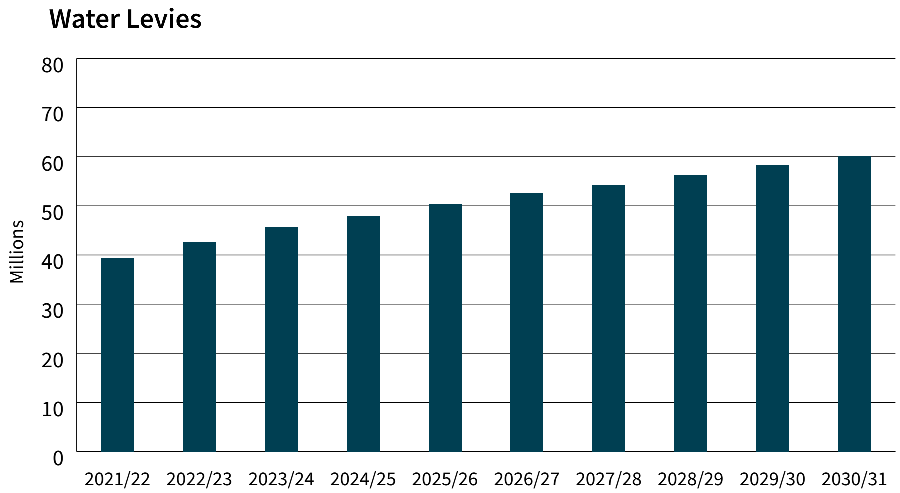


Water levy

Bulk water is delivered to Wellington, Hutt, Upper Hutt and Porirua through Wellington Water Limited, a joint council owned organisation. This is funded via a local council water levy which is on charged to ratepayers.

We plan to increase the levy by an average of 5.3 percent over ten years. The increases are driven by major capital projects aimed to look after the existing infrastructure, reduction in water consumption activities, key water treatment plant resilience programmes and the extension of the bulk water network aligned with the city council growth planning. Funding increase for each of the first three years will ensure reduction in service interruptions, lower risk of critical asset failure and maintenance of customer service.

The total water levy we expect to receive over the 2021-31 Long Term Plan period is $507 million.



Rates

When setting rates we seek to balance the demand for additional work, regional economic development and long-term community well-being with ratepayers' willingness and ability to pay. This is always a challenge.

To ensure we can meet our planned levels of service, manage the financial impact of Covid-19 and address the impacts of climate change, rate increases are required as part of the financial strategy. The increase in rates will result in rates collection increasing from $141 million in 2020/2021 to $323 million by 2030/31 and represents an average annual rates increase of 8.75 percent. In 2021/2022 the rates increase is 12.95 percent.

This equates to approximately an average increase per week of $1.31 (incl. GST) for the residential ratepayer, $5.01 (excl. GST) for the business ratepayer and $1.65 (excl. GST) for the rural ratepayer region-wide.

To provide ratepayers with certainty regarding rates over the Long Term Plan period we have set the following rate benchmarks:

- Total rates revenue will comprise up to 45 percent of the Council's annual revenue requirements.
- The average Regional rates per average ratepayer increase benchmark is $100 per annum. The average over the ten years is $76.50.

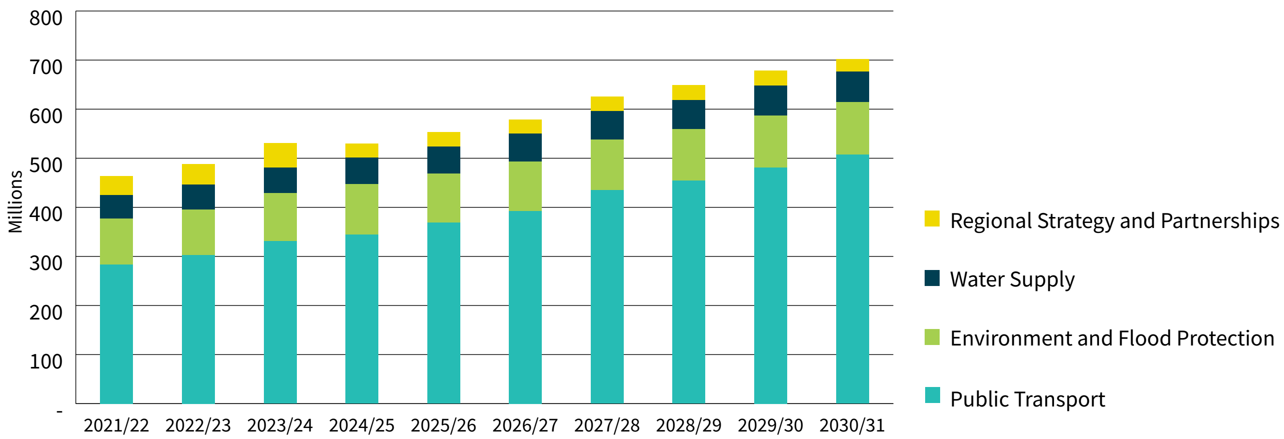
Operating expenditure

Our total operating expenditure over the Long Term Plan period is forecast to be $5.8 billion Expenditure by activity class is shown in the below chart.

Most operating expenditure is in public transport of $3.9 billion over the ten years and reflects costs associated with running the network, KiwiRail transitional rail pass through costs, increasing patronage and servicing borrowing costs. Operating expenditure is also expected to increase in the water supply and flood protection activity classes due to ongoing maintenance and servicing borrowings from capital expenditure aimed at improving resilience and reducing the impact of climate change.

Operating expenditure is funded by rates, levies, grants and subsidies and external revenue and they are set at levels to achieve this.

Operating expenditure by activity group



Capital expenditure

Capital expenditure is funded through the following means:

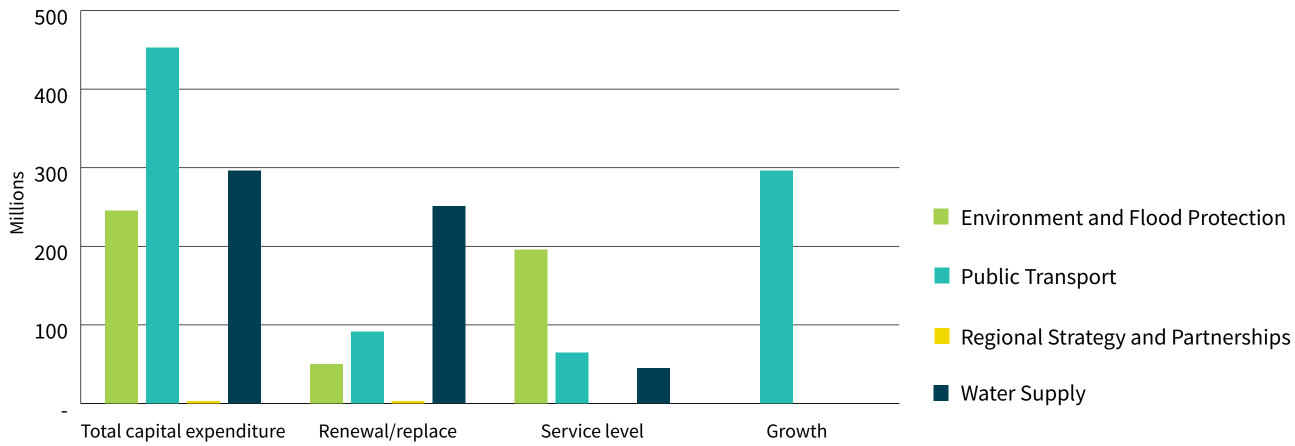
- borrowings (debt)
- proceeds from asset sales
- reserve funds

Total capital expenditure over the 2021-31 Long Term Plan period is $1 billion. The investment in the programme is for one or more of the following purposes: to maintain the required levels of service to enhance long-term community wellbeing through delivering critical assets, manage asset renewals, achieve carbon neutrality, improve resilience and support the economic recovery following COVID-19. Large capital expenditure investments are predominantly in public transport infrastructure of $457 million, water supply of $296 million and environment and flood protection programmes of $239 million over the 2021-31 Long Term Plan.

We categorise our capital expenditure into asset renewals, service levels (i.e. new assets to improve existing services) and growth (i.e. new assets to support regional growth). The below chart details activity groups' capital expenditure by category over the course of the Long Term Plan period.

Detailed rationale and analysis of our capital expenditure is contained within our Asset Management Plans.

Capital expenditure by activity

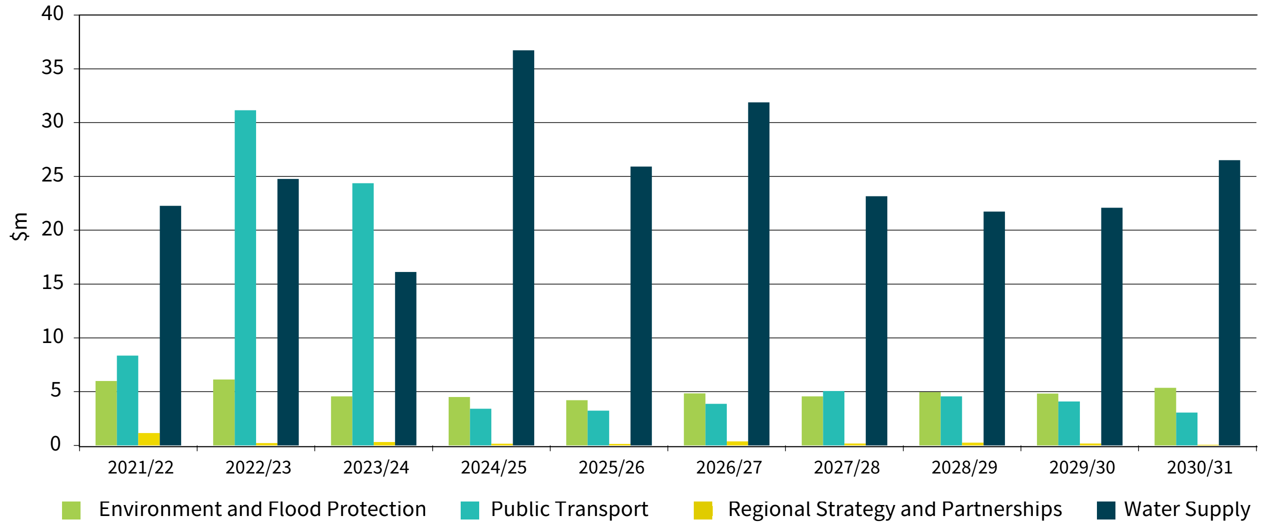


Asset renewals

We continue to replace and renew our existing assets to ensure they are fit for purpose and deliver an appropriate level of service. An important aspect of our asset renewal programme is ensuring expenditure results in assets becoming more climate resilient.

Total asset renewal expenditure of $427 million is forecast over the 2021-31 Long Term Plan period. The majority of which is Water Supply $251 million.

Asset renewals by activity group

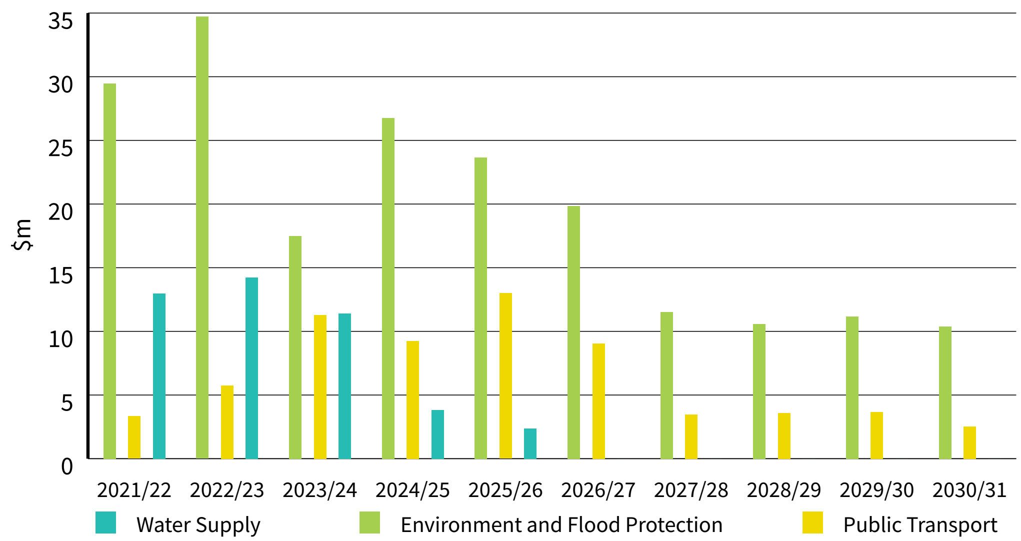


Levels of service

Total service level capital expenditure over the 2021-31 Long Term Plan period is $305 million. This includes the following major projects:

- Waterloo station redevelopment $22 million
- Upgrade to rail station customer amenities $19 million
- RTDI development $11.6 million
- Decarbonisation layover CenterPort and Lambton Quay $6.8 million
- Te Marua water treatment plant water network resilience improvement $35.3 million
- RiverLink $97 million for flood management resilience

Level of service capital expenditure by activity group



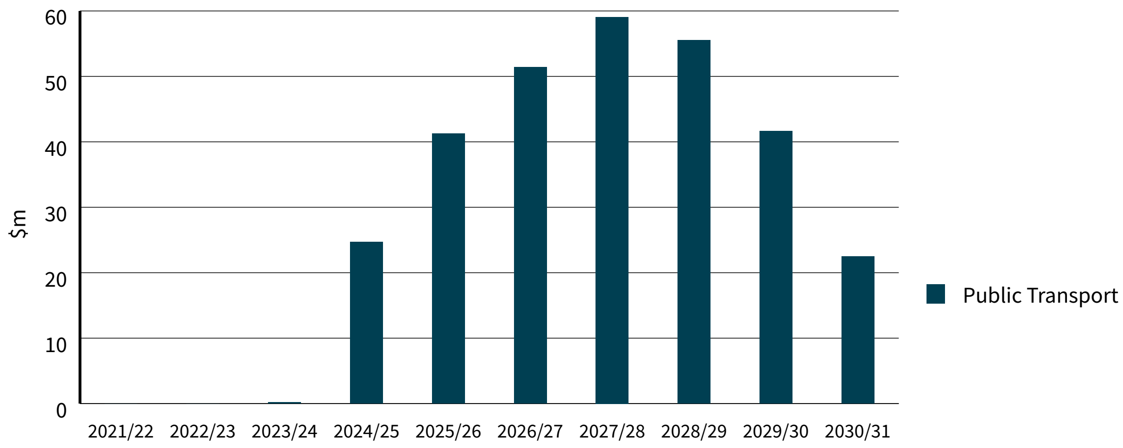
Growth

Additional demand for capital expenditure to meet growth is predominantly due to the need to modernise the region's public transport system. We have also received an extra boost from the Government's shovel-ready projects grants to enhance our existing flood protection and control works programme for stopbank protection, reconstruction and improvement, lake restoration, buffer establishment land and tree planting. These meaningful projects offer long-term positive outcomes for the environment and for our communities.

The financial strategy includes $296 million for growth expenditure to meet these requirements. Included within our growth expenditure forecasts are the following key initiatives:

- Let's Get Wellington Moving project implementation of $295.2 million

Growth capital expenditure by activity group



Debt

Debt is used for capital expenditure and ensures intergenerational equity is achieved by spreading the costs over the life of the asset. It also reduces volatility in our rates requirements and their absolute level.

Debt is managed within limits that are consistent with Local Government Funding Agency (LGFA). These are set at prudent levels and within LGFA and credit rating agency requirements. This ensures we retain debt capacity for unexpected events and can maintain a sustainable level of borrowings over the long term.

We use four different measures to limit the level of debt. Projected borrowings fall well within the limits set:

Treasury Management Policy	2021/22	2022/23	2023/24	2024/25	2025/26	2026/27 & out years
Net external debt/Total revenue	<300%	<295%	<290%	<285%	<280%	<280%
Net interest on external debt/Total revenue	<20%	<20%	<20%	<20%	<20%	<20%
Net interest on external debt/Annual rates and levies revenue	<30%	<30%	<30%	<30%	<30%	<30%
Liquidity	>110%	>110%	>110%	>110%	>110%	>110%

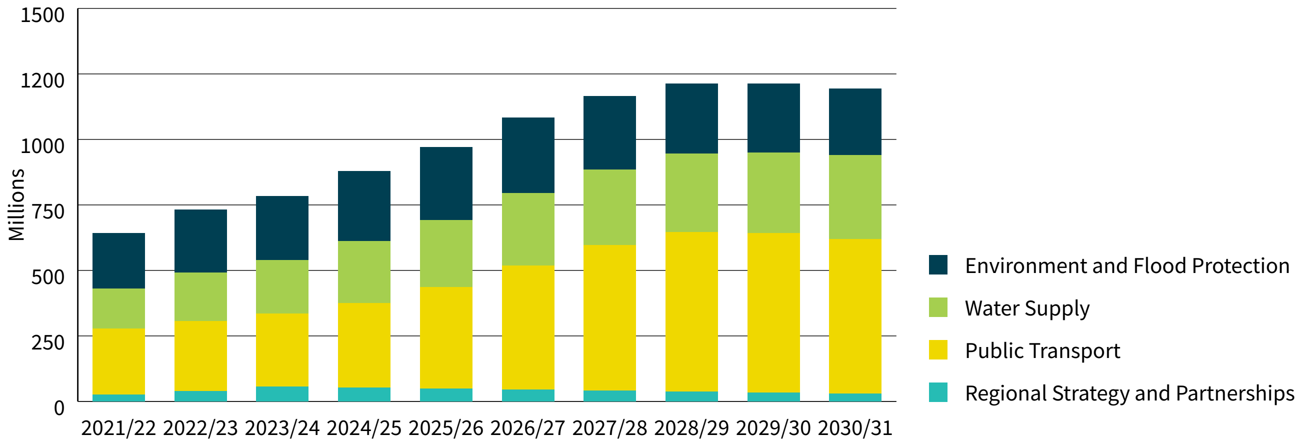
External borrowings

The financial strategy includes a $497 million increase in borrowings over the Long Term Plan period on the 2020/21 Annual Plan, resulting in total outstanding borrowings of $1.2 billion by the end of the period. This is driven by the significant investments being made throughout the period.

Debt is also being used to fund expected reductions in public transport revenue in the first three years of the Long Term Plan. This reflects the impact of COVID-19 and assumes fewer people will be using public transport. A return to pre COVID-19 patronage levels is expected by 2024/25.

The below charts outline the years of the proposed new borrowings, the programmes to be funded and our overall debt profile.

Borrowings profile by activity group



Security for borrowings

We use a Debenture Trust Deed to grant security to our lenders when we borrow funds. Under the Deed, our borrowings and interest rate risk management instruments are secured by way of a charge over rates and levy revenue under the Local Government Rating Act. The security offered by us ranks equally with other lenders.

Physical assets will be charged only where:

- There is a direct relationship between the debt and the purchase or construction of the asset it funds (such as an operating lease or project finance)
- Where security interests are leases or retention of the arrangements which arise under the terms of any lease or sale and purchase agreement
- We consider a charge over physical assets to be appropriate

Financial risk management

We provide a range of core services to our community. In doing this, there is a need for financial risk strategies to reduce the financial impacts of unforeseen events. Examples of this are disaster recovery provisions in relation to catchment management works and maintaining the sustainability of the region's flood infrastructure both from financial and environmental performance perspectives.

Our approach to insurance is to focus on the effects of low probability, high impact events. We do not insure all assets, because it is unlikely all assets would simultaneously be affected by a hazard event. Our annual budgets provide funding for repairs as a result of smaller, more frequent events.

Insurance coverage for our assets is provided in a variety of ways, with each insurance vehicle providing protection against a different level of risk. Our insurance framework is delivered through the following mechanisms:

- Commercial insurance
- Self-insurance through disaster recovery reserves and cash deposits
- Central government funding through National Recovery Plan

Disaster recovery reserves are budgeted at the required levels. Insurance cover has been put in place to address risks associated with the more frequent weather events that may cause damage to assets, reducing the requirement for self-insurance through the disaster recovery reserves. Adverse weather events will require funding to be drawn down from these reserves in order to meet costs to repair damages. Insurance vehicles is part of our Risk Financing Strategy summarised in Appendix 1.

Appendix 1: Insurance vehicles for infrastructure assets within our Risk Financing Strategy

Treatment Option	Item	Description
Internal financing	Recovery reserves – flood protection recovery fund	We maintain a major flood protection recovery fund to meet flood protection damages for larger floods (25 to 40 year return period) We have a contingency reserve for flood protection for smaller floods with a 5 to 25 year return period Based on flood risk assessments, we have determined that the following reserve balances should be held: Flood protection recovery fund – an annual provision of $0.300 million Contingency reserve for flood protection– annual provision of $0.150 million from 2021/22 to 2023/24 and growing to $0.350 million from 2045/25 and out-years
Internal financing	Disaster recovery reserves and cash deposits for underground assets – water supply	We hold funds for hazard events as cash deposits or reserves. Based on our hazard events assessment, we have determined that the hazard events fund should be held at $74.4 million by 2030/31 The gap between this amount and the maximum probable loss may be covered by a mix of insurance, borrowing or government assistance
Risk transference	Insurance – above-ground assets	We maintain a material damage business interruption insurance policy for all our above-ground assets (excluding motor vehicles and rolling stock which are separately insured). Assets are insured on a maximum probable loss basis. We partake in insurance collective with Hutt City, Upper Hutt, Kāpiti Coast District and Porirua City councils. We share a large excess (5 percent of site sum insured to a maximum of $20 million for earthquake events) in order to reduce premium costs. The excess is substantially less for other hazards, such as fire. We have a material damage fund, which is at $13.2 million as at 30 June 2020 and is planned to rise to $26.2 million over the next ten years

Treatment Option	Item	Description
Risk transference continued	Insurance – above-ground assets continued	We insure our rail rolling stock at the higher end of the maximum probable loss mainly due to the noted uncertainty around the tsunami assessment We transfer the rolling stock risks to our rail operator Transdev because they have a high degree of influence over the rolling stock We are liable for a shared insurance excess with KiwiRail, which insures the bulk of the Wellington metropolitan rail assets under a maximum probable loss scenario Our rail infrastructure assets, including station buildings (excluding Wellington Station), bridges, over and under passes and improvements on park & ride land are insured by our material damage property risk programme. We insure our four largest flood protection assets – the barrage gates at Lake Wairarapa, the flood walls on Hutt River at Waiwhetu, the Seton Nossiter and Stebbings Dams at Johnsonville
Risk transference	Underground assets – water supply	In March 2019 we agreed to supplement our contingency fund with insurance to meet our commitment along with Central Government's to cover the risk of a seismic event for these below ground assets