Draft Financial Strategy Long Term Plan 2024-2034

Business Unit	Finance
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Owner	Group Chief Financial Officer, Jenny Livschitz

Version	Author	Date	Description
V 1.0	Deepu Nunnian, Manager Financial Strategy and Planning	February 2024	Draft

Contents

Summary and overview

Council's Financial Strategy is based on a number of important principles that provide the foundation for prudent sustainable financial management. These principles can be summarised as:

- achieving intergenerational equity by spreading costs between both present and future ratepayers
- maintaining prudent borrowing levels
- achieving a balanced operating budget and ensuring that everyday costs are paid for from everyday income
- careful consideration of the affordability of rates charges
- delivering services effectively and efficiently, and
- strengthening Council's financial position in the long term.
- maintaining principle of "growth pays for growth"

Our financial strategy focuses on strong fiscal management while addressing growing demands for increased capital investment in core infrastructure assets. Council is proposing a capital investment spend of just over $2.6 billion for the 10 years of the plan, 63 per cent of which is for three waters and 21 per cent for transport. This investment level is a significant increase of $1.2 billion compared to Long term plan 2021-31, largely due to the need to support investment in a growing city, address the infrastructure deficit with ageing assets and the impact of significant cost escalations due to a challenging economic context.

Borrowings are a key component of recognising the intergenerational equity principle, whereby the cost of long-term assets should be met by ratepayers over the life of those assets. It is important that we prudently manage the amount of borrowings, while enabling the step-up of investment in infrastructure assets. Net debt of $0.3 billion at June 2023 is projected to increase to just over $1 billion by 2030. Council has reviewed the borrowing limits and increased them to enable the funding of the larger investment programme (refer table 1). The net debt to revenue ratio is set at a limit of 250%, which is within the Local Government Funding Agency debt covenants requirements of a limit of 280%. The Council has set the limit lower at 250% as it considers it essential to maintain headroom and the ability to fund the impacts of significant natural disasters should they occur, such as extreme weather events or earthquakes, .

The proposed investment in three waters is lower than the levels recommended by Wellington Water Limited (WWL), which would have investment increasing by a further $1 billion. This significantly higher investment level would result in borrowing limits being exceeded if there were not offsetting mechanisms applied, such as much higher rates increases or budget cuts to other services (please refer to the Consultation Document for further information). With the proposed lower level of investment included in this draft plan, the Council is effectively applying an affordability lens, which constrains the rates revenue increases and in turn limits the amount of debt we can take on. There are a range of service level impacts and risks related to the proposed investment, which are outlined in the Infrastructure Strategy.

Annual income of around $250 million is largely applied to fund operating costs for services delivered by Council and to maintain assets. A guiding principle of this financial strategy is the importance of a balanced operating budget. This means ensuring that projected operating revenue is set at a level sufficient to meet projected operating expenses, and that current ratepayers are contributing an appropriate amount towards the cost of the services they receive or are able to access; i.e., 'everyday costs are paid for from everyday income'.

We are facing many cost pressures largely due to high inflation, interest rates, insurance, higher construction and resourcing costs. These significant economic pressures are set to continue to impact us and all councils up and down the country.

The 10-year plan projects that Council will not achieve the balanced operating budget target for a number of years, until 2029-30 (see Figure 17). This projected balanced operating budget position provides a pragmatic balance between managing the pressures on current ratepayers and ensuring the Council remains financially sustainable into the future, whereby the actions of today do not significantly impact unfairly on ratepayers in the future. This approach is financially prudent and in line with the legislative requirements, due to the longer-term plans for rates revenue generation and repayment of debt occurring to avoid a significant impact on future ratepayers. The level of funding also enables Council to maintain its levels of service and undertake asset renewals and is consistent with the Revenue and Financing Policy.

Council has considered the level of rates revenue in light of a number of factors, including affordability to ratepayers, the legislative requirement for financial prudence and the economic environment. The Council has a high dependency on rates as a principle revenue source, and there are few options available to offset cost pressures.

Over the course of developing this 10-year plan a range of savings were identified and applied to budgets totalling $34.8M over the period. These are ongoing and reduce the rates funding requirement over the 10-year period, the projected rates revenue increases for ratepayers range between 16.9 per cent and 7.2 per cent. Based on the rates revenue setting proposed, an overall increase in rates charges for 2024-25 is estimated at 16.8% for an average residential property. The rates revenue rise equates to an average increase of $10.81 per week per household or an average increase of $562 per annum. Investment in Three Waters infrastructure makes up around 45% ($251) of the average $562 per annum rise. The remaining $311 covers cost increases for all the other services provided (including roading, parks, community facilities, rubbish, recycling etc.). For an average commercial central property the increase is $63.04 per week.

Section A: Introduction and setting the scene

What is a financial strategy?

Our financial strategy is intended to guide the decisions we make now and, in the future, to enable Council's contribution to the vision for Lower Hutt. The financial strategy builds on our current financial position and sets out our overall financial goals for the 10-year plan. Our strategy focuses on strong fiscal management while addressing growing demands for increased capital expenditure in core infrastructure assets such as the wastewater, water supply, stormwater and transport networks.

The Local Government Act 2002 (LGA) requires us to manage our revenues, expenses, assets, liabilities, investments and general financial dealings prudently. In doing so, we're aware of the impact our costs and funding decisions have on our community. We're particularly concerned about the affordability of Council services, and have carefully considered this in developing our strategy, in particular regarding the impact of rates charges.

Setting the scene from the Annual Plan 2023-24

Annual Plan 2023-24 saw council having to deal with unprecedented levels of cost escalations, increasing the tension on our ever-challenging balance of debt and rates funding. Council made some tough choices to slow down capital investment, implement savings and increase the fees and charges as well as rates revenue funding to better manage these cost pressures. It was apparent through this process that the rates and debt levels would continue to have to rise significantly in the short term in order to address the infrastructure deficit and battle high-cost escalations across council services. These challenges have carried over into the 10-year plan and are summarised below:

1. Infrastructure deficit – Council owns a lot of ageing assets which require significant investment. While investing in core infrastructure is critical for supporting a city that thrives, there is a need to balance investment in key projects against financial sustainability and rates affordability.

2. Affordability constraints - Council must consider carefully what it invests in to ensure the best return on investment for the community. We don't want to put off intergenerational and strategic investments, but we do want to ensure we aren't unnecessarily adding to people's financial pressures. At the same time we also need to ensure we maintain the ability to pay for our everyday costs with everyday revenue, i.e. operational expenses are paid for by operating revenue.

3. Borrowing capacity – Due to the rising costs across the board, as well as the challenges around infrastructure deficits, the Council needs to consider the strategic outcomes it wants to achieve in the longer term and the best way to mitigate risks related to achieving those outcomes through prioritisation of the investment options.

<u>Strategic context and links to key aspects in the 10 year plan</u>

Significant forecasting assumptions

Infrastructure Strategy

Revenue and Financing Policy

Section B: Our financial position leading into the preparation of the 10-year plan

As at 30 June 2024, the Council's total assets are projected to be worth over $2.3 billion and include infrastructure assets, land and buildings; whilst total liabilities are projected to be around $0.6 billion and include borrowings and payables to suppliers.

In August 2023, Standard & Poors Global Ratings Agency affirmed the Council's AA credit rating but adjusted the outlook from stable to negative; reflecting in particular the higher borrowings.

Financial trend information of some key indicators from 2018 to 2024 are shown in figures 1 to 4; these include capital investment, net debt, revenue and expenditure. Our most recent audited Annual Report, for the period ended 30 June 2023, showed that Council achieved income of $213M and incurred operating expenditure of $241M, with a net operating deficit of $28M (per balanced operating budget definition). This result excludes the unbudgeted gain on revaluation of financial instruments of $3.6M and capital contributions of $31M.

Figure 1: Capital programme expenditure and delivery trend

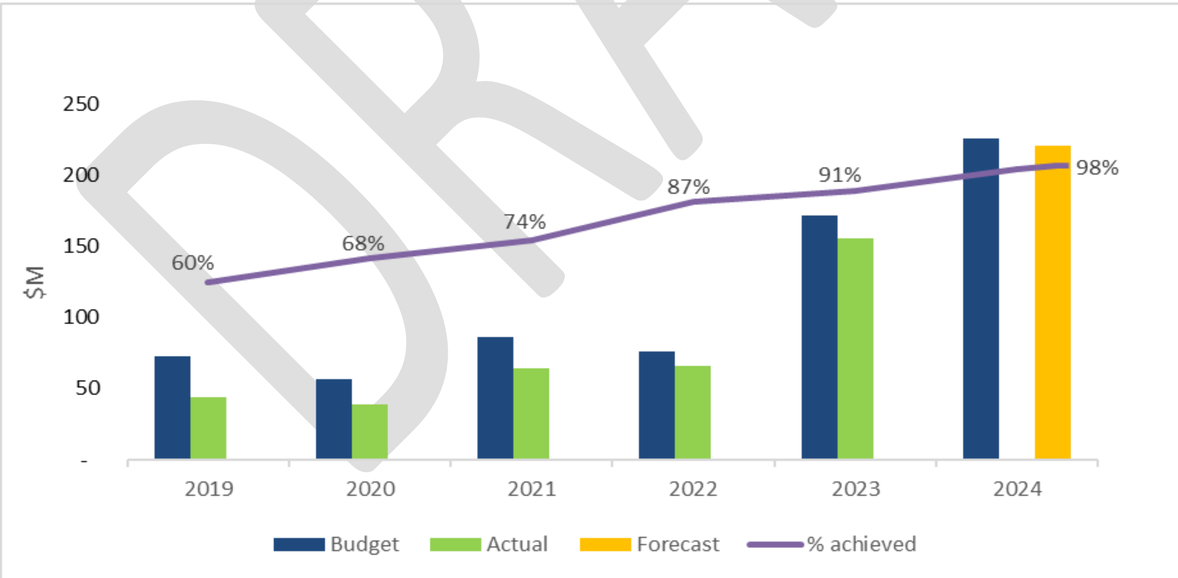


Figure 2: Council net debt

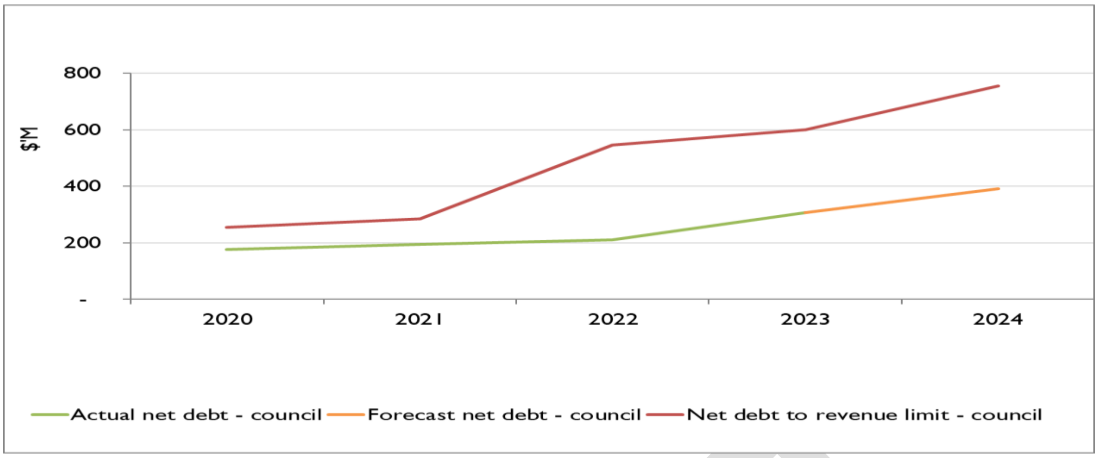


Figure 3: Sources of revenue trend

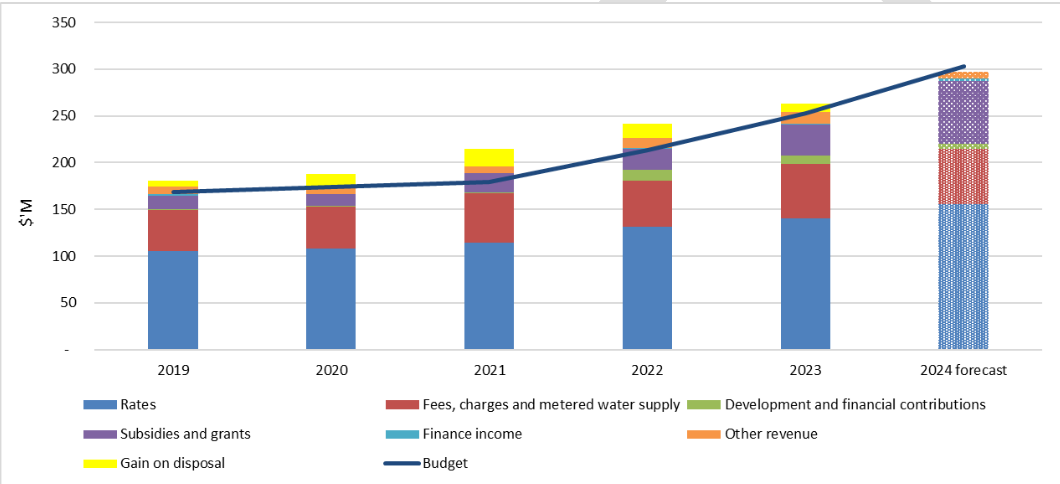
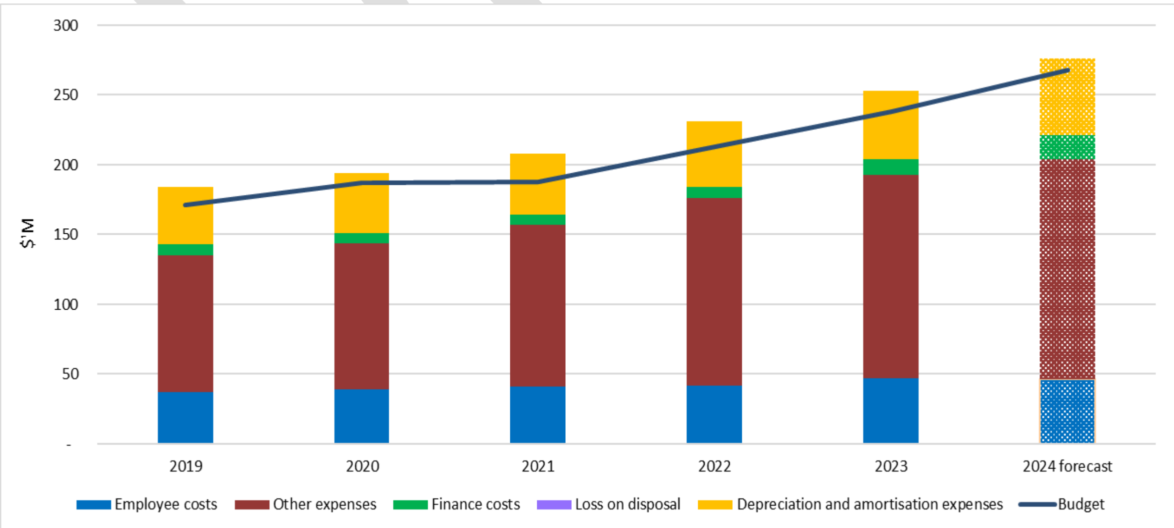


Figure 4: Operating expenditure by category trend



Section C: Financial strategy guiding principles for the 10-year plan

Our financial strategy is based on guiding principles which provide the foundation for prudent sustainable financial management, as detailed below.

Key financial Strategy guiding principles:

1) The financial strategy enables Council's contribution to the vision for Lower Hutt.

2) Fairness and equity
The funding of expenditure is equitable across both present and future ratepayers.

    a) Intergenerational equity – the cost of long term assets should be met by ratepayers over the life of those assets. This is reflected by debt funding new assets and funding the replacement or renewal of assets from rates(depreciation funding).

    b) Balanced operating budget – projected operating revenue over the lifetime of the LTP is set at a level sufficient to meet projected operating expenses (including depreciation), ensuring that current ratepayers are contributing an appropriate amount towards the cost of the services they receive or are able to access, i.e. 'everyday costs are paid for from everyday income'.

3) Prudent sustainable financial management – budgets are managed prudently and in the best interests of the city in the long term. Debt must be maintained at prudent levels and be affordable.

4) Ability to pay (affordability) – affordability is an important consideration as it ensures that the ability of our diverse community to pay rates is transparently considered as part of the decision-making process. Consideration will be given at both the macro level (i.e. generally affordable to most) and also at the micro level (i.e. for a specific individual where rates rebates, remissions or postponement policies may be required).

5) Value for money – any proposals must contribute to the strategic outcomes agreed with the community and the total cost must be reasonable. The cost effectiveness of the funding mechanism must be considered.

6) Prioritisation of investment choices – careful consideration is given to investment choices and options, with priority given to core infrastructure investment and 'invest to save' options.

7) Environmental sustainability - Funding decisions will consider community outcomes being sought, including wider environmental and climate change impacts.

8) Distribution of benefits – consideration is given to the distribution of the benefits from Council activities over identifiable parts of the community, the whole community or individuals (users). Where there are identifiable direct benefits the proportion of costs associated with these benefits should be covered by the user(s).

9) Growth pays for growth – the capital costs incurred to develop infrastructure that supports growth within the city should be primarily covered by those causing the growth and increasing the demand on Council infrastructure.

10) Good financial governance and stewardship
Good stewardship of Council's assets and finances requires Council to ensure that its actions now do not compromise the ability of future councils to fund future community needs. Under this principle:

a) Assets must be maintained at least at current service levels to avoid placing a financial burden on future generations.
b) Debt must not be used to fund operating expenditure other than in specific exceptional circumstances.
c) The level of debt is regularly reviewed to ensure that it is at a level that will not restrict a future council's ability to fund new assets through debt.
d) The consequential operational expenditure implications of capital expenditure decisions are considered.

Key considerations in developing the financial strategy:

A range of considerations have been applied to ensure the strategy meets the balanced operating budget and financial prudence requirements such as:

- A careful review of debt limit settings to ensure headroom is available to fund the impacts of a significant natural disaster, such as extreme weather events or earthquakes;
- The ability to fund the interest costs of debt;
- The approach to debt repayment with funding increased to support repayments;
- The approach to revenue generation being minimum increases to continue to fund services and meet cost pressures.
- The rates settings and limits imposed to meet rates affordability considerations;
- The review of projected depreciation expense and capital renewal expenditure, and the use of depreciation funding;
- A careful review of the balanced operating budget position (i.e. operating expenditure and operating revenue) and the long term broader financial impacts.

Section D: Capital expenditure programme

Capital expenditure is categorised into renewals (renewing existing assets), service improvement (new assets that improve the services provided to the community) and growth (new assets required to accommodate growth within the city). This financial strategy focuses on strong fiscal management whilst addressing growing demands for increased capital expenditure in core infrastructure assets such as the stormwater, wastewater, water supply and transport networks.

Over the next 10 years, Council plans to spend $2.6 billion on capital investment, 63 per cent of which is in the wastewater, stormwater and water supply area, and 21 per cent on transport. This significant capital investment will be funded largely by borrowings. This is a significant increase in investment from the previous 10-year plan of $1.2 billion and reflects the need to meet community expectations for our growing city in the context of the infrastructure deficit and factor in cost escalation. It should be noted that this higher investment is still lower than the recommended level by WWL for three waters. There is an option being consulted on with the recommended level of investment but would require higher rates increases to fund as we near our debt capacity constraints. There are risks associated with the lower investment as outlined in the Infrastructure Strategy. We need to remain mindful that although there is higher investment proposed under the preferred option, we still might not be able to get on top of the work required to prevent asset failure. While the focus of this plan is for 10 years, there are significant challenges beyond the period of this plan related to the deferred investment and how this will be funded.

Key investment in the plan includes:

1. three waters investment of $1.6 billion, which includes asset renewals of $939 million together with investments in reservoirs, a range of works to reduce flooding risks, works to improve environmental water quality, Infrastructure acceleration fund projects (stormwater and wastewater) and water meters etc. to name a few.
2. transport investment of $544M, including asset renewals of $149M together with investment for the Cross Valley Transport Connections project, Tupua Horo Nuku, Eastern Hutt road resilience etc.
3. investment in solid waste to the value of $58M, in city development to the value of $167M, in open spaces, and social, cultural and wellbeing to the value of $188M.

Total capital expenditure by council activity Figures 5, 6, 7 and 8 respectively show the cost of this programme by activity, spend per annum, the driver for the projects and the funding sources. This expenditure includes the cost of renewing existing assets that are coming to the end of their useful lives. It also includes the cost of improving existing assets and investing in new assets. Our asset management practices ensure we maintain service levels to at least current levels.

The significant increase in the capital programme, particularly in water services, also carries a level of uncertainty and risks to achievability. Wellington Water has been building capacity and capability over the last few years to improve delivery performance. Council has also been reviewing its organisational structure and making incremental changes through increased project delivery staff and the functions that support them. It is important to us that there are no delays to the programme as that may result in not meeting planned levels of service or greater costs in the long term.

Figure 5: Total capital expenditure by council activity

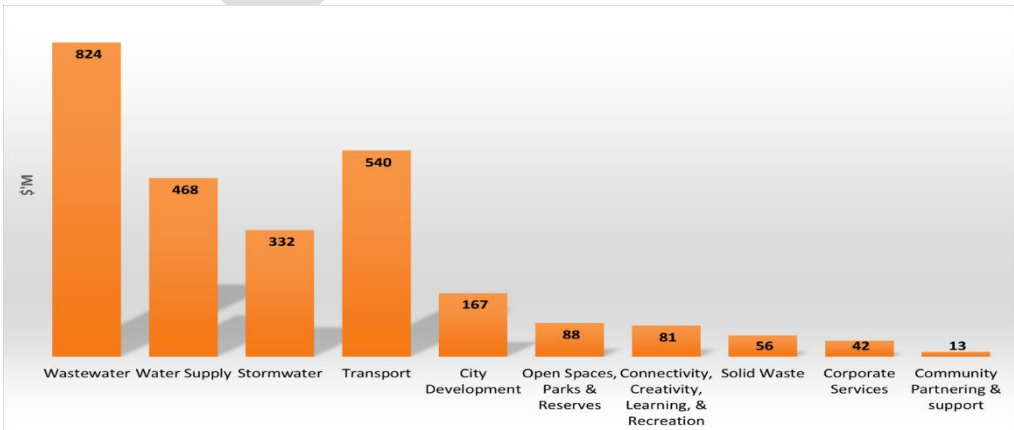


Figure 6: Planned capital investment per year over the 10 year plan

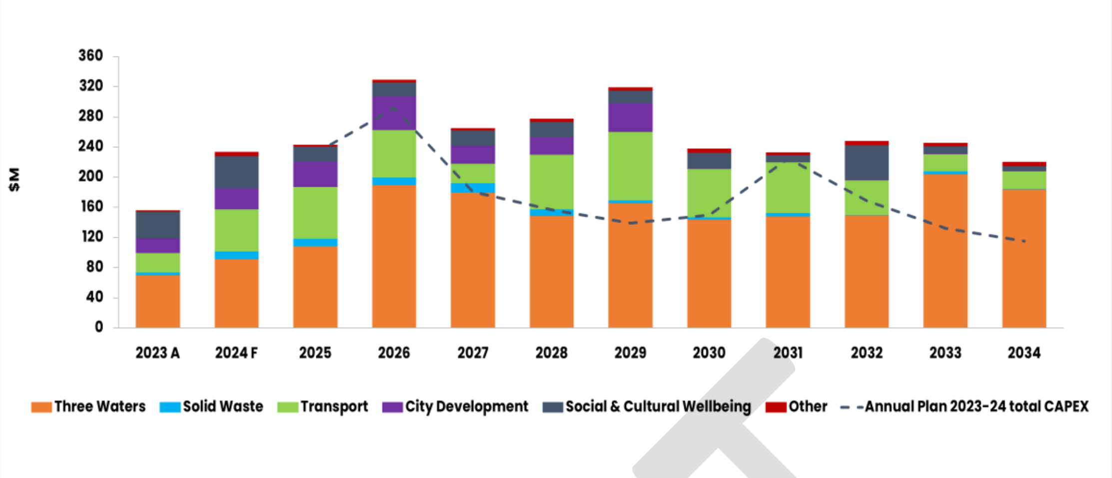


Figure 7: Total capital expenditure by driver

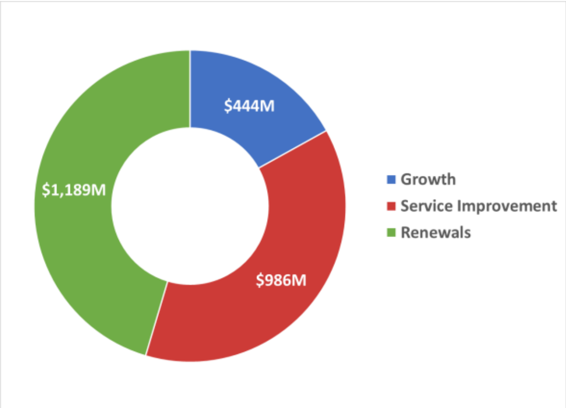
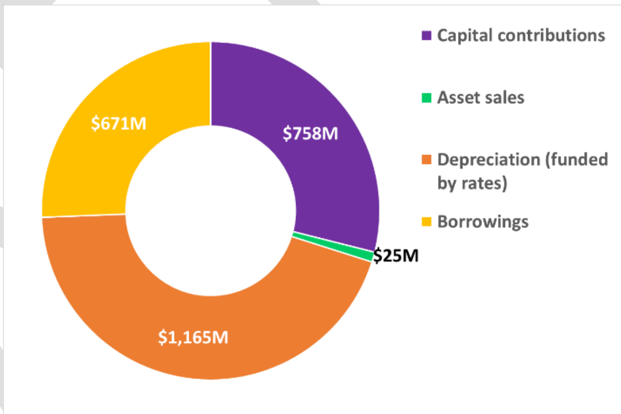


Figure 8: Capital expenditure funding sources



Asset management

Infrastructure deteriorates as it ages, increasing the likelihood of failures and disrupting service to customers. These failures also increase maintenance, operations and customer service costs. Planning to renew infrastructure that is reaching or at the end of its life reduces the risk of service interruptions and minimises maintenance costs. To support our budget forecasts, Wellington Water use age-based asset information to prioritise the areas most in need of renewals. Over the next 30 years, our goal is to reduce the renewals backlog and address future needs. Council is also working to better understand the condition of our assets in order to reduce the level of uncertainty and improve our overall understanding of the condition and expected life of asset.

Three waters: We received advice on our three waters assets based on the current information available to Wellington Water Limited (WWL). We are proposing to include a significantly higher capital budget for the maintenance, operations and renewal of these assets based on this advice. We have not included budgets at the levels recommended by WWL due to the constraints on debt and rates funding. This means that the available budget will be used for the most urgent jobs/projects which could mean longer times to resolve and address non-urgent jobs/projects and issues being resolved at a slower rate. The budgeted spend is however expected to result in improvements to the three waters network over the 10 years.

Transport: The Integrated transport strategy developed in 2022 has identified some key challenges for our transport network. This 10-year plan is a step towards addressing some of these and is expected to improve the overall condition of the transport network over the 10 years. Funding constraints have also played an important role in the planned investment for this plan. Furthermore government priorities are not yet finalised and further changes may be required in future plans to reflect these priorities.

Renewals (looking after what we have)

It is important the Council continues to renew/replace assets to ensure our assets are fit for purpose and deliver the level of service that is required. Our asset management plans identify the timing for renewals based on the condition of assets. An ongoing programme of condition assessment helps to build a detailed picture of assets and the necessary investment.

Forecast depreciation could be considered a reasonable estimate of annual renewal costs. If over time, renewals expenditure is approximately equal to depreciation, it can be reasonably assumed that the assets and services that they are providing are sustainable. Depreciation is however based on a number of assumptions and may not reflect the actual future asset renewal funding requirements (e.g., due to the long life of infrastructure assets, cost escalations, changes in scope or compliance requirements etc.).

Where there is surplus depreciation above the capital renewals level, this will enable debt to be repaid. New assets which have a long life will not generally require a replacement earlier in their life, so a depreciation surplus will be created which will enable debt to be repaid. The required funding will need to be borrowed when these assets come to the end of their useful life. The depreciation surplus would be dependent on the level of depreciation funding that is in place; for HCC this may be limited in the short to medium term but more certain in the longer term.

Based on current projections, while at an overall level the renewals are funded through depreciation (for the most part from year four onwards, refer figure 10) and any remaining surplus depreciation funded could be used to make debt repayments. By funding renewal expenditure, together with moving to a balanced operating budget (see Section G), this enables a financially sustainable asset replacement programme.

Figure 9: Summary of renewal expenditure by council activity

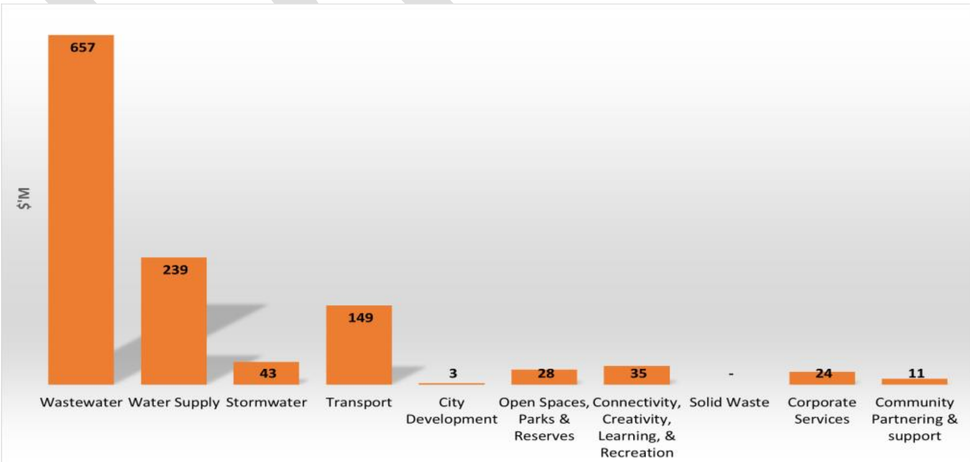
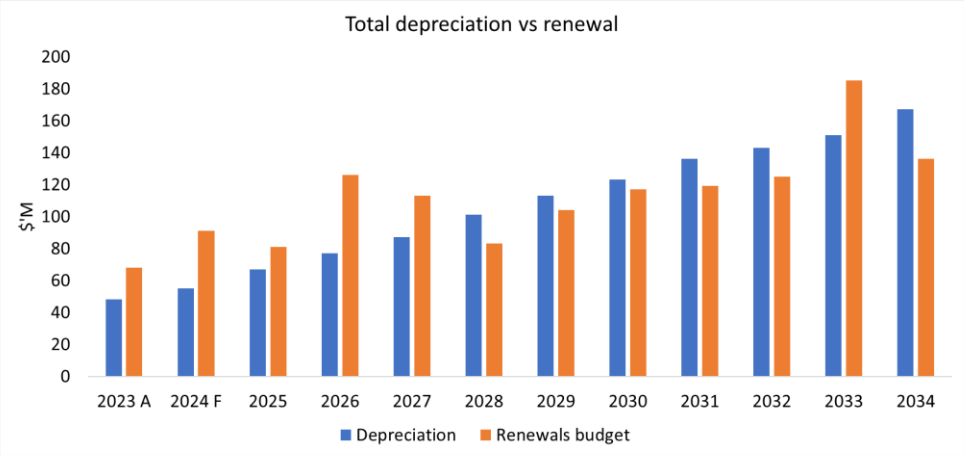


Figure 10 - Capital Renewals compared to depreciation



Growth

The population of the city at the 2018 Census was 104,532 (Source StatsNZ).
The population is estimated to have grown by around 8,497 people, an 8 per cent increase to the 2023 figure. Further increases of around 11,817 (10% per cent) people is expected from 2023- 2033. The growth in households is projected to be about 4,217 (10 per cent) over the same period. (Source Sense Partners)

Council's asset management plans and infrastructure strategy have taken these growth forecasts into consideration, and our existing assets, together with the growth projects included in the plan, will ensure the city continues to meet the levels of service outlined in this plan. Total growth spend for the 10-year plan is $444M; this amount represents the growth portion of all capital projects.

Council uses development contributions to allocate the costs of growth to ensure equity between developers and ratepayers. The projected revenue from development contributions is estimated at $172M over the period of the plan; this will be a funding source for the growth-related capital works programme. See the Infrastructure Strategy for further information on capital expenditure plans, together with asset information and service levels.

Section E: Operational expenditure

The Council is forecasting operational expenditure of $4.1 billion over the life of the 10-year plan, on average $408M per year over 10 years. This reflects the costs of continuing with the Council's programme to prioritise spend based on the key priorities (see Figure 11).

We are facing many cost burdens largely due to high inflation, interest rates, insurance, higher construction and resourcing costs. These significant economic pressures are set to continue to impact us and all councils up and down the country.

The key issues we are facing are largely as a result of:

1. growth – there will be more households in Lower Hutt, based on our growth assumptions of 1.1 per cent in the first year and 0.9 per cent thereafter per annum

2. depreciation and interest payments – the increased capital expenditure programme means corresponding increases in the costs of servicing these assets.

3. price increases – inflation and the factors that influence it will mean that it will cost increasingly more to do business. BERL forecasts that costs in general for the local government sector could increase by 22 per cent over the 10-year period of the plan.

Figure 11: Average operating expenditure per year over 10 years by Council Activity

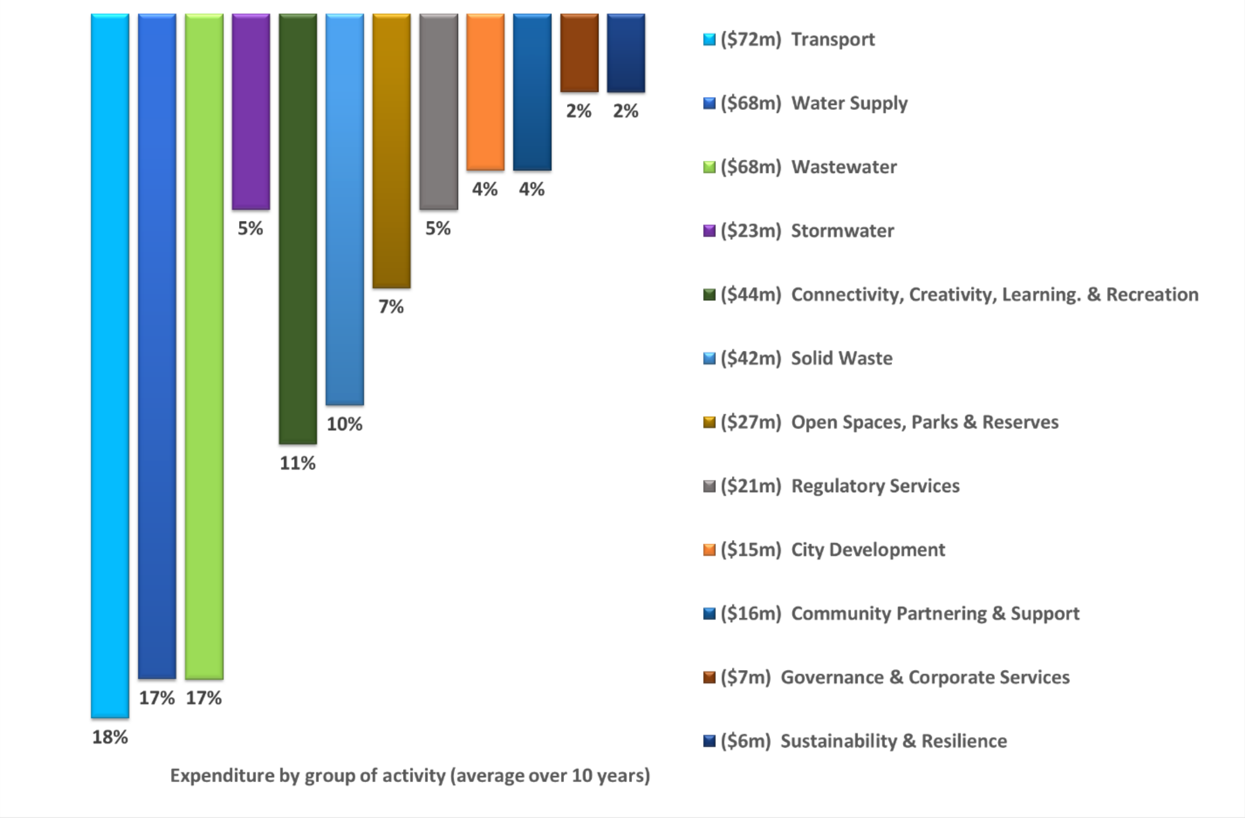
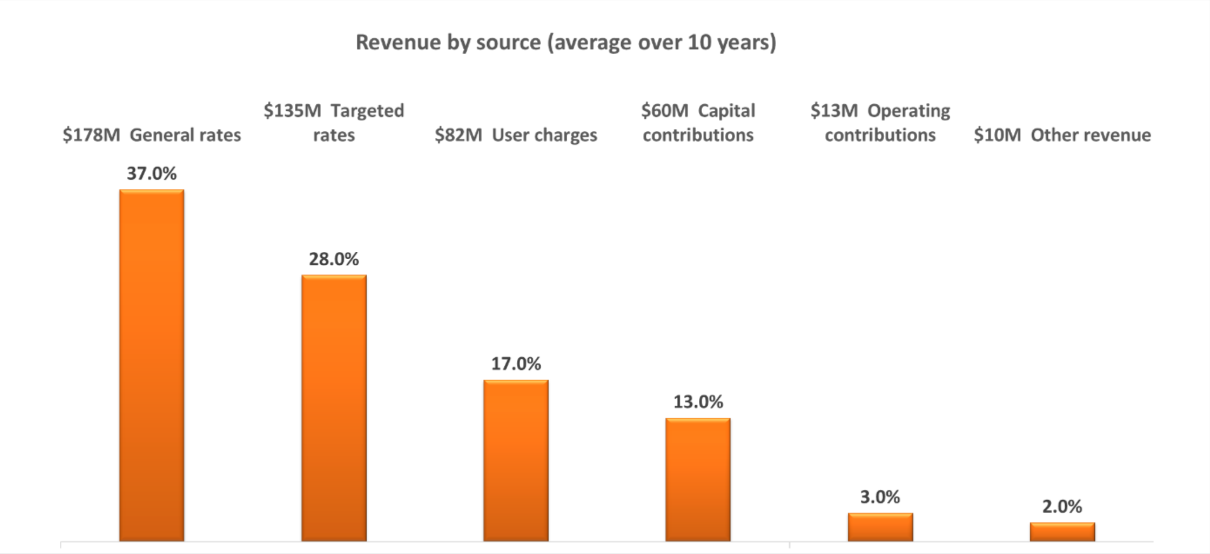


Figure 12: Revenue sources to fund operational expenditure (average over 10 years)



Through the previous 10-year plan and Annual Plan 2023-24 savings were identified and applied to budgets. Through September to October 2023, officers conducted base budget reviews which yielded $6.1M of savings over the period of the DLTP, which have been applied to budgets and had a favourable rates impact of 0.2% in 2024-25.

During November 2023, officers conducted further budget reviews to identify savings and revenue opportunities of $17.4M over the period of the DLTP, which were applied to budgets (favourable rates impact of 0.9% in 2024-25).

Council has also made a range of savings and spending cut related decisions on 27 November 2023 which has led to further $11.3M reduction over the period of the DLTP (favourable rates impact of 0.4% in 2024-25).

All these savings have an ongoing effect and also reduce the rating impact, Council will continue to drive for efficiencies and revenue opportunities to reduce the rates burden into the future.

Section F: Borrowings and investments

Borrowings are a key component of recognising the intergenerational equity principle and that the cost of long term assets should be met by ratepayers over the life of those assets. It is important that the amount of borrowings is prudently managed, whilst enabling continued investment in infrastructure and community assets to continue.

With the significant capital expenditure plans we will need to increase our debt to fund what is not provided for by way of capital subsidies, development contributions income and depreciation.

The projected debt profile is outlined in figure 13 which also highlights the much higher borrowing levels compared to the Annual Plan 2023-24. The Financial Strategy for the upcoming 10 years reflects increases to other funding sources such as development and financial contributions, higher rates revenue and fees and charges to help fund the cost of infrastructure. After taking other funding sources into account, increased borrowings are funding the capital investment programme. Net debt of $0.3 Billion as at June 2023 is projected to increase to a peak of just over $1 Billion in 2029-30. As outlined in figure 12, rates revenue is our major source of funding which is constrained due to considerations around affordability which in turn constrains our debt capacity. This is because the debt we take on is directly linked to the total revenue we recover, as there are specific limits we need to stay within as outlined in table 1 below. This means the higher the rates revenue we can generate, the higher the amount of borrowings we can take on and vice versa.

The increase in Council's debt is the result of funding major infrastructure improvement and renewals. The timing of the programme and the associated borrowing requirements has been carefully considered to ensure that this best meets the needs of the current and future generations. The proposed programme fully utilises the debt headroom capacity available whilst ensuring debt is managed prudently within the limits set.

Managing debt in a prudent manner helps the Council build resilience and sustainability, as it provides the Council with financial capacity to cope with exceptional circumstances. The Treasury Risk Management Policy outlines different measures the Council uses to limit its level of debt;

Table 1 summarises these. These limits are set at prudent levels and meet the requirements of the Local Government Funding Agency. Council has reviewed the limits as part of the development of this 10-year plan; the net interest to revenue and net interest to annual rates income limits have been increased to enable the funding of the increased investment programme (Figures 15 and 16).

Table 1 – Borrowing limits

Measure	Limit
Net interest to revenue	Below 15% (10% in 2024)
Net debt to total revenue	Below 250%
	Net debt can be increased to a maximum of 270% of total revenue at any time, provided that this is due to a significant natural disaster.
Net interest to annual rates income	Below 25% (20% in 2024)
Liquidity	Greater than 110%

Figure 13: Projected net debt compared to debt to revenue limit of 250%

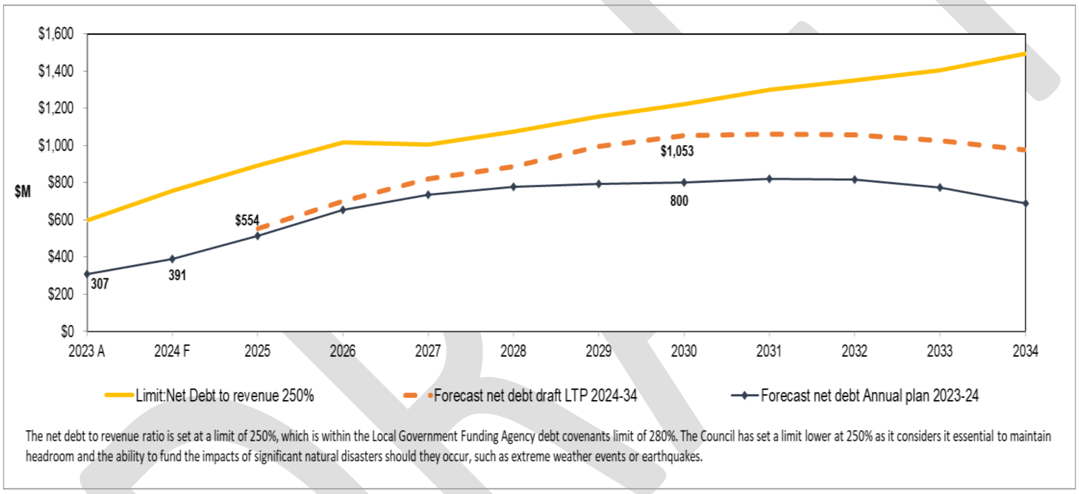


Figure 14: Projection of net debt to revenue ratio compared to debt to revenue limit of 250%

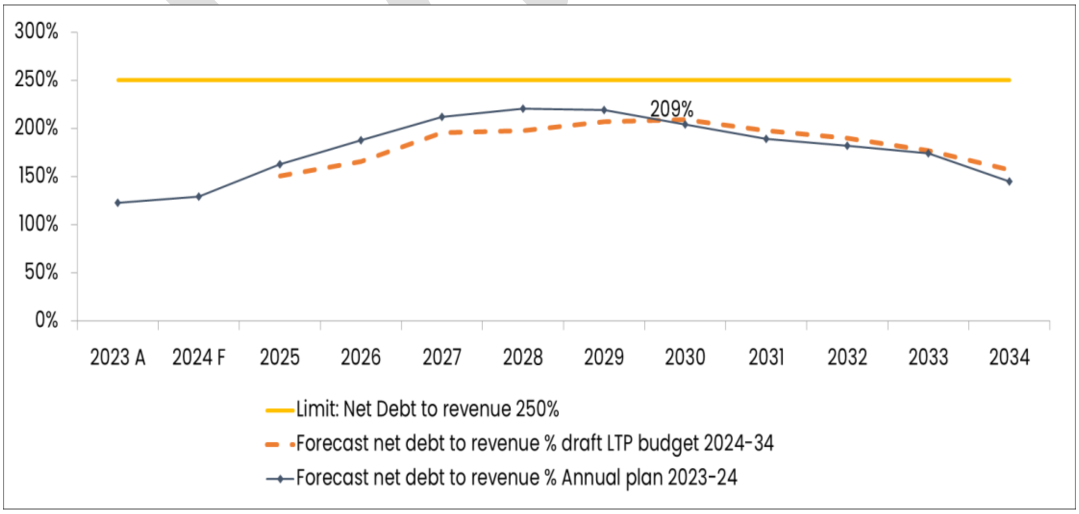


Figure 15: Projection of interest to revenue ratio compared to limit of 15%

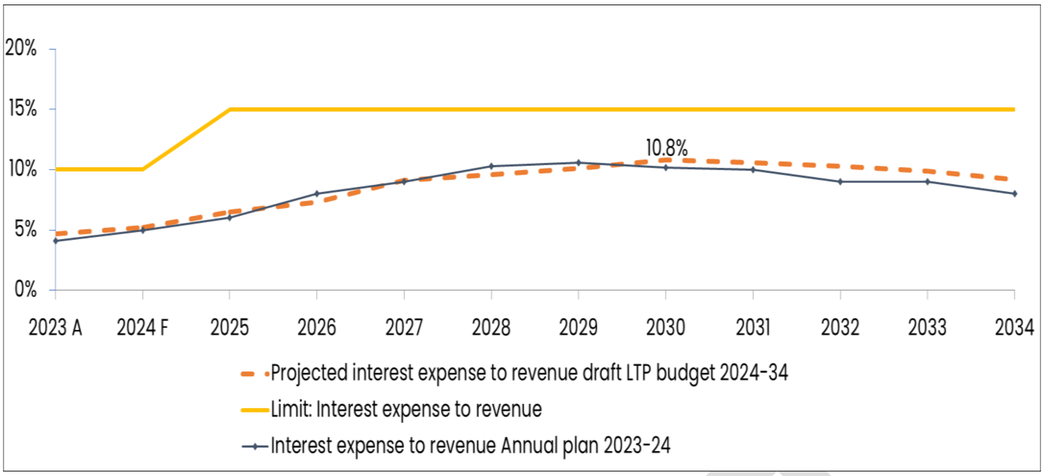
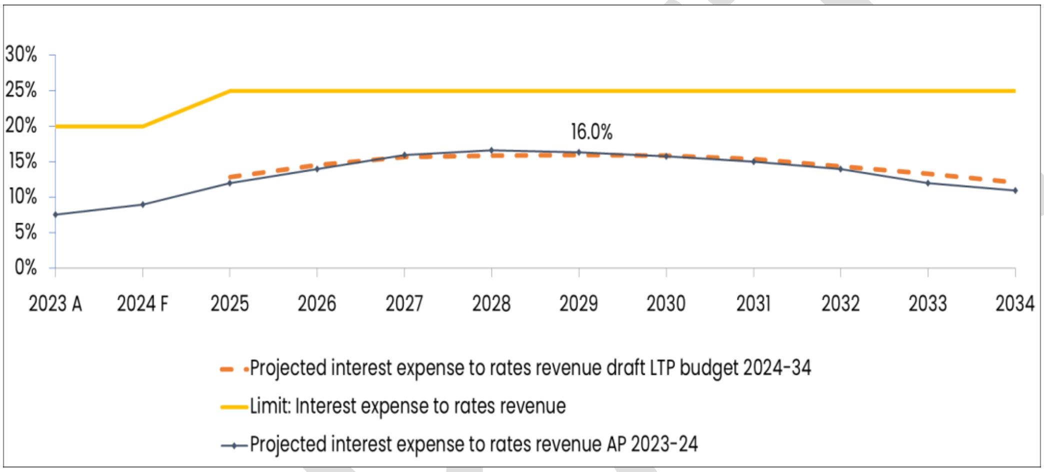


Figure 16: Projection of net interest to annual rates income limit of 25%



Managing our debt: We place reliance on a strong financial position to ensure we have capacity to borrow, both for forecast expenditure needs and any unforeseen requirements that may arise. We manage the risks proactively and ensure we have appropriate levels of debt in accordance with our debt limits, with no significant concentrations of debt repayment in any one year, ensuring working capital is maintained to meet ongoing commitments and surplus cash is invested or used to repay debt. We also focus on collection of monies owed to ensure no concentrations of credit risk exist.

Council secures borrowing by way of a debenture trust deed that provides security over rating income.

<u>Investments</u>

Council has investments in several Council Controlled Organisations (CCOs), Civic Financial Services Ltd, the Local Government Funding Agency, property and cash.

The 10-year plan assumes that there will be no material return on investments from the CCOs, but rather that profits generated will be applied to reinvestment in the business or to repayment of borrowings to the Council. Cash investments: Council maintains liquidity and credit facilities to minimise financial risk and maintain secure and cost-effective funding sources to meet financial needs. In managing its liquidity, cash is invested on short-term deposit to manage cash flows and maximise returns. Surplus cash is placed on call or term deposits as appropriate. Property investments: Council has a small property portfolio with which it seeks to achieve market returns. These properties are largely held for strategic reasons, such as the RiverLink project. A property sales programme exists and will continue to deliver sales; however, Council expects these to be relatively minor for the life of the Long Term Plan. For further details on borrowings and investments are available in our Treasury Risk Management Policy

Table 2: CCO investments

Entity	Shareholding/control %	Principal reason for investment	Budgeted return
Urban Plus Limited and Group	100%	Housing	Nil
Seaview Marina Ltd	100%	Marina services	$0.2M per annum
Local Government Funding Agency	0.4%	Borrowing	Nil
Civic Financial Services Ltd	4.27%	Risk management	Nil

Section G: Balancing the operating budget

A guiding principle of this financial strategy is about the importance of a balanced operating budget. This means that projected operating revenue over the lifetime of the LTP is set at a level sufficient to meet projected operating expenses, ensuring that current ratepayers are contributing an appropriate amount towards the cost of the services they receive or are able to access, i.e. 'everyday costs are paid for from everyday income'.

We need to move towards a sustainable position, balancing the budget over the medium term. The proposed capital investment programme and cost pressures in the LTP, together with limitations on revenue particularly due to affordability issues of rates, makes this very challenging. The proposed draft LTP projects a balanced operating budget position being achieved in 2028-29 (refer figure 17).

The Local Government Act 2020 (LGA) requires Council to budget each year for operating revenue at a level sufficient to meet operating expenses budgeted for that year. This is known as the "balanced operating budget" requirement. The LGA does allow councils to budget for a deficit, if it resolves that it is financially prudent to do so.

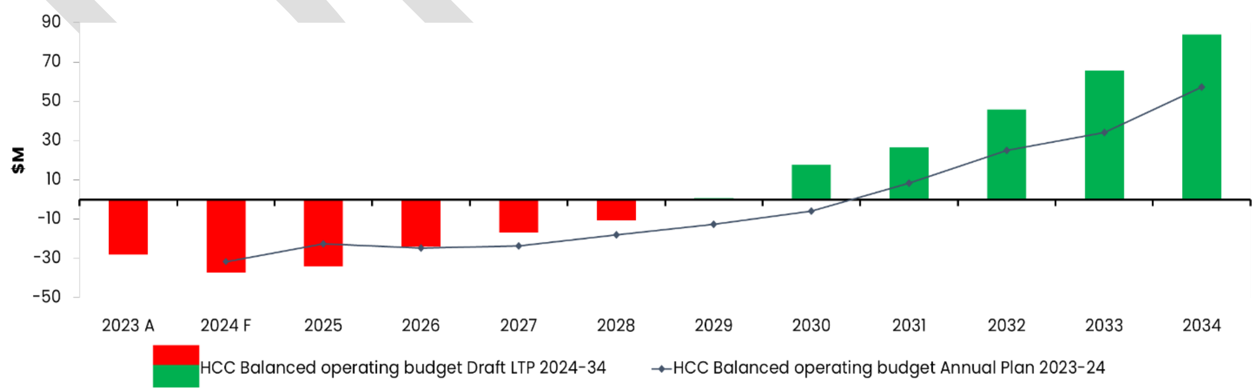
In assessing a financially prudent decision, consideration is given to:

- the estimated expenses of achieving and maintaining the predicted levels of service provision set out in the LTP, including the estimated expenses associated with maintaining the service capacity and integrity of assets throughout their useful life

- the projected revenue available to fund the estimated expenses associated with maintaining the service - capacity and integrity of assets throughout their useful life
- the equitable allocation of responsibility of funding the provision and maintenance of assets and facilities throughout their useful life
- the funding and financial policies adopted under section 102 of the LGA.

We acknowledge that we run deficits from a balanced operating budget perspective mainly due to revenues not covering the full cost of depreciation. Council will use the following financial levers to move progressively towards achieving a balanced operating budget: fees and charges, rating for depreciation, development and financial contributions, efficiencies, debt repayment and rates setting. The 10-year plan projects that Council will not achieve the balanced operating budget target for a number of years: until 2029-30, which effectively means we are borrowing to offset the funding shortfall. Council has considered the level of rates revenue in light of a number of factors, including the legislative requirement for financial prudence, as well as the economic environment and increasing cost pressures on households due to the high cost of living(see Section H). Setting rate levels to achieve a balanced operating budget earlier would increase the rates burden for ratepayers, and there are concerns about affordability. Adopting some smoothing of the impact over a number of years results in the best fiscal and sustainable outcome. The projected balanced operating budget position provides a pragmatic balance between managing the pressures on current ratepayers and ensuring the Council remains financially sustainable into the future, whereby the actions of today do not significantly impact unfairly on ratepayers in the future. It is financially prudent and in line with the legislative requirements due to the longer term plans for rates revenue generation and repayment of debt occurring to avoid a significant impact on future ratepayers. The level of funding also enables Council to maintain its levels of service and undertake asset renewals, and is consistent with the Revenue and Financing Policy

Figure 17: Projected HCC balanced operating budget position



Council meets the legislative balanced budget requirement, as defined in s100 of the Local Government Act 2002, over the 10 years of the plan. Council is projecting to receive significant capital grants and subsidies which are required to be applied to capital projects and cannot be used to fund operational costs over this period. The Hutt City Council balanced operating budget is therefore as defined in the Local Government (Financial Reporting and Prudence) Regulations 2014 and modified to exclude revenue from NZ Transport Agency Waka Kotahi's capital improvement subsidies and other capital grants. You can refer to our Financial Strategy for further details.

Section H: Rates and rates increases

Rates revenue is the amount Council requires to provide services to residents and ratepayers after allowing for other income, such as fees and charges, grants and subsidies. The Council has a high dependency on rates revenue as its principal source of income. As Figure 12 shows, 75 per cent of operating expenditure is funded from rates over the life of the 10-year plan. Affordability of rates is a key principle of the Financial Strategy. It was front of mind as the 10-year plan was developed and rates increases considered. The Revenue and Financing Policy has been carefully reviewed; however no material changes have been made to the policy. A rates remission for financial hardship has been proposed for the first three years of the 10-year plan to ease the burden on those households impacted by the current economic environment. Council has determined its rates increases based on a number of factors, including the levels of service it wants to provide and its capital programme. The rates revenue increases reflect the guiding principles and issues referred to earlier in this strategy, including the challenge of achieving a balanced operating budget. The economic environment with a number of legislative reforms underway, new government with potentially new priorities and high inflationary pressures introduces further uncertainty and the possibility of further financial challenges.

Due to the affordability constraints on rates revenue and limit on our ability to debt fund, there are a range of risks that the levels of service could be impacted in some areas due to cost pressures that exceed our assumptions around inflation in the future.

Some level of smoothing of rate changes can provide more certainty to residents; Council considers this to be a better approach. Council has applied this approach in its projected rates increases for the 10-year plan. The Water Services Reform legislation in place, led by the previous government, is a significant consideration. Potentially all (or some) of the current three waters assets and related borrowings could transfer from council balance sheets to a new Water entity. Due to the change in government there is a lot of uncertainty as to what the future holds in this area; as a result, the 10-year plan assumes that Council will retain the current three waters infrastructure. The projected rates increase have been considered in light of this. This allows us to provide certainty to our community around the rating impact and the planned levels of investment. This assumption will be advised as new information becomes available.

The LGA requires the Council to quantify its limits on rates increases, see Table 3. The rates revenue increases below have been It is important to distinguish between the increases in rate revenue from year to year and the average rate increase. Our revenue does not only reflect the impact of rates increases to the average ratepayer; it also includes rate revenue received from the growth in new rateable properties each year, which are expected to be about 1.1 per cent for the first year then 0.9 per cent per annum thereafter. Further information about the indicative rating impact for the average ratepayer by category and suburb is available in the Rates Funding Impact Statement (refer section X).

Table 2: Summary of proposed rates revenue increase limits and projected rates

	2024/25	**2025/26**	**2026/27**	**2027/28**	**2028/29**	**2029/30**	**2030/31**	**2031/32**	**2032/33**	**2033/34**
Projected rates income[1] ($millions)	182.1	203.7	228	255.1	285.5	319.4	345.3	373.3	403.5	436.2
Rates revenue increase[2]	16.9%	12.0%	12.4%	9.5%	11.0%	11.0%	7.2%	7.2%	7.2%	7.2%
Rates revenue increase for new Food and Green Waste service[3]				2.0%						
Local Government Cost Index benchmark	3.4%	2.2%	2.3%	2.3%	2.2%	2.1%	2.0%	2.0%	1.9%	1.9%
Assumed growth in rating base[4]	1.1%	0.9%	0.9%	0.9%	0.9%	0.9%	0.9%	0.9%	0.9%	0.9%

Notes:

1) These figures include inflation but exclude GST.
2) These figures do not take into account additional income from new properties in the city each year. Property growth is assumed to be around 1.1% in the first year then 0.9% annually.
3) Targeted rates for introduction of the new Food and Green waste service will be consulted on through the Long term Plan 2024-34. This service is required to meet longer term waste minimisation goals.

Appendix 1: Further explanation about our approach to the balanced operating budget

The Local Government (Financial Reporting and Prudence) Regulations 2014 established eight benchmarks against which all councils must report. One of these benchmarks is the balanced operating budget, defined as 'Council Revenue excluding development contributions, vested assets, gains on derivatives and revaluations of property, plant and equipment as a proportion of operating expenses – excluding losses on derivatives and revaluations.

This definition includes Waka Kotahi NZ Transport Agency capital subsidies as revenue and assumes councils fully rate for depreciation. Depreciation spreads the capital cost of assets over their useful lives, so that each generation of ratepayers pays for their share of the use of the asset. Not fully funding for depreciation may place a burden on future ratepayers, who have to pay for the asset replacement. Funding depreciation supports the intergenerational equity principle, whereby everyone who benefits from use of an asset pays for their share over the asset's useful life. By rating for depreciation, we are providing cash to fund the capital renewal programme. Depreciation is, however, based on a number of assumptions and may not reflect the actual future asset renewal funding requirements (e.g., due to the long life of infrastructure assets).

For our roading assets, it is not necessary to fully fund depreciation, as we receive a Waka Kotahi NZ Transport Agency capital funding subsidy. We need to provide funding for 'our share' of the expenditure. Council has some significant projects, such as the Cross Valley Transport Connections and cycleways programmes, which we have assumed will be funded by Waka Kotahi NZ Transport Agency in the financial projections. The Waka Kotahi NZ Transport Agency funding and central government grant funding of the capital improvements and growth is significant, at $356M. In assessing our balanced operating budget target we have applied the Local Government (Financial Reporting and Prudence) Regulations 2014 definition, modified to exclude the Waka Kotahi NZ Transport Agency capital improvement subsidies from the calculations of revenue. The reason for this Waka Kotahi NZ Transport Agency adjustment is that the funding is not available to meet our day-to-day operational costs. In a similar way we have also modified the definition of revenue to exclude central government co-funding for various projects.

Understanding the operating surplus/(deficit)

Figure 18 shows a comparison of the projected operating results based on three different methods: financial accounting standards (orange), the local government balanced operating budget benchmark method (green) and the Hutt City Council balanced operating budget method as described in Figure 17 (blue).

The projected financial accounting results (orange) include non-cash items such as 'income' from vested assets and the impacts of revaluations of assets resulting in three-yearly peaks. These accounting results reflect the accounting position as meeting all the Public Benefit Entity International Public Sector Accounting Standards (PBE-IPSAS) reporting standards. The large spikes in favourable results are a result of the accounting requirement to revalue assets, which is assumed to occur every three years. Although there are projected accounting operating surpluses for most years of the plan (orange), and projected balanced operating budget benchmark surpluses (green), the Hutt City Council balanced operating budget target shows deficits until 2028/29. This is because part of the income we receive is from Waka Kotahi NZ Transport Agency in the form of a subsidy for expenditure on our roading network. The subsidy is to cover both operating and capital expenditure. We also receive capital grant funding tagged to specific capital spend.

The capital components of the above funding need to be spent on capital items and is not available to meet the day-to-day operational costs. This funding is reflected in the orange and green lines and hence the projected results are more favourable. In the Hutt City Council balanced operating budget projection, the ring-fenced funding for Waka Kotahi NZ Transport Agency funded capital improvement works has been excluded, as well as central government grant funding tagged for capital projects. Excluding this ring-fenced funding from the operating results provides more accuracy in terms of the projected underlying operating result.