

# Draft Amended Financial Strategy

## 1. Overview

The challenge that the City faces over the 2016-2025 period and beyond is funding the rebuild and restoration of the City. This means returning the levels of service to roading, water, waste water and land drainage to at least their pre-earthquake condition, as well as meeting community expectations on facilities and services. There is the further challenge of funding the replacement of the underground pipes first installed in the building boom of the 1950s and 1960s and which will reach the end of their useful life within the next 30 years. This expenditure challenge is exacerbated by uncertainties around the quantum and timing of funding sources.

Fundamentally, the financial strategy needs to solve the relationship between the expenditure required to deliver levels of service, and the available funding levers of rates, debt, and release of capital from CCHL's investment portfolio. The four factors are inter-related and movement of one needs to be balanced by movement in at least one of the other variables. For example, if rate increases are reduced then some combination is required of reduced expenditure, more debt, and/or more capital released. As a further example, if less capital is to be released then some combination is required of reduced expenditure, higher rates or more debt.

The draft amended financial strategy that follows presents a solution to these challenges and outlines the key financial parameters and limits that the Council will operate within over the remaining nine years of the Long Term Plan (LTP).

In the period following the release of the LTP, Council staff have further updated all capital projects with better cost estimation and timing. In addition the timing of the overall programme has been smoothed to better reflect our ability to deliver. The net effect is a reduction of \$466 million over the first three years, (inclusive of the current year), but a minimal reduction in the programme of \$167 million over the original ten year plan. This may place additional risk around some levels of service but we will address this through continually reassessing the priority of critical projects where circumstances allow. This is further addressed in section 2b, below.

In addition we've incorporated the better than planned financial results in 2014/15, the insurance settlement, and a reduction in the estimated cost of SCIRT repairs, (partly offset by Cost Share Agreement changes).

Operational savings which have arisen from the Great for Christchurch project and the Fit for Future restructure have been introduced progressively over the first three years and maintained thereafter. The total saving over the remaining LTP period is \$201 million.

These changes have enabled rate increases to be held to 5.0 per cent for each of the next three years, (previously 7.18 per cent, 6.98 per cent and 5.74 percent), (refer graph in section 4). The changes have also enabled the capital release from CCHL to be reduced by \$150 million, with the remaining \$400 million rescheduled from 2016/17 and 2017/18 to \$200 million in each of 2017/18 and 2018/19. There are still some uncertainties around funding and this deferral helps ensure that only the minimum release of capital will occur. (See section 2f.)

This results in net debt/ revenue peaking at 186 per cent in 2020 and declining to under 150 per cent by 2042. The Local Government Funding Authority absolute ceiling for net debt to revenue is 250 per cent.<sup>1</sup>

Headroom has improved from \$300 million in every year except 2020 to a minimum of \$460 million in every year. The value of headroom is that it allows future councils a degree of flexibility if unforeseen circumstances arise. This is considered a prudent level of headroom.

## **2. Key Factors Impacting on our Financial Position**

### **2a Christchurch's Growth and Infrastructure Needs**

#### **Rating Base Growth**

Before the earthquakes, Christchurch City Council enjoyed steady growth in its ratepayer base of around 1 per cent a year, resulting in a \$3 million increase to rates revenue each year. However, this growth declined in recent years due to slower natural population growth (i.e. subdivisions, residential and commercial building activity) and the demolition of earthquake-damaged properties. Since September 2010 the city's capital value has reduced by \$2.29 billion as a result of 4,200 residential demolitions (value \$1.25 billion) and 1,350 commercial demolitions (valued at \$1.04 billion). An additional \$2.38 billion of capital value has been lost in the residential red zone through a combination of demolition and the devaluation of 7,000 properties (to 10% of their previous value) as part of the 2013 citywide revaluation. It had been expected that the rebuild/recovery from the earthquakes would have occurred at a greater pace than has occurred. Up until June 2014 the number and value of demolitions exceeded the number of properties being built or rebuilt. The outcome of this is that existing ratepayers have faced a higher rates increase than if there had been normal growth.

Capital value growth returned to and surpassed historical levels during 2014-15. Higher growth continued during 2015-16 and is expected to continue to accelerate in these early years of the LTP as both the residential and commercial rebuild of the City takes shape. In 2018-19 growth is expected to return to pre-earthquake levels when it is assumed that the residential rebuild and repair programme will be complete. Commercial capital value is expected to grow rapidly in the early years. The expected growth is centred within the Four Avenues and dominated by office, retail, industrial and accommodation sectors. From 2018-19 it is expected growth will track long-term household and population growth forecasts for the remainder of the Plan period.

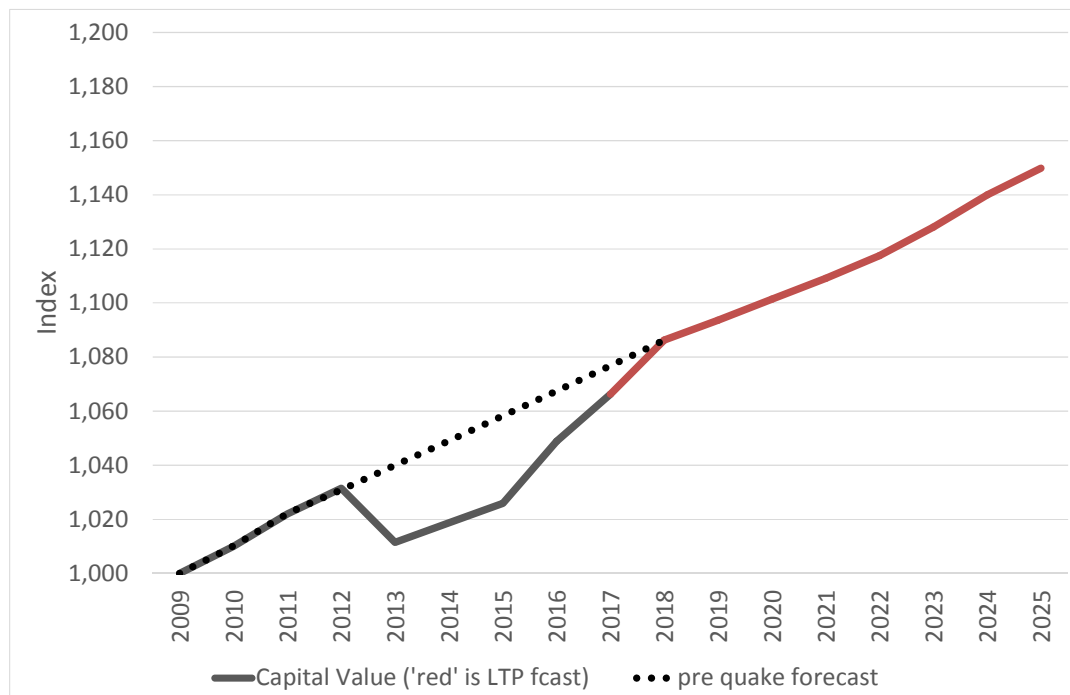
Through an Order in Council, the Government has given Council the ability to decrease rates for a property the month after it is demolished and to increase rates the month following a rebuild or new build. This Order in Council was originally due to expire in June 2016 but it is expected that it will be extended through to June 2018. Once the Order in Council finally expires, Council will revert to making alterations to rating unit valuations on an annual basis in line with the rest of New Zealand.

The following Capital Value Growth index demonstrates the slowdown and loss in capital value with the dotted line representing the expected growth in the city before the earthquakes hit. The red line shows the growth path that is assumed through this LTP.

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<sup>1</sup>This is further explained in section 4, along with Standard and Poor's credit rating information

## Capital Value Growth Index



### Expected Changes in Population and Use of Land

Following the 2010 and 2011 earthquakes approximately 7,000 properties in Christchurch City were re-zoned by the Canterbury Earthquake Recovery Authority (CERA) meaning the land is not considered suitable for urban purposes (i.e. private or public, residential or commercial use) without substantial remediation. The Council has accelerated the amount of land made available for urban purposes so that people who have had their homes and businesses destroyed and have had to relocate, have alternative sites to move to. While much of this movement has already occurred it is still having some effect on land use demand.

Land is also needed for the natural growth of the Christchurch population which is predicted to reach 383,000 by 2025, an increase of 6 per cent over 2015 with the number of households increasing 13 per cent over the same period. In addition, housing is required for many of the workers coming to the Greater Christchurch region for the rebuild over the next few years. It is estimated that there could be up to 8,000 additional workers required from September 2014 until the peak at the end of 2016.<sup>2</sup>

The supply of industrial business land (Zoned B3 – B8) has increased steadily since the earthquakes as new land has been rezoned. Take-up of this land was low in the two years immediately following 2011-12, at around nine hectares a year. Since then, take-up has increased to around 20 hectares a year which is approaching the pre-earthquake rate. The Land Use Recovery Plan (LURP) identified:

- approximately 600 hectares of business greenfield areas available for future business development. As at January 2016, 285 hectares of this was zoned and 216 hectares available for take-up.

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<sup>2</sup> <http://www.dol.govt.nz/publications/research/canterbury-rebuild/canterbury-job-matching-sep-2014.pdf>

- approximately 20,000 potential residential sections. As at October 2015, resource consents were either granted or in progress for around 6,000 of these, including more than 1,700 where building consents have been granted for new housing.

### **Rating Unit Projection**

2016	2017	2018	2019	2020	2021	2022	2023	2024	2025
166,693	168,666	170,440	171,714	172,987	174,261	175,535	177,229	178,924	180,618

The overall growth in rating units is not anticipated to match either the expected growth in households or capital value. The commercial rebuild is mainly taking place on existing, but demolished, rating units and the residential housing stock still includes large numbers of unoccupied dwellings.

To provide infrastructure for the growth outlined above, the amended Long Term Plan includes \$601 million of capital projects over the remaining nine-year planning period.

For further details on the specific projects please refer to the proposed capital programme.

### **2b Levels of Service**

To better reflect our levels of service, and so the community can monitor progress, it is proposed to add an additional level of service which measures the average roughness of the roading network. This measure will also allow the residents of Christchurch to benchmark our roads with those of other Councils.

Renewal works will be prioritised across the whole network to ensure that priorities are based on the delivery of the levels of service at the lowest lifecycle cost. The Draft Annual Plan also contains a proposed reduction in the levels of service regarding ratepayer satisfaction with roading, as deformities in the pavement will remain for longer periods.

Within the three waters area the changes will not affect levels of service in the short to medium term. However they do increase the risk of failure.

Levels of Service for infrastructure assets, with the exception of water supply, are forecast to gradually improve over the period of the Plan. Water supply shows a gradual deterioration, in part due to the practical difficulties involved in putting cameras into pressurised pipes to identify any damage. (Note that the decline in levels of service for water supply does not apply to the quality of potable water itself; it applies to the frequency of pipe failures.) More information around the actual level of service for each activity can be found in the Activity Management Plans. Links to specific levels of service for each activity (and their trends over time) are available at <http://www.ccc.govt.nz/ltp>

Sport and recreation and Arts and culture are showing improved levels of service as a result of the new pools in the East and South West along with the new library in the South-West. The funding sources for these are set out in Appendix 1, Table 1 below. These Level of Service increases are funded mainly through additional borrowings of \$36 million in 2017/18 and 2018/19. The additional operational costs of these facilities will begin from 2018 with the overall impact on rates being 1.2 per cent spread over three years.

### **2c Cost Share Ownership and Opex**

The Cost Share Agreement is the underlying document between Council and the Crown that determines ownership and operating cost responsibilities for each of the Anchor Projects.

In most instances ownership is clear but where the Agreement is ambiguous Council has assumed as follows for the purposes of this Plan:

- **Bus Exchange**
  - Crown ownership and operation for the first three years.
- **The Frame, (Public realm)**
  - Council ownership and maintenance
- **The Square**
  - Council ownership and maintenance
- **Central Library**
  - Council ownership and operation
- **Car parking**
  - Council / private ownership and operation
- **Earthquake memorial**
  - Crown/ Council ownership and maintenance
- **Metro Sports Facility**
  - Council ownership and operation.
- **Avon River Precinct**
  - CDHB and Council ownership and operation.
- **Stadium**
  - For planning purposes we have assumed this will be completed towards the end of the LTP period (although Christchurch Central Development Unit website indicates a completion date of 3<sup>rd</sup> Quarter 2021).

We are not expecting any additional operating costs from any other anchor projects.

## **2d Capital Expenditure**

The planned capital programme has been established through the Infrastructure Strategy, Activity Management Plans and Asset Management Plans prepared as part of the LTP process. These plans link the forecast rebuild outcomes, population growth, levels of service and Council strategies such as the Greater Christchurch Urban Development Strategy and the Government's Land Use Recovery Plan.

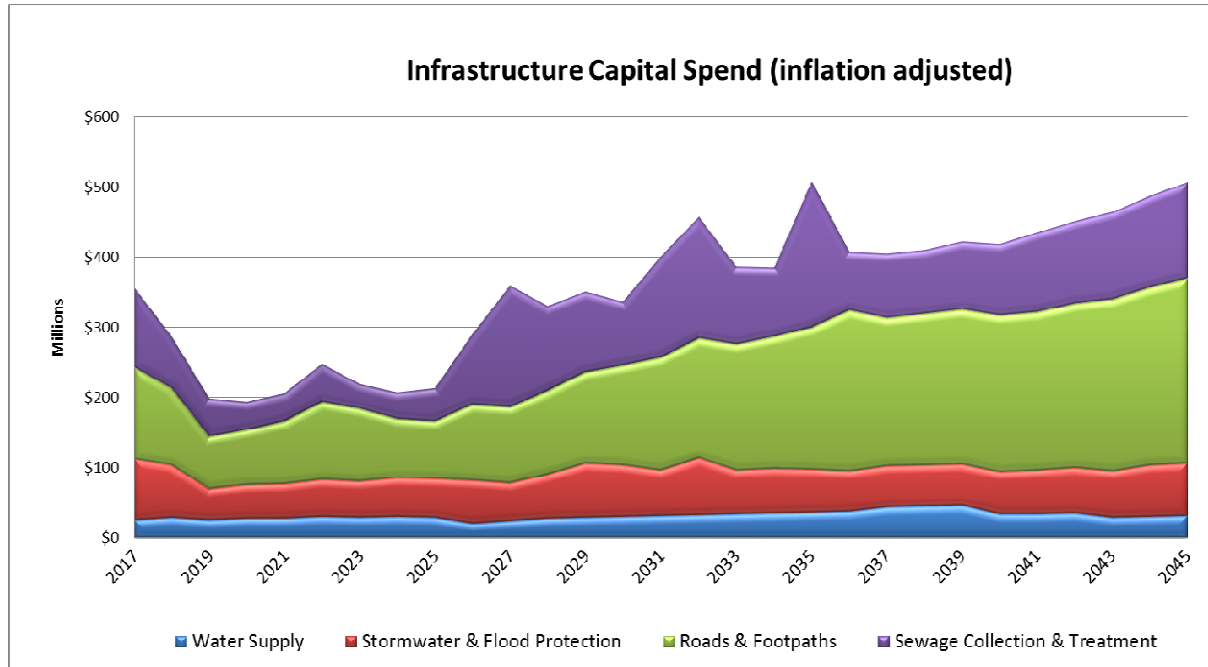
As commented above, Council staff have further updated all capital projects with better cost estimation and delivery timing based on more current information. In addition the timing of the overall programme has been smoothed to better reflect our ability to deliver. Costs associated with the Horizontal Infrastructure programme have been updated to reflect the latest forecasts resulting in lower funding requirements to complete this programme. The level of Crown funding supporting the Horizontal Infrastructure spend has also been clarified with the Crown since issuing the original 2015-25 LTP. As a result, the projected Crown funding has been reduced to reflect the lower cost to deliver the remaining works and account for clarified eligibility criteria. However, if the contribution is lower than expected due to final eligibility calculations, the impact to ratepayers is a 0.25 per cent increase in rates, (spread over two years), for every \$10 million of additional borrowing. This increase covers the interest cost and repayment of the extra borrowing.

The infrastructure programme of work for the next 30 years is depicted in the graph below, and is a summary of the findings contained within the amended Infrastructure Strategy.

The draft amended financial strategy includes provision for this work including the cost to replace the post-World War II infrastructure. The City's engineers were always aware of, and had planned for, this replacement but recent analysis has shown that the 2010/11 events reduced the useful life of many of these assets by up to 20 years although they remain in serviceable condition. This renewal programme

begins to impact the Council’s capital programme from the mid-2020s as shown. For further information please refer to the *Infrastructure Strategy, Financial Estimates and Assumptions*.

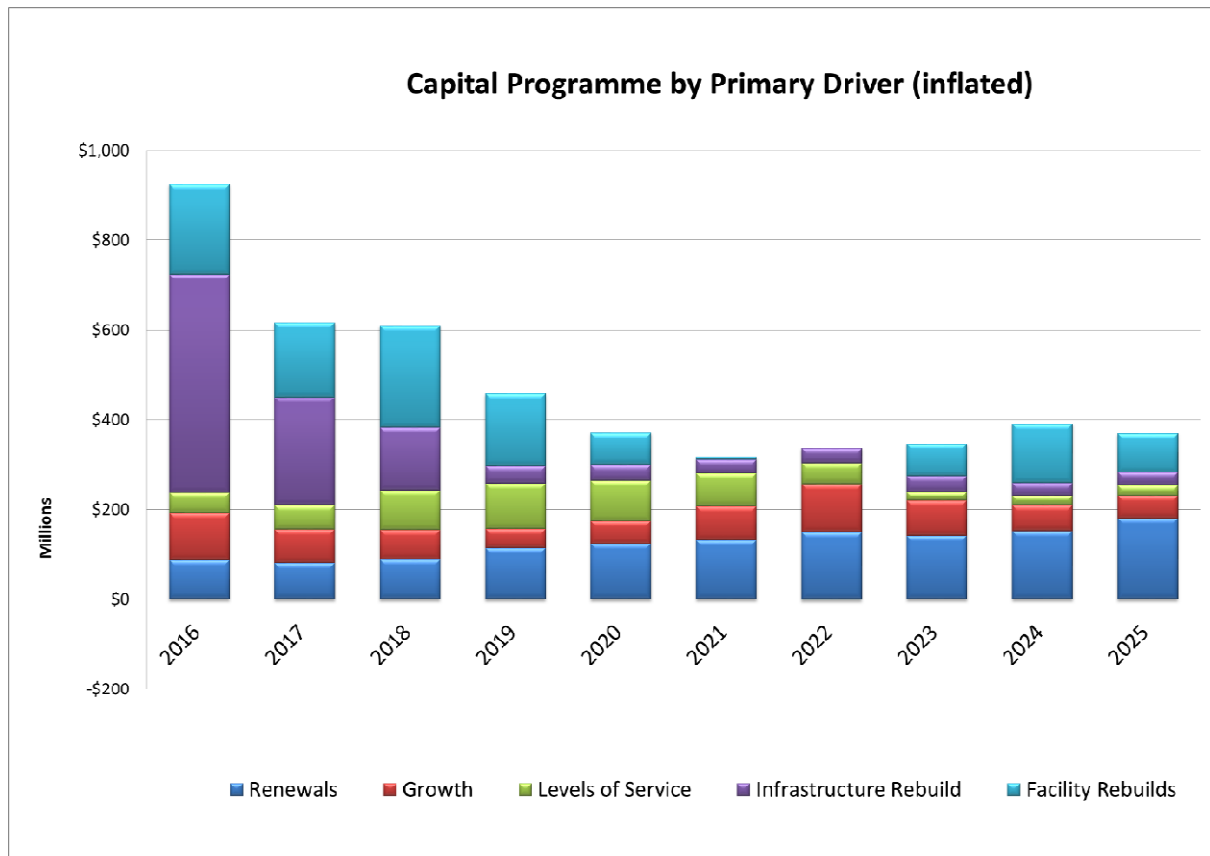
**Graph of total infrastructure spend for the next 30 years, by class of asset**



The capital programme for the remaining nine years of the Long Term Plan includes the infrastructure projections above, along with the non-infrastructure programmes for community facilities and internal services such as Information Technology, fleet and corporate accommodation. It includes provision for renewal of existing assets, plus additional capacity to meet demand growth and increasing levels of service. The planned capital expenditure for the amended LTP is summarised by these categories in the graph below. Renewals are heavily impacted by the rebuild in the first three years.

Major community facilities – the rebuild of facilities included under the Cost Share Agreement, remain significantly behind schedule. Any delay in delivery reduces our borrowing and operating costs. The Council’s commitment is set out in Appendix 1, Table 1.

**Graph on renewals, level of service and growth for the 10 years of the LTP**



**2e Deferred Renewals**

The Three Year Plan assumed that some of the income from rates previously intended to pay for the renewal of the City’s infrastructure assets would be used instead to fund earthquake recovery costs, (referred to in the Three Year Plan as deferred renewals) because so much of the damage to roading and pipes was being addressed through the SCIRT programme.

A programme prioritisation/ optimisation review was undertaken following the signing of the Cost Share Agreement. As a result some work was removed and the standard of renewal that SCIRT had previously been achieving was reduced. This could result in some of the city’s roads and pipes needing to be replaced sooner than originally forecast. Any delay in renewing them can result in higher operating maintenance costs.

An independent review of the programme’s cost and scope in April 2015, determined the funding issues were outside the scope of the review. The Crown clarified its position in November 2015 that it would not fund the renewal element of the remaining programme.

**2f Funding Streams Uncertainties**

While insurance has been settled, there are still some uncertainties around the quantum and timing of other funding sources.

Should additional funding be received from any source which is above the levels assumed in this strategy, the following options are available:

- further reduce the release of capital from CCHL, or
- maintain the \$600 million capital release and reduce our debt levels, or
- maintain the \$600 million capital release and further reduce rates<sup>3</sup>.

In the event of additional funding becoming available Council will make a decision at that time on the basis of a recommendation from staff.

Equally, should funding levels drop, or requirements around the cost share agreement increase, the decision to reduce the capital release to \$600 million would need to be reassessed.

## **2g Other Assumptions**

This Draft Financial Strategy is also based on the assumptions set out in the Significant Forecasting Assumptions companion document.

## **3. Financial Strategy Considerations**

In developing a strategy we were mindful of the following.

We believe it is important to:

- keep debt levels under control throughout the remaining nine years in order to provide the capacity to borrow from 2025 onwards when the next asset renewal peak begins.
- choose a solution that spreads the cost across those ratepayers who will benefit from the services the assets provide (intergenerational equity). Our policy is to retain this by funding renewals through rates and borrowing for the balance of the capital programme. This additional debt is repaid over 30 years.
- build in financial resilience over time. The challenge facing the City is to do this over an appropriate timeframe while not over-burdening current ratepayers. Specifically, should another disaster event occur (a remote chance but no one was anticipating the earthquake sequence), we need to be in a position to fund our share of the repair and rebuild costs. The Government's Civil Defence Emergency Plan covers 60 per cent of the bill but only if we can meet the first 40 per cent. The Council holds a significant investment through Christchurch City Holdings Limited (CCHL) but this is not readily convertible to cash during the first critical 12 month period when response costs are highest. We consider it is unrealistic to build a strategy which positions the Council to be in the financial position to withstand a significant disaster immediately after sustaining the first. The period of time to achieve this financial resilience is a key parameter of the financial strategy and realistically occurs around 2037 when our net debt/ revenue ratio falls below 170 per cent.

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<sup>3</sup> Note the Draft Financial Strategy's parameters are rates for the first three years of 5.0%, 5.0% and 5.0%, which when combined with a capital release of \$600 million, all else being equal, results in the net debt/ revenue ratio peaking at 186% in 2020.



- set revenue at a level that will meet operational expenditure including a provision for depreciation and keep rates at a level which contributes towards the additional funding but does not unreasonably move the burden on to existing ratepayers.
- maintain a balanced budget; i.e. ensure that our revenue continues to exceed our expenses.
- maintain a rate which recovers around 62 per cent of our estimated depreciation. We have revalued the majority of our assets post-earthquake and the results are reflected in this plan. There is a possibility however, that the current costs are overstated as a result of a shortage of contractors, which would mean that we've over-estimated the long term replacement cost. This will become clearer with future valuations as the market settles; at which point we can take steps to correct any under-provision. In the meantime the renewals rated for will steadily increase and be around 68 per cent of the estimated depreciation by 2025. This means that although we're moving towards fully funding depreciation, it could be some years before it's achieved. However, given the current uncertainty, we consider it prudent to achieve this over the medium to long term rather than make an immediate adjustment.
- maintain a policy of financial prudence through managing revenues, expenses, assets, liabilities, investments, and general financial dealings prudently and in a manner that promotes the current and future interests of the community through all of the above.

## 4. Financial Strategy

### Capital Release Assumptions

To access sufficient funds to meet expenditure while at the same time complying with our need for prudence, financial resilience and intergenerational equity, the decision was made in 2015 to consult on releasing up to \$750 million of the investment portfolio held by CCHL.

As a result of this consultation, Council resolved to retain Lyttelton Port Company, Orion and Christchurch International Airport Limited within its strategic assets. This year, largely because of the smoothing of the capital programme we are recommending that the \$750 million be reduced to \$600 million and that the timing of the remaining \$400 million be deferred to \$200 million in each of 2017/18 and 2018/19.

CCHL are currently undertaking further analysis including capital restructuring options where available. This analysis will be presented to Council prior to the financial year end and form the basis of the Council's future capital release programme. As stated in the 2015-25 LTP no decision will be made to sell down strategic assets without consultation.

Appendix 2 provides the reader with a reminder of the Cameron Partners report framework for consideration of Asset Ownership. This report was released in August 2014.<sup>4</sup>

The sale of City Care Limited is currently underway and is expected to be completed before 30 June 2016.

### Rates Increases

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<sup>4</sup> <http://resources.ccc.govt.nz/files/TheCouncil/policiesreportsstrategies/reports/CameronPartnersReviewAugust2014.pdf>

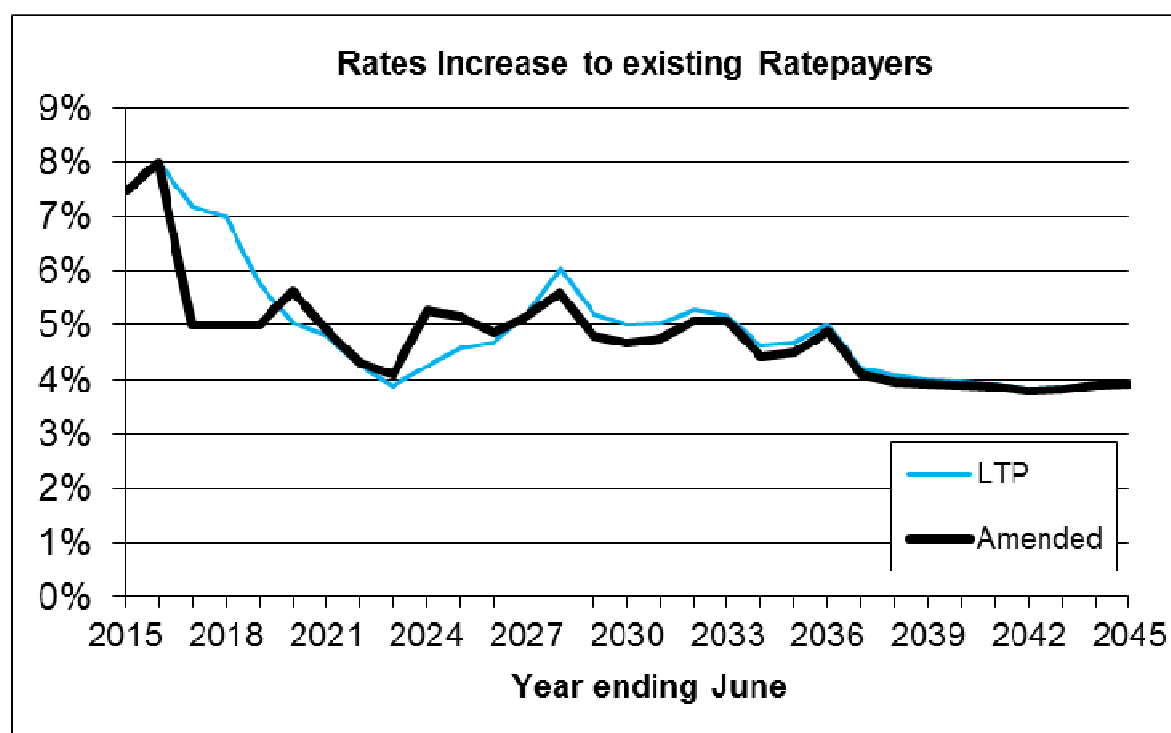
This year, the smoothing of the capital programme coupled with the financial benefits outlined in section 1 above, has allowed us to recommend a \$150 million reduction in the capital release to realise a net value of \$600 million. In addition we're proposing lower rate increases to current ratepayers over the next three years of 5 per cent. This results in net debt/ revenue peaking at 186 per cent in 2020 (previously 213 per cent) and declining to under 150 per cent by 2042.

We have maintained \$460 million of headroom in every year.

Financial projections show rates increases stabilising at around 5 per cent in the medium term during the post World War 2 infrastructure replacement period, and 4 per cent thereafter.

The series of graphs below show the rates, debt levels and key indicators for the recommended amended LTP against those adopted last year as part of the Long term Plan.

**Graph of rates increases to existing ratepayers for the next 30 years**



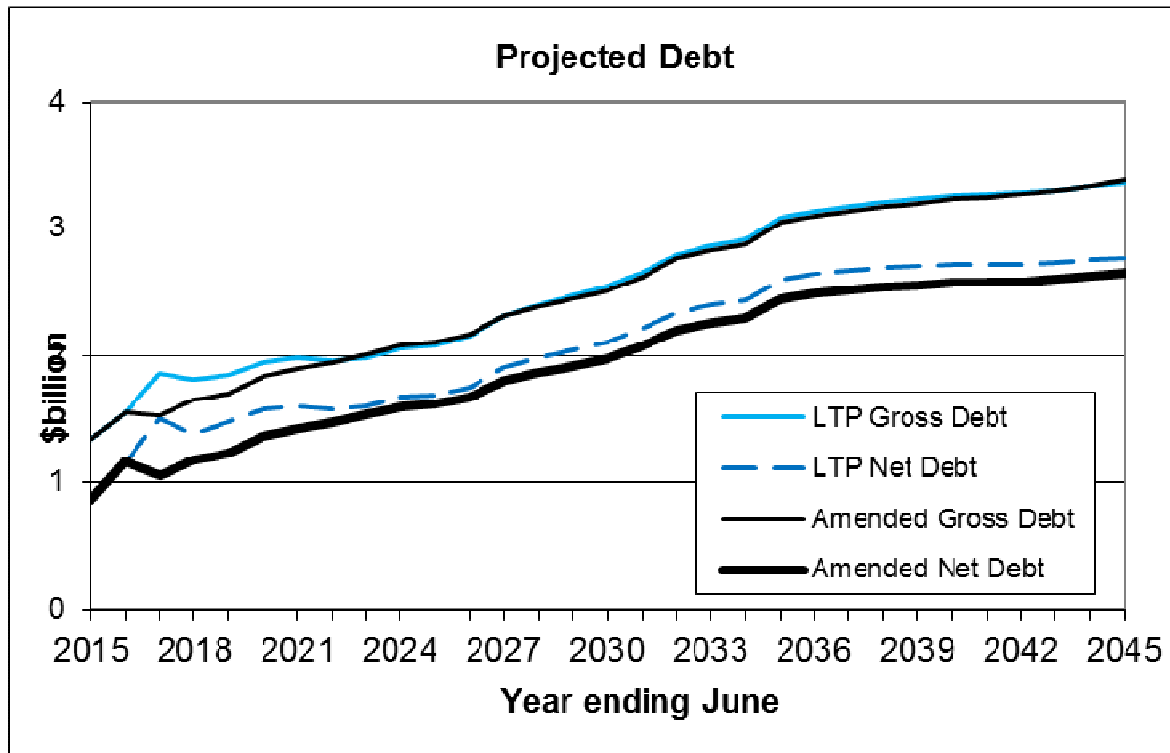
This option proposes a total rates increase over the next five years of 25.5 per cent. The higher rates increases for the decade from 2024 is due initially to the new stadium and then by the extended programme of renewals requiring further ratepayer-funded borrowing.

**Borrowing**

Debt is capped at 250 per cent of the net debt to revenue ratio, a key measure of financial resilience, with the maximum expected to be 186 per cent in 2020, thereby providing headroom for further borrowing in the event of an emergency.

The magnitude of the costs faced by the Council means that if we are to keep rates increases to an affordable level and deliver the rebuild within an acceptable period of time, we must increase our debt

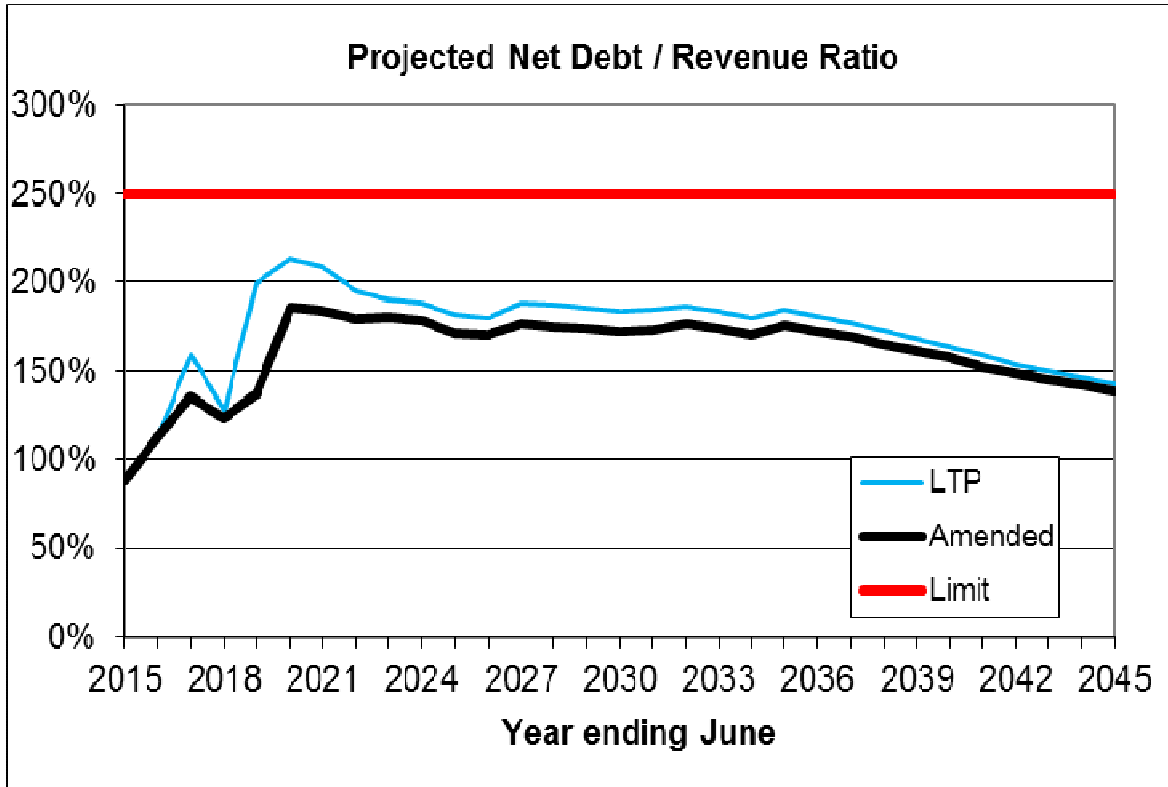
levels. The black line on the graph below shows Council’s total debt projection as a result of the infrastructure rebuild and facilities rebuild borrowing required, along with that for replacing post-World War II infrastructure.



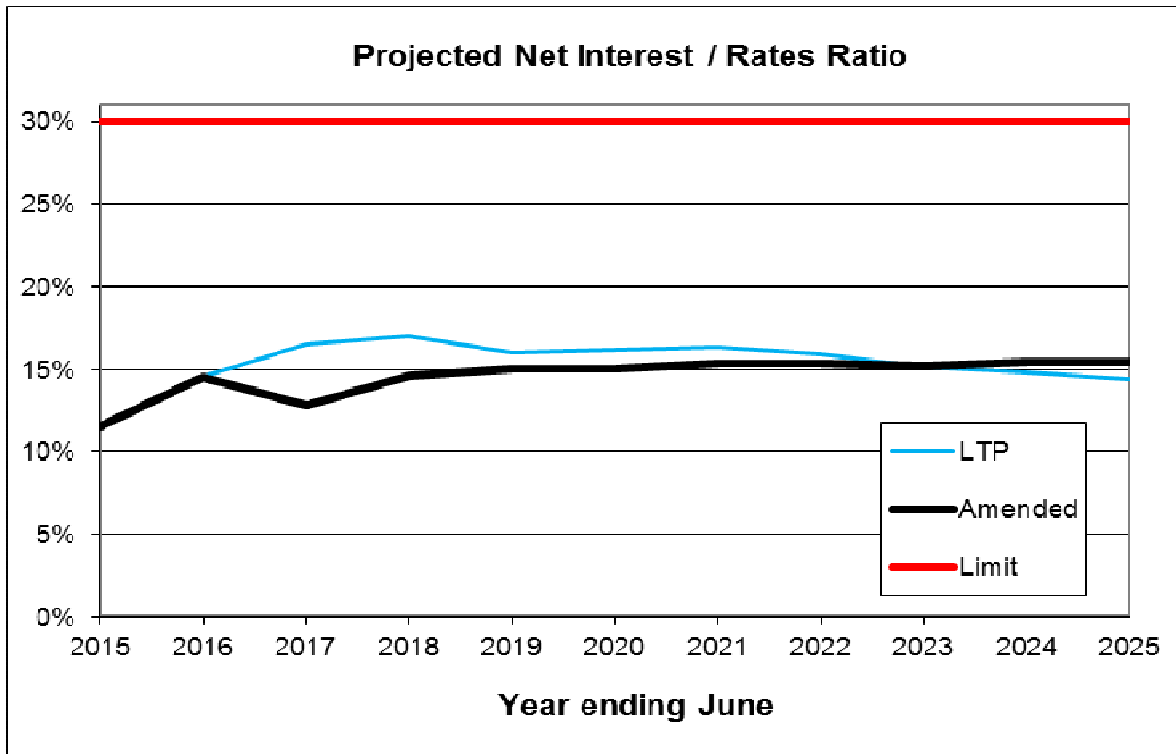
We are conscious both of the amount of debt we need to take on, and the affordability of that debt. In its foundation policies, the Local Government Funding Agency (LGFA) established debt covenants that govern the total amount of debt a local authority may borrow from the Agency. Council has ensured that it remains within both the affordability (net interest as a proportion of rates) and quantum ratios (net debt as a proportion of total revenue). The Council’s Liability Management Policy limits align with the Local Government Funding Authority foundation policy limits.

The LGFA limit is 250 per cent for net debt to total revenue and 30 per cent for net interest to rates income. The Council’s debt is forecast to increase with the ratio peaking in 2020 at 186 per cent. The net interest ratio stabilises at around 15 per cent over the LTP period. We consider the net debt/revenue ratio ceiling of 250 per cent is appropriate as most of the City’s assets do not generate any return, and our debt repayment is largely funded through rates and CCHL dividends. As for any other borrower, it is important to consider the affordability of our debt. As mentioned above, our net interest ratio stabilises at 15 per cent but this is in an environment of extremely low interest rates. While we have much of our exposure hedged, our hedging contracts do not extend for the full 30 years and it is prudent to leave some headroom to meet our obligations should rates increase.

**Graph of net debt to revenue for the next 30 years**



Graph of net interest to rates income for the next 10 years



The charts above demonstrate that although the Council's total debt levels climb as a result of the rebuild and growth, the strategy for repaying this debt ensures the City's net debt stabilises over time. In addition, because the city continues to grow, so do its rates and total revenues. By controlling the increase of debt following the rebuild process, Council's key debt covenants return to conservative levels later in the 30-year period.

## **Credit Rating**

The increase in debt in the short to medium term may lead to a further decrease in the Council's credit rating. In its review at the end of the 2015 calendar year, Standard & Poor's removed the Council from negative watch and reconfirmed its A+ rating. It also commented that while they consider the Council's financial strategy to be prudent, Council's credit rating would likely be reviewed if its net debt exceeded 180 per cent of revenue or net interest exceeded 9 per cent of revenue. (Standard and Poor's use different ratios and inputs for their purposes compared with those set by LGFA). Council debt ratio peaks in 2020 as a result of the rebuild borrowing. If the capital programme proceeds as forecast, Council will exceed these two ratios, but not the LGFA covenants. As a result it will come under close scrutiny by Standard & Poor's. However, it does not automatically follow that the Council will be downgraded. In making their assessment Standard & Poor's consider the group results which have improved ratios due to CCHL's strong operating revenues. Their assessment also includes the economy, the entity's financial management, liquidity, and budgetary performance, and flexibility. They also consider the stability of the governance and executive management and its willingness to make hard decisions.

The Significant Assumptions include an indication of the increased cost of borrowing should a downgrade occur.

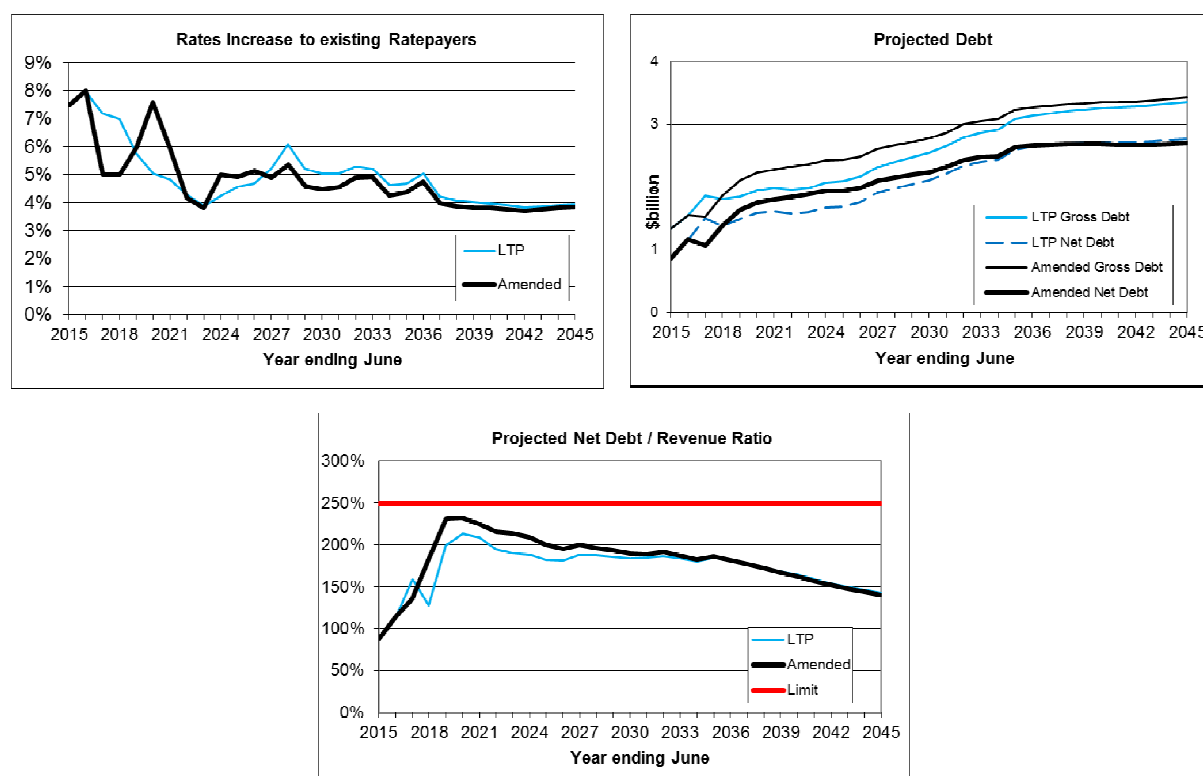
Any downgrade would have only a marginal impact on interest rates within the term of this Plan. This has not been incorporated into the financials. Notwithstanding this, should a downgrade occur, it is expected the Council's credit rating would be restored over time as the funding uncertainty decreases and the net debt/revenue ratio returns to more conservative levels.

## 5 Alternative Options

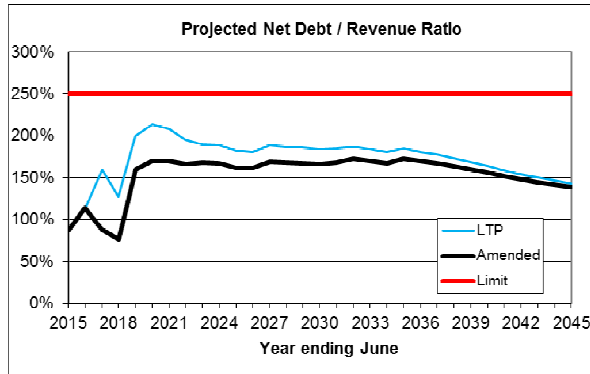
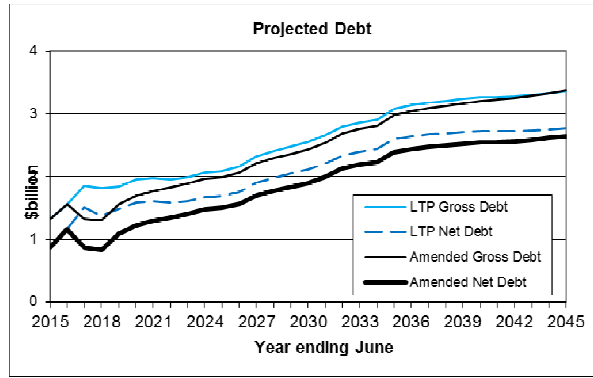
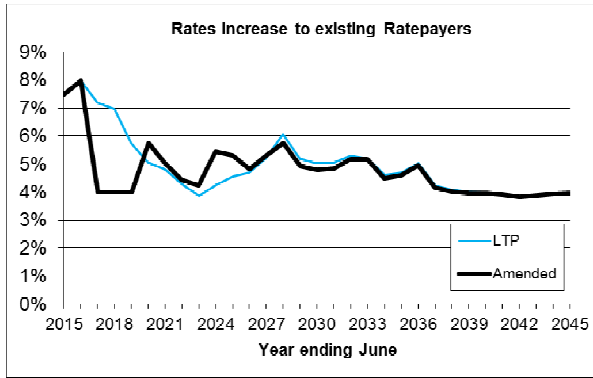
The following alternative options have also been considered and are available to fund the currently proposed expenditure. They have differing impacts on the Council's key ratio limit of net debt / revenue. In particular:

**Option 1:** If the City wishes to maintain the balance of its portfolio of CCHL assets, meaning no further capital release other than the sale of City Care which is underway, higher rate increases in the order of 29.6% over five years would be required, ranging from 5% to 7.6% per annum. The net debt/revenue ratio peaks at 232% in 2020, leaving very little headroom and hence very limited flexibility if unforeseen circumstances arise. A ratio at this level may well impact on the Council's credit rating.

The graphs below show the impact of Option 1.



**Option 2:** Should the City wish to remain with the existing quantum and timing of the capital release (\$750 million being \$200 million in 2015/16, \$200 million in 2016/17 and \$350 million in 2017/18), rates increases over the next three years could be smoothed to 4 per cent per annum before higher rates increases in the following two years of 5.7% and 5%. Total rates increases to existing ratepayers over five years would be 22.7%. The net debt/revenue ratio would peak at 170% in 2020. The graphs below show the impact of Option 2.



The Draft Financial Strategy is recommended, rather than either of the two alternative options above, as a balance between rates, net debt/ revenue, and capital release. We are seeking your feedback on the Draft Financial Strategy and the above or other options.

On the issue of affordability, Christchurch City Council rates are still well below most comparative metropolitan councils and our neighbouring District Councils, (see Chart of Estimated Average Residential Rates 2014-15 to 2024-25 by Metropolitan and District Council in Section 6 below).

Rates rebates and other support mechanisms are available for those ratepayers on fixed incomes.

## 6 Quantified Limits on Rates and Rates Increases, and Borrowing: Debt Headroom

The quantified limits on rates and rates increases relate to total rates income, which includes penalties and rates collected during the year under the Order in Council. Note these are particular definitions required to be disclosed under legislation which are different to those used to produce the previous rate percentage information. For existing ratepayers the actual increase is always lower than the absolute increase as long as the number of ratepayers continues to grow. For this reason existing ratepayers should focus on the previous graph rather than the table below. The quantified limit on rates is set at 1 per cent above the rates income contained in the amended LTP financial statements. This allows Council some limited flexibility to cope with difficult to forecast changes in the pace of the rebuild.

The quantified limit on rates increases is similarly set at 1 per cent above the nominal year-on-year increase in rates income.

The quantified limit on borrowing is set at the sum of 250 per cent of annual revenue, liquid assets, and on-lending to Council Controlled Organizations.

The quantified limits and debt headroom are as follows:

Year	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025
Rates (\$m)	397	429	456	479	509	537	564	591	627	662
Rates Increase	10.67%	9.02%	7.30%	6.25%	7.23%	6.49%	5.91%	5.80%	7.07%	6.69%
Borrowing	2,956	2,424	2,858	2,714	2,302	2,404	2,535	2,601	2,722	2,841
Debt headroom (\$m)	1,398	896	1203	1012	468	506	582	592	639	736

The large amount of debt headroom in the period 2016 to 2019 is due to the abnormally high revenue that Council will receive being the release of capital from CCHL investments in those years. Figures for 2020 onwards are based on more normal revenue flows.

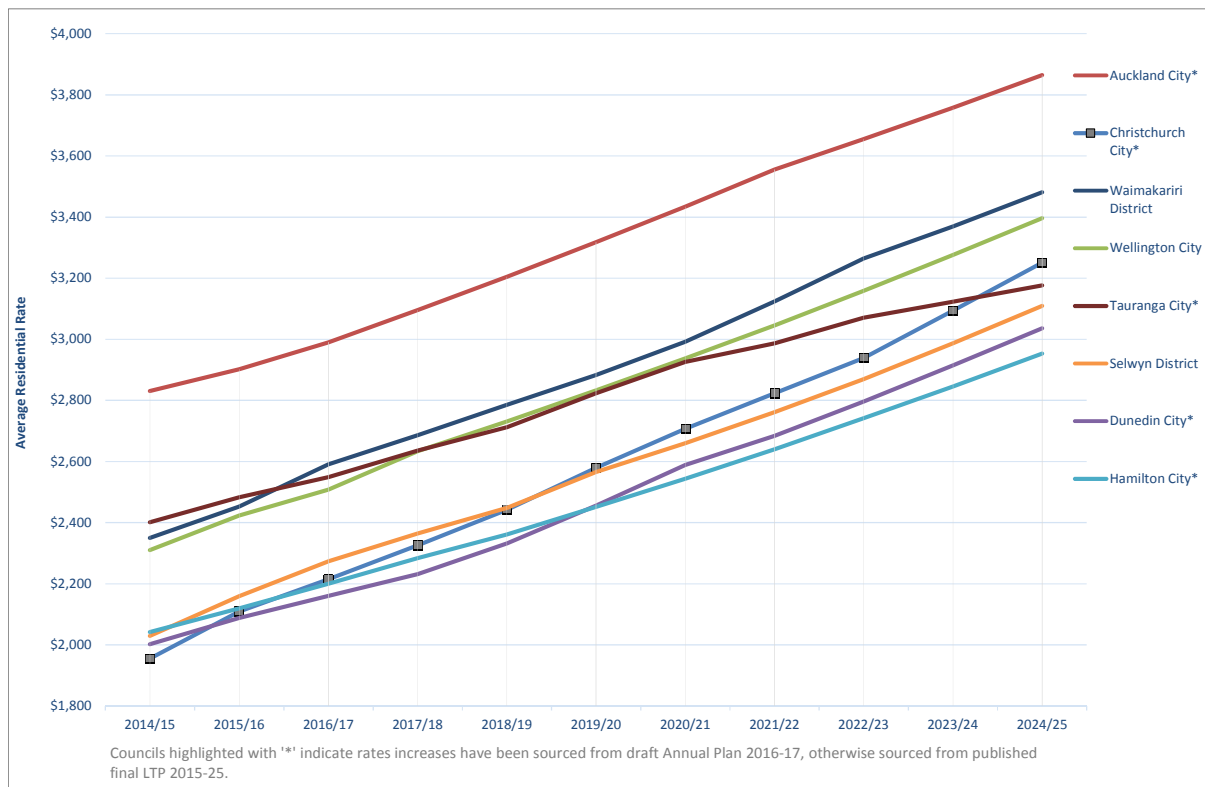
The following graph shows the estimated average residential rates for the period of the Long Term Plan 2015-25 by relevant metro and district council. Historically rates in Christchurch have been lower or broadly comparable to the other metro councils and neighbouring district councils. Our proposed rates increases mean Christchurch rates charges will overtake Hamilton this year, Selwyn by 2019-20, and Tauranga by 2024-25; leaving Christchurch rates still lower than Wellington, Waimakariri and Auckland by the end of the LTP.<sup>5</sup>

<sup>5</sup> The average residential rate calculated by each individual council includes all revenue from charges made to residential ratepayers (including water where charged separately) and is divided by the number of residential properties liable for the charges. The 2013 base data has also been presented within the Ratepayers Report as published by Fairfax Media in June 2014.

The base average rates bill figures have been inflated by the indicated percentage increase included in the Consultation Document or Financial Strategy for the Draft Amended LTP 2016-25. Christchurch rates reflect the proposed rates increases as outlined in the Draft LTP 2016-25.



## Estimated Average Residential Rates 2014/15 to 2024/25 by Metropolitan and District Council



## Appendix 1

**Table 1: Major Community Facilities /Anchor Projects**

The Council remains committed to the rebuild or repair of the major community facilities listed below, either as part of the Cost Share Agreement with the Crown or on its own. Facilities which are part of the Cost Share are marked with an asterisk.

	Council contribution (\$m)
Christchurch Art Gallery	56.7
Central library*	75.0
Athletic track	6.7
Eastern aquatic facility	30.5
Christchurch Town Hall	127.5
Performing arts*	30.0
South-west library and service centre	12.7
Convention centre*	-
Carparking *	70.0
Former AMI stadium*	253.0
Central city multi-sport facility*	147.0
Avon river park*	6.4
Transport Interchange*	39.9
Transport Plan –phase 1*	27.0
The Square	4.6

### Insurance

Over the last four years we have progressively increased our level of insurance cover over the City's assets as the insurers and reinsurers re-enter the Christchurch market. This extends to full cover including earthquake cover for 777 above- and below-ground buildings, valued at \$1,533 million, and cover for fire and other perils, excluding earthquake, over a further 359 above-ground buildings valued at \$373 million. The remaining 722 buildings totalling \$169 million, with individual values of less than \$2 million, remain self-insured.

We have a limited amount of earthquake cover on the new below-ground water and waste water pipes and anticipate being able to increase this over the next few years. In the meantime we are relying on having sufficient borrowing capacity to fund 40 per cent of any damage incurred through a disaster, thereby entitling the Council to the remaining 60 per cent under the Government's Civil Defence and Emergency Management Plan.

### Policy on Securities

Council secures its borrowing by way of a charge over the Council's rates revenue. This process is used when we borrow from the Local Government Funding Agency, and under the Debenture Trust Deed for our general borrowing programme.

From time to time, with the prior approval of Council and the Debenture Trustee, security may be offered by providing a charge over one or more of the Council's assets. This is only done where there is a direct relationship between the debt and the purchase or construction of the asset being funded, such as an operating lease or project finance, and the Council considers a charge over the asset to be appropriate.

## **Investments**

The Council's investments are in CCHL, other companies and loans and securities.

### **Investment in Companies**

The Council's main investment is in CCHL which holds investments on behalf of the City. The Council's objective for owning CCHL is that the company monitors the Council's existing investments. CCHL's dividends provide a key source of revenue for funding Council's activities and services. The return on our CCHL investment from cash dividends has averaged 3 per cent in the last three years and 4 per cent in the last 10 years. When the appreciation in the capital value of its investments is taken into account, CCHL has achieved an internal rate of return over the past five years of 13.3 per cent a year, or 26.1 per cent a year since its inception in 1996. This significant return is due to asset growth. The capital release by CCHL allows it to realise this increase in asset value and return it to Council as a cash dividend. Further information on CCHL's subsidiary companies is provided in the Long Term Plan and in the companies' Statements of Intent.

The Council has shareholdings in a further eight companies. These are held principally to achieve efficiency and community outcomes and not to receive a financial return on investment.

We believe the risk to Council of investing in all of the above is low.

## Council Investments

<b>Company</b>	<b>Shareholding</b>	<b>Principal reason for investment</b>	<b>Budgeted Return</b>
<b>Council Controlled Trading Organisations</b>			
Christchurch City Holding Investments	100%	Return on capital Holding company for the Council's trading investments.	\$28.9 - \$51.8 million per annum as detailed in the forecast dividend table below. Plus special dividends of \$200 million in 2015-16, \$200 million in 2017-18 and \$200 million in 2018-19
Vbase Limited	100%	Economic Development Achieved through the provision of venue management and event hosting services at its own venues (Horncastle Arena and the earthquake damaged Town Hall and Lancaster Park) and those it manages	None in Long Term Plan period.
Civic Building Limited	100%	Property Investment The company holds the Council's 50% investment in the joint venture that owns the Civic Building offices. This is a long term investment.	Returns expected from 2020 onwards.
Tuam Limited	100%	Property Investment Property has been sold and insurance settled. Company's future to be determined.	Return of all capital in 2016.
Canterbury Development Corporation Holdings Limited	100%	Economic Development Provides the Council and community with economic monitoring data. Certain Council levels of service are delivered by CDC.	None
<b>Share Investments</b>			
Transwaste Limited	38.9%	Regional landfill	\$3.1 - \$15.2 million per annum
New Zealand Local Government Funding Agency	8.3%	Borrowing	\$120,000 per annum
New Zealand Local Government Insurance Corporation	12.9%	Risk Management	None
Endeavour Icap	12.8%	Economic Development	None

The Council provides loan funding to its 100 per cent subsidiaries as and when required. Interest is charged on this lending at a market rate.

The forecast dividend income is outlined below:

	2015/16	2016/17	2017/18	2018/19	2019/20	2020/21	2021/22	2022/23	2023/24	2024/25
<b>CCHL</b>	\$246 million <sup>1</sup>	\$40.6 million	\$241 million <sup>2</sup>	\$229.3 million <sup>3</sup>	\$28.9 million	\$29.5 million	\$37.4 million	\$43 million	\$47.4 million	\$51.8 million
<b>LGFA</b>	\$120,000 per annum									
<b>Transwaste</b>	\$9.2 million	\$5.2 million	\$15.2 million	\$4.4 million	\$3.4 million	\$3.2 million	\$3.1 million	\$3.2 million	\$3.3 million	\$3.3 million

<sup>1</sup> includes \$200 million from the release of capital in investments.

<sup>2</sup> includes \$200 million from the release of capital in investments.

<sup>3</sup> includes \$200 million from the release of capital in investments.

The Council is reviewing the following investments:

- CCHL

As discussed in the consultation document the Council is reviewing the investments held by CCHL with a view to releasing funds to assist with its funding needs over the period of the strategy.

- Tuam

The future need for Tuam is currently being assessed.

### Christchurch City Holdings Limited Investments

The key purpose of CCHL is to invest in and promote the establishment of key infrastructure assets in a commercially viable manner to assist proactively in the development and recovery of Christchurch. This involves the identification of infrastructural needs and then playing a role in helping to meet those needs. CCHL encourages appropriate investment by its trading companies when significant updates are required in existing infrastructural assets.

The dividends paid by each CCHL subsidiary in the last five years is shown below. Past information is used as we do not yet have the final Statements of Intent covering the three years 2017, 2018 and 2019. There is a level of uncertainty regarding future dividend payments as these are dependent on the financial performance of the companies.

Company	Shareholding	Principal reasons for investment	Value of investment <sup>6</sup>	Total Dividends paid last 5 years <sup>7</sup>
<i>Infrastructure</i>				
Orion New Zealand Limited	89.3%	Regional Economic Development	\$753 million	2015 \$56 million 2014 \$34 million 2013 \$32 million 2012 \$34 million 2011 \$38 million

<sup>6</sup> As recorded in the financial statements of CCHL at 30 June 2015.

<sup>7</sup> Total dividend paid by the companies to all shareholders.

Company	Shareholding	Principal reasons for investment	Value of investment <sup>6</sup>	Total Dividends paid last 5 years <sup>7</sup>
Christchurch International Airport Limited	75%	Regional Economic Development	\$635 million	2015 \$9.9 million 2014 \$6.6 million 2013 \$8.8 million 2012 \$17.2 million 2011 \$8.5 million
Lyttelton Port Company Limited	100%	Regional Economic Development	\$459 million	2015 \$22 million 2014 \$2 million 2013 nil 2012 nil 2011 \$3 million
Enable Services Limited	100%	Economic Development & Long Term Investment Returns	\$86 million	No dividends have been paid
<i>Contracting</i>				
City Care Limited	100%	Investment and Certainty of supply of service	\$113 million	2015 \$5.7 million 2014 \$5.7 million 2013 \$6.3 million 2012 \$7.9 million 2011 \$6.4 million
Red Bus Limited	100%	Public Transport Investment	\$44 million	2015 \$1.9 million 2010 \$0.7 million
EcoCentral Limited	100%	Certainty of supply of service	\$9 million	2015 \$0.3 million 2014 \$0.2 million

### Considerations of Ongoing Council Ownership of its Trading Companies

Advantages of Council Ownership	Counter-arguments to Council Ownership
<p><b>Synergies.</b> Provides opportunities for broader Council / Community objectives to be reflected in the companies objectives. Allows companies to proactively respond to community aspirations such as climate change, energy use, sustainability, and social equity in a more direct and binding manner.</p>	<p><b>Synergies.</b> Community values should be reflected in regulation, policy and incentives that are transparent and contestable. The use of Statements of Intent to influence commercial behavior can lead to sub-optimal business performance.</p>
<p><b>Local control.</b> While operating on a commercial basis, wider economic benefits to the region are taken into account – largely through the Statement of Intent process (e.g. recognition of Council strategies etc). The CCHL model ensures that intervention is by way of guidance rather than direct lobbying or interference with recognised best practice board governance processes. The model reflects similar principles adopted for Crown commercial enterprises.</p>	<p><b>Local Control.</b> This can lead to mixed messages for the companies and reduce efficiency or returns if companies are required to compromise their potential rate of return. Companies associated or linked to Council may also perceive an inability to act as commercially as competitors.</p>

<b>Advantages of Council Ownership</b>	<b>Counter-arguments to Council Ownership</b>
<p><b>Asset reliability.</b> A public owner of key infrastructure is more likely to accept a lower return in the short term to ensure there is sufficient investment into these assets for the long term (e.g. investment in increased network resilience, or proactive asset maintenance).</p>	<p><b>Asset reliability.</b> The private sector has strong incentives to invest in asset reliability and maintain the performance of its assets to ensure it maximizes profits. Further it will not over-invest or gold-plate its assets. Council-controlled companies may be less inclined to reduce services, reduce quality of assets and infrastructure due to community expectation.</p>
<p><b>Investment returns.</b> CCHL has generated a return to shareholders (cash dividends and capital growth) of 25.9 per cent since 1996. The current cash dividend forecasts (\$46 million in 2015-16) excluding dividends from a capital release have the effect of lowering Council rates required by approximately 13 per cent. The total shareholder returns exceeds the Council's cost of capital in investing in these companies. Independent professional directors appointed to CCTOs can be as effective at ensuring efficiency in Council-owned companies as those with private sector ownership.</p>	<p><b>Investment returns.</b> Notwithstanding that total returns (including capital growth) to Council are higher than the cost of capital, cash dividends paid to Council have averaged a 4% return in the last five years decreasing to 3% in the last three year. Cash dividends currently are less than interest forgone on any capital release. An alternative shareholder may bring additional value to these companies, and private sector ownership ensures better efficiency.</p>
<p><b>Pricing.</b> Where there is no effective competition in a market, the existence of a Council-owned company can stimulate pricing and help to ensure that pricing for Council tenders is competitive or control pricing where there is a monopoly provider.</p>	<p><b>Pricing.</b> This is only true where markets are not mature and in most instances of monopoly, pricing is regulated.</p>
<p><b>Future potential.</b> Also known as "option value", this enables future flexibility with these assets, e.g. Port redevelopment, and Enable investment. If they are sold this value is gone.</p>	<p><b>Future potential.</b> Council should not be exposed to unnecessary commercial risks, e.g. Council's ownership may be questioned where it owns assets that are speculative, high risk or for purposes not connected to the well-being of the community.</p>
<p><b>Long-term investment horizon.</b> Because they have an owner who is focused on long-term outcomes, the companies have a greater ability to invest in the long-term, where profitability may take some time but creates gain where aligned to the strategies (Community outcomes) of the City.</p>	<p><b>Long-term investment horizon.</b> This investment exposes ratepayers to risk that the private sector is not prepared to accept. If the investment is made by the Council, it should be sold once it becomes commercially viable to reduce the commercial risk.</p>
<p><b>Stability of ownership.</b> Strong stable ownership can create a competitive advantage for the operating companies. Private sector owners are more likely to seek profit in a shorter timeframe and not be as prepared to invest in the long-term.</p>	<p><b>Stability of ownership.</b> Stability of ownership can also be achieved through a strong private-sector parent. A private sector parent may also bring other skills and experience that add value to the companies.</p>

<b>Advantages of Council Ownership</b>	<b>Counter-arguments to Council Ownership</b>
<b>Availability of capital.</b> Council decision-making to make further capital available will be moderated by how the investment contributes to commercial and non-commercial outcomes for the City. The Council could choose to allow its companies to access normal capital markets (CCTOs already raise debt capital through the normal market).	<b>Availability of capital.</b> A wider range of capital raising options is available to privately-held companies. Exposure to capital markets places stronger commercial disciplines on businesses.

### **Cash Investments**

The Council typically holds a limited amount of surplus cash, to cover short-term working capital requirements or pre-fund the maturity of term borrowings. Cash may be invested for short periods to enhance returns provided that this does not undermine the Council's liquidity position. Overall cash returns are expected to exceed the Reserve Bank's Official Cash Rate.

### **Capital Endowment Fund**

The Capital Endowment Fund was formed in 2001 using the proceeds received from the sale of Orion's gas subsidiary. The Fund provides an ongoing income stream which is applied by Council to economic development, and community events and projects. The Fund is invested according to the Council's Investment Policy, including internal lending to the Council to minimise Council's external borrowing. The Council pays the Fund interest on such internal loans at a market rate, although no more than it would pay for a similar loan from an external lender. Fund investments are consolidated with those of the Council for reporting purposes.

The Fund is projected to make returns over the nine remaining years of the Long Term Plan of:

	2016/17	2017/18	2018/19	2019/20	2020/21	2021/22	2022/23	2023/24	2024/25
Return	4.27%	4.07%	4.05%	4.05%	4.05%	4.54%	4.67%	5.18%	5.23%

### **Community Loans**

From time to time the Council makes loans to community groups to enable them to pursue their stated objectives. The return on these loans ranges from interest free through to 4.4 per cent depending on when they were granted and the conditions imposed on them at the time. The total face value of these loans at 1 July 2015 was \$7.3 million.

### **Other Investments**

Under the terms of its shareholding in the Local Government Funding Agency (LGFA), each time Council borrows from LGFA it must invest a portion of that borrowing back into LGFA in the form of Borrower Notes. Council earns interest on Borrower Notes at an interest rate equal to the base interest rate charged on the associated borrowing (i.e. excluding any margins).



## Appendix 2: Cameron Partners Report

In their report of August 2014 Cameron Partners conclude that the Council will need to look at what its strategic objectives are for its assets in terms of quality, availability and price of services, and impact on regional economic development.

### Key questions:

- what are the Council's strategic objectives for its assets?
- does it need to retain ownership to ensure those objectives are met?
- can its objectives be met through regulation or policy?
- can it contract for or enter into partnerships to ensure its objectives are met?

Some assets may not require Council involvement because third parties can provide the same services, with regulation ensuring Council's required outcomes are met.

The Council may need to own / fund assets which provide public benefits that would be uneconomic or too risky for the private sector to provide, e.g. public open space, civic facilities, roads. Some assets may be able to be provided by the private sector with the Council contracting for the services it requires.

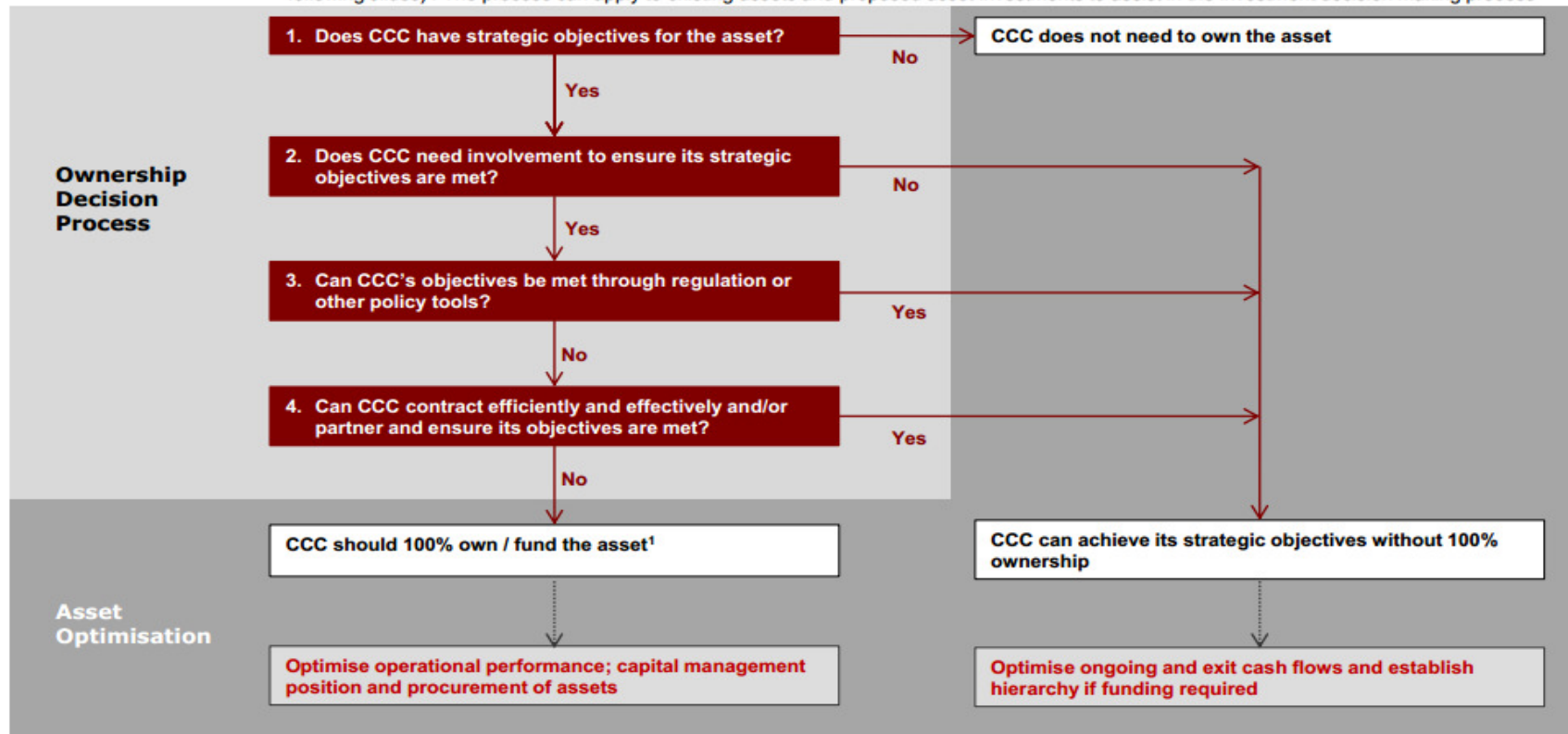
### Options for changing asset ownership while meeting the Council's strategic objectives:

- set a sale price that reflects the need to meet Council objectives and ensure contracts with new owners of the business asset are suitably aligned
- partial sell-down with shareholders agreement / changes to constitution to ensure the strategic objectives are met
- achieve Council's strategic aims through contractual arrangements
- partnering with other like-minded investors / long-term strategic partners (Crown, local authorities, iwi)
- this is shown diagrammatically on the next page and the full report is available at <http://resources.ccc.govt.nz/files/TheCouncil/policiesreportsstrategies/reports/CameronPartnersReviewAugust2014.pdf>

## 7. Asset Optimisation

### Assets Requiring CCC Involvement – Decision Framework

- The process for assessing whether CCC involvement is required or not is broadly as outlined in the following flow chart (with commentary on the following slides). The process can apply to existing assets and proposed asset investments to assist in the investment decision making process



<sup>1</sup> An exception could be where an investor is aligned with CCC and is happy for its non-value maximising objectives to be pursued – e.g. Govt; other local authorities; iwi; philanthropic sources)