

# Financial Strategy

## Balancing unprecedented city growth with good financial management

Over the last three years the Council has improved its financial position but higher than expected city growth has meant this improvement has been slower than planned. The city continues to experience unprecedented growth which has put pressure on existing infrastructure and services. The significant demand for new affordable housing in Hamilton means growth will continue over the next 10 years. The financial strategy has been adapted to allow for a sustainable response to growth that is cost effective to existing ratepayers.

In 2017/18, everyday revenue is not enough to cover the everyday costs of running the city which means the balance is being paid for by debt. A key initiative of this 2018-28 10-Year Plan is to ensure everyday costs pay for everyday revenues by July 2020. For the next two years the average rates increase to existing ratepayers will be an average of 9.5% before reverting to 3.8% thereafter.

As a response to city growth, in the first year of this plan the Council will embark on its biggest ever capital programme. It also includes an increased investment in maintaining the city's existing assets. To fund these initiatives Debt will increase but will stay within a prudent debt to revenue limit of 230%.

By budgeting within these rates and debt limits, the Council will better maintain existing assets, can increase its investment in improving services to the community and provide for a growing City in a prudent and sustainable manner. Debt is an effective way to ensure these costs are shared appropriately across generations.

## Debt

### Debt Limit

The debt to revenue ratio will remain below 230%.

The Council plans to invest in its largest capital programme ever. This includes an increase in spending on community infrastructure, on renewing existing assets and on building a bigger city in response to the challenges of growth.

The limit of 230% is higher than has been set in the past six years so that the Council can respond quickly to the City's future housing demand projections.

Remaining under this 230% limit supports the Council's strong credit rating (AA-) and still provide capacity to fund any unforeseen events.

**Table 1: Debt to Revenue Ratio**

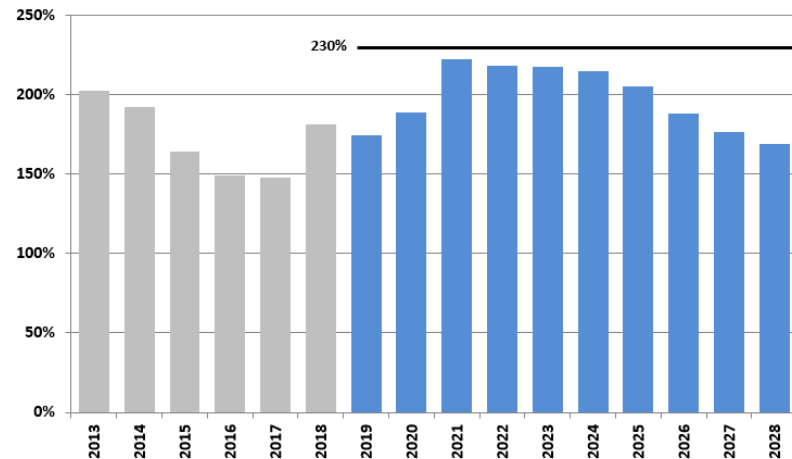
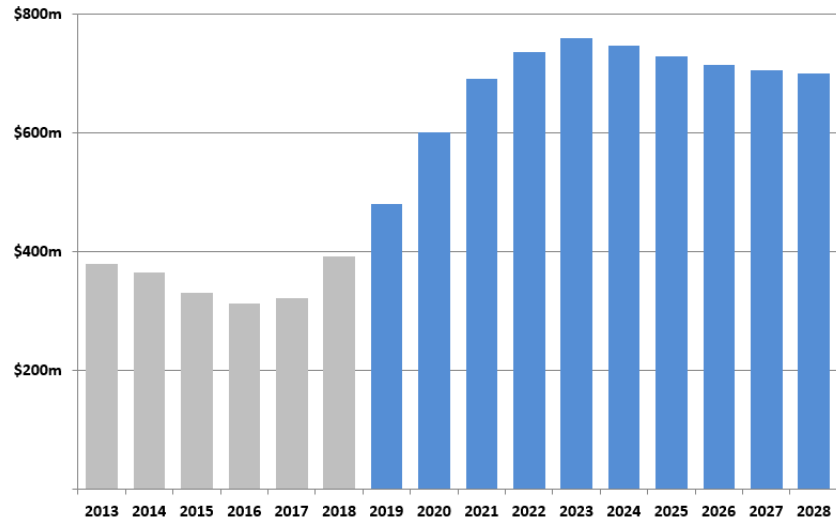


Table 2 shows actual net debt from the financial years ending 30 June 2013 to 2017 with a forecast for 2018. Projections from 2019 to 2023 show debt increasing to fund the \$1.2 billion infrastructure investment needed to respond to growth over the next 10 years. Debt will rise to a peak of \$760 million in 2023. Maintaining rates increases from 2021 onwards at 3.8% will create surpluses to repay debt. By 2028 debt is reduced to \$700 million. After 2023, debt will be reduced with a continuation of rates increases at 3.8%, while still maintaining an \$816 million investment programme over the 5 remaining years of the 2018-28 10-Year Plan.

By 2028 the Council will have \$250 million of debt capacity within the 230% debt limit. Debt beyond 2028 should continue to reduce so that sufficient debt capacity is available for a future infrastructure investment.

**Table 2: Net Debt**



Council debt includes a Housing Infrastructure Fund (HIF) loan from central government. This provides \$180 million interest free for 10 years, providing a significant benefit to interest costs of \$65 million over the interest free period.

The HIF loan is no different from other debt when considering the Debt to Revenue 230% debt limit and the impacts of debt on the Council’s credit rating.

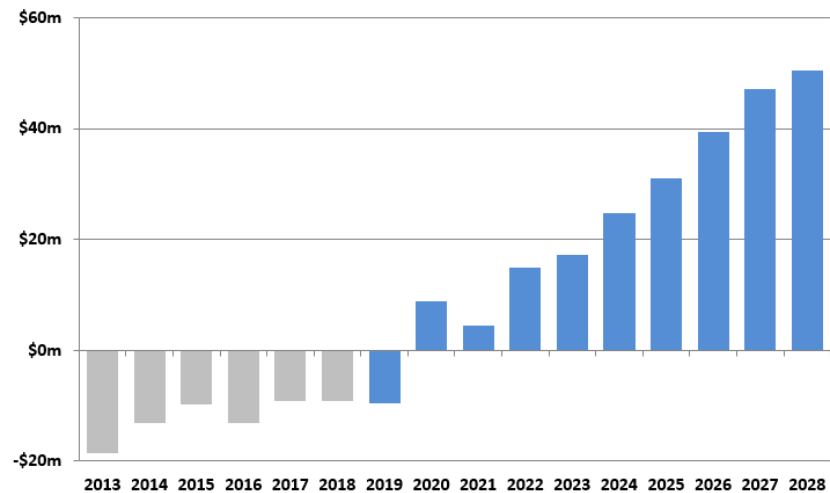
## Paying for the city’s Everyday Costs

Everyday costs should be paid for from everyday revenues.

If the Council fails to achieve this, these costs are funded by increasing debt. This means existing ratepayers are not paying for some of the services and amenities being provided to them. Using debt to fund everyday costs also means future ratepayers will pay for this cost and the extra interest. This is not prudent or sustainable.

Council must operate with surpluses if it is to repay debt and continue to invest in the future by maintaining existing assets and building new infrastructure for a growing City. This financial strategy enables this from 2019/20 onwards.

**Table 3: Everyday costs and revenues**



To do this sooner than 2020 would require an average 16% one-off rate rise in year one and 3.8% onwards from year two. In considering this, the Council has decided it is more appropriate to spread the increase over two years at an average of 9.5% in 2018 and 2019 and 3.8% thereafter.

The Council has adopted a new more conservative measure of everyday costs and revenues. The 2018/19 measure is even more conservative than the Government’s Balance the Books measure. Excluded from the new measure are capital items and extraordinary operating items that would not be considered by ratepayers as appropriate everyday costs or revenues of running the City. The result is a more transparent view of what it would normally cost to run the City.

## Rates

### Rating Limits

#### Rate Increases

Average rate increases to existing ratepayers will not exceed 9.5% in 2019 and 2020 and then 3.8% from 2021.

#### Total Rates

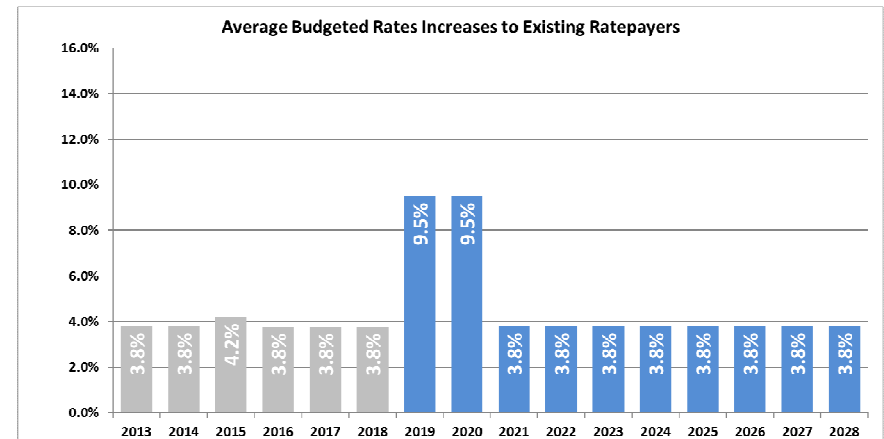
Rates will not exceed 0.627% of Hamilton’s rateable capital value.

After making its budget decision, capping debt and determining that it was a priority that everyday costs are paid for by everyday revenues the Council has determined its rates limits.

Rather than addressing the revenue shortfall with a one-off 16% rate increase to existing ratepayers, the Council has decided to spread this rate increase over two years at 9.5% each year. Rate increases from 2020 are again proposed at 3.8%, which is a sustainable level that allows for maintenance of existing assets and services and repayment of debt.

When including new ratepayers from new housing developments the Council’s total rates revenue is budgeted to increase 12% in 2018/19 and 2019/20 and 6% per year to 2028.

**Table 4: Average rates increases (to existing ratepayers)**



## Growth

Managing the unprecedented growth that is forecast is a significant challenge but also a great opportunity. Growth brings big benefits to the city. More people are wanting to live here and this attracts businesses, events and investment.

With this growth comes the need for new investment in infrastructure and this is expensive. This presents a financial challenge to the Council. A key guiding principle in the development of this 2018-28 10-Year Plan has been to more closely align those that benefit from growth to paying for that growth. This includes ensuring developers and new ratepayers pay an appropriate share.

Growth rates were relatively flat from 2008-2012 following the global financial crisis. However, since 2015 growth has accelerated much faster than anticipated in the 2015-25 10-Year Plan.

In this 2018-28 10-Year Plan, the Council has adopted the Low series of population projections provided by the National Institute of Demographic and Economic Analysis. This translates to the Council needing to supply 12,500 new dwellings over the next 10 years and 32,000 over the next 30 years. Currently there are 58,000 dwellings in Hamilton. The population has been projected to grow from 165,000 in 2018 to 187,000 in 2028.

Dwelling projections have been used to prepare a 30-year demand forecast for the 2018-2048 Infrastructure Strategy and the related capital expenditure programme for the 2018-28 10-Year Plan has been prioritised from this forecast.

**Table 5: Capital Expenditure**

Activity Group	2018-28 10-Year Plan			
	Growth (\$000)	Improve Service Levels (\$000)	Renewal (\$000)	10-Year Total
Wastewater	248,202	35,414	104,747	<b>388,363</b>
Stormwater	91,451	40,060	10,012	<b>141,923</b>
Transport	634,953	82,290	182,212	<b>899,455</b>
Water Supply	111,065	15,434	100,577	<b>227,076</b>
Other	81,662	53,744	171,188	<b>306,594</b>
All Activity Groups	<b>1,167,333</b>	<b>227,342</b>	<b>568,736</b>	<b>1,963,411</b>
External Funding (excluding Development Contributions)				<b>357,858</b>

Table 5 shows the total cost of projects over the period of the 2018-28 10-Year Plan categorised by type of expenditure. Growth capital expenditure provides new or improved assets which supports more residents to live in our city. Capital expenditure to improve service levels is where we are investing in new assets to service the existing population; and renewals restore our existing assets to their original function or capacity.

There are additional operating costs, such as depreciation, (mostly after 2020) associated with adding new assets. These costs are absorbed in the proposed 3.8% rates increase limit.

*Risk of Growth being higher or lower*

Should growth be lower than forecast revenue budgets for rates, building consents, resource consents and development contributions may not be met. This will

constrain borrowing as the debt limit of 230% is calculated at 2.3 times revenue. The Council would need to reconsider the appropriateness of the capital programme.

Should growth be higher than forecast revenue would be higher. Council would need to consider the speed and timing of the capital programme to maintain the housing supply.

**Unplanned Events**

The 2018-28 10-Year Plan provides for the everyday maintenance of assets and the renewal of assets at the end of their economic life. Unplanned events require earlier than planned investment (e.g. civil defence emergencies, natural events, fire, theft, and safety concerns). These events, if they occur, could result in significant unplanned operating and capital costs.

With the Debt to Revenue limit at 230% the Council has access to a further 20% (\$54 million in 2019). This debt capacity could be used to fund the consequences of unplanned events.

Collectively with other Waikato councils, the Council has an insurance programme through Local Authority Shared Services Ltd (LASS). This programme will fund some operational costs (e.g. business interruption) and capital costs where a claimable event occurs.

All councils in the LASS group have material damage insurance and infrastructure insurance using a ‘maximum probable loss’ approach rather than reinstatement value for all properties. This policy has the benefit of spreading risk across a wider geographical area. Maximum probable loss is the anticipated value of the biggest monetary loss that might result from an event, whether natural or otherwise.

Additionally, the Council has a layer of insurance to ensure appropriate cover for key assets including the five Waikato River bridges, key transportation bridges and underground infrastructure. The water and wastewater treatment plants, reservoirs and pump stations are fully insured including increased costs of operation through business interruption during a disaster event.

## Investments

The Council holds investments in companies, a trust, property and cash.

### *Investments in Companies and a Trust*

The Council is an equity holder in six companies and one trust. The principal reason for holding an equity interest in these investments is to achieve efficiency and community outcomes rather than for a financial return on investment. The Council holds shares in the following companies and trusts:

**Table 9: Council's Shareholdings**

Company	Shareholding %	Principal reason for Investment	Budgeted return
Hamilton Properties Ltd	100.00	Protect tax losses	Nil
Waikato Regional Airport Ltd	50.00	Economic development	Nil
Waikato Innovation Growth Limited,	100.00	Economic development	Nil
Waikato Local Authority Shared Services Ltd	24.58	Efficient government	Nil
New Zealand Local Government Funding Agency Ltd	8.30	Borrowing	\$100,000 per annum
Civic Financial Services Ltd	3.17	Risk management	Nil
Vibrant Hamilton Trust	100.00	Community funding	Nil

The Council has no plans to change its shareholdings, though in accordance with good practice this is reviewed regularly.

In July 2017 following discussions between the Vibrant Hamilton Trust and the Council, the Council resolved to support the views of the Trustees that the Trusts funds should be granted by the Trust to significant projects. The Council has budgeted for a significant grant to be made to the Waikato Regional Theatre. This grant could lead to the winding up of the Trust.

### *Property Investments*

The Council's Economic Development group of activities includes property investment activity. Property investments are divided into two categories:

- Municipal and Domain Endowment Properties, and
- Municipal Endowment Investment Properties.

The Council's objective is to maximise the return from both categories, however due to historic arrangements the return on endowment properties is below market rates.

Expected rate of return on property value for the two categories is 3.5% on the Municipal and Domain Endowment Properties, and 7% on Municipal Endowment Investment Properties.

The Council from time to time will buy and sell endowment properties in the portfolio to improve financial returns. Surplus cash is held in the Municipal or Domain Endowment Fund and is available for reinvestment in property. All endowment transactions are governed by the Council's investment and endowment policies.

### *Cash Investments*

Council holds cash for three main reasons:

- To support the balance of reserves.
- To ensure strong lines of liquidity and access to cash. Cash is supplemented by committed banking facilities. In the present financial markets, holding cash is a cheaper option than is available through committed facilities.
- To provide the funds for maturing debt.

Cash is invested on short-term deposit to manage cash flows and maximise returns. The Council targets to exceed the average 90-day bank bill rate.

### *Other Investments*

As part of borrowing from the Local Government Funding Agency, the Council is required to invest in financial bonds with the agency. The Council will receive interest on these bonds.

## Policy on Securities

To borrow money the Council must offer its lenders security, just like residents do with their mortgage. Like most councils, debt is secured against rates income.

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

The Council may offer other security, including physical assets, in certain circumstances.

The full policy on giving securities can be found in the investment and liability management policy on the Council's website.