Financial Strategy

Financial Strategy 2018-2028 Long Term Plan

Contents

1 Introduction

Under the Local Government Act 2002 a local authority must, as part of its long term plan, prepare and adopt a financial strategy for the financial years covered by the long-term plan.

The strategy explains the Council's current and forecast financial position and identifies the changes to expenditure, non-rates revenue and debt of the three financial options between the draft Long Term Plan and that adopted by Council as part of the final Plan.

The Council's Service Plans and 30 Year Infrastructure Strategy underpin this Strategy and should be read in conjunction with it. The future work programmes detailed in those documents are based on achieving the Council's agreed Levels of Service and on achieving standards imposed on local government by central government (such as drinking water standards). Other supporting documents include the Council's Revenue and Financing Policy, which details how the operating and capital costs of each Council activity will be funded; and the Council's Significant Forecasting Assumptions.

2 Overview

This Financial Strategy replaces the one adopted in June 2016 as part of the Amended Long Term Plan 2015-25. The previous Financial Strategy was based on the assumption that the Christchurch City Holdings Limited (CCHL) subsidiary, City Care Limited would be sold as part of a $750 million capital release programme, originally committed to in 2015, and amended to $600 million in 2016. This did not eventuate. An amended programme was developed with CCHL committing to provide $440 million over the years 2015/16 - 2018/19; a further reduction of $160 million. That capital release programme has been retained as part of this LTP along with debt, rates and government subsidies as the key sources of funding.

The Council is investigating other funding options including a fuel tax, such as is planned for Auckland along with further collaborations or joint ventures similar to the Community Wellbeing and Resilience Partnership fund.

Council is in discussion with the Crown over a potential global settlement and allocations from a $300 million Capital Acceleration Facility relating to Anchor Projects and potentially other matters. This follows from earlier Crown and Council agreements following the Canterbury earthquakes, in particular the Cost Share of 2013 and the public pronouncements from Government. Because this is yet to be confirmed neither this funding nor the offsetting cost has been incorporated into the Long Term Plan, however it is highly likely, that subject to an approved business case, funding from this facility will be used as the Crown's contribution to the

Multi Use Arena (Stadium). The timing and project(s) for the remaining funding is still to be determined.

This Strategy seeks to reconcile the relationship between the expenditure required to deliver the levels of service the community expects, and the call on funding from rates and debt. These factors are inter-related and movement in one causes movement in at least one of the other variables. For example, if rates are reduced then some combination of reduced or delayed expenditure is required, which in turn will likely result in a reduced level of service being delivered, or increased debt.

Balancing levels of service and cost is more complex for Christchurch City Council than for other local authorities as we continue to address the impacts of the earthquakes of 2010/11 on Council infrastructure and service provision.

This Financial Strategy presents the Council's solution to these challenges and details the key financial parameters and limits that the Council will operate within over the period of the Long Term Plan (LTP).

With limited funding options available, this LTP incorporates rescheduling (through deferring aspects of) the capital programme, with some reductions in the levels of service, as a means of keeping rate increases to an acceptable level. Councillors have requested that rate increases be held to a maximum of 5.5 per cent in each of the next two years, then reducing over time to be closer to the local government rate of inflation.

In the Draft Long Term Plan three capital programme scenarios were considered with differing levels of investment over the life of the LTP - low, medium (preferred) and high.

The budget for the medium, (preferred option) was to deliver $15.2 billion over 30 years; $4.2 billion within the 10 year LTP period.

Of the three options, only the preferred one, based on a medium capital programme, provided a financially viable and prudent long term solution. The capital programme is further discussed in Section 5 and the rates and debt effect are set out in sections 8 and 9 below, but in summary;

- The preferred option as modified following consultation has a rates increase of 5.5 per cent in 2018/19, plus the ten year special heritage (Cathedral) targeted rate (0.22 per cent). The average rate increase to existing ratepayers for the 10 years of the LTP is 4.3 per cent per year. Gross debt plateaus at $2.7 billion in 2026. Water supply, wastewater and stormwater assets would be maintained in their current condition.

- The net debt/ revenue ratio peaks at 221.4 per cent in 2024 and declines to under 150 percent by 2035, well within the New Zealand Local Government Funding Agency Ltd (LGFA) limit for net debt to revenue of 250 per cent. Council complies with all of its Financial Prudence benchmarks other than two:

- Balanced budget benchmark; in the period 2020 – 2023, planned revenue is marginally less than planned expenditure. The difference of 1 per cent is due to an insufficient allowance for asset renewals, which is rated for in lieu of depreciation. The rating for renewals increases steadily across the LTP period and the 4 year shortfall is not considered to be a material breach. The graphs are contained within the Financial Prudence Benchmarks section of the LTP.

- Debt servicing bench mark; planned borrowing exceeds the 10 per cent benchmark from 2019 onwards, peaking at 14.5 per cent in 2024 before reducing slightly. If Christchurch was considered to be a high growth council the benchmark would be 15 per cent. The benchmark was designed to allow comparison between councils and the legislators did not contemplate the cost involved in recovering from an earthquake. Council has sufficient operating funds to service the debt.

Financial headroom (the ability to borrow more if required without breaching financial covenants) has a low point of $269 million in 2023, significantly less than the 2016 Amended LTP's figure of $529 million in 2020. This is largely due to Council borrowing $160 million in lieu of receiving it as a capital release from CCHL. The value of headroom is that it allows for a degree of flexibility in the future if unforeseen circumstances arise. This is considered a prudent level of headroom.

There are a number of possible new work streams within the Council's overall work programme that are being discussed and/ or evaluated but which have been assumed will not progress in any significant way in the lifetime of the Long Term Plan 2018-28. These are:

- Projects to protect infrastructure from the natural hazards arising from climate change (e.g. sea level rise and coastal erosion), noting that climate change is taken into account where possible when designing new projects
- Additional contributions to regeneration projects, particularly Ōtākaro-Avon River corridor and Cathedral Square, other than $9 million for Cathedral Square, $118 million for Avon flood plain management and stormwater treatment and $26 million for New Brighton regeneration projects
- Alpine Fault earthquake (AF8) readiness, in addition to the civil defence preparedness already undertaken by the Council
- Variations to the Cost-Share Agreement with the Crown (e.g. Multi-purpose Arena)
- Moving to dispose treated wastewater to land, other than for Duvauchelle.

3 Context

Earthquake recovery

Significant earthquake-related investment is still required in Council's key infrastructure assets of roads, water supply, sewerage, and flood protection. Although the investment undertaken by the Stronger Christchurch Infrastructure Rebuild Team (SCIRT) has now been completed, this was only intended to provide for restoration of service provision of broken infrastructure – large parts of the networks remain functional but significantly damaged, and the investment needed to repair these and restore desired levels of service will continue to place pressure on Council's capital spending and borrowing requirements for many more years to come.

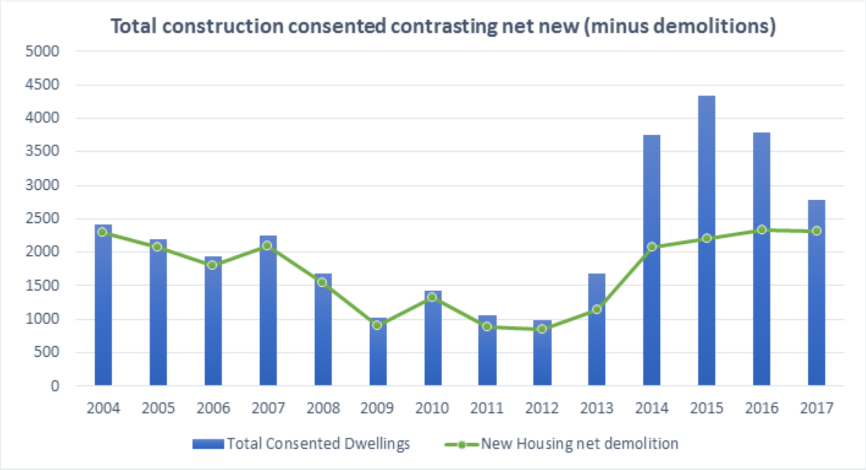
Council is progressing well with its facility and heritage asset restoration/replacement projects with many now open to the public. Council committed to a programme early on in the recovery process to ensure local communities could return to a level of normality.

The Council also has commitments to Anchor Projects, and will face on-going operating cost pressures as new community facilities (such as the Central Library and Metro Sports facility) are completed.

In the private sector, earthquake recovery is progressing well – the District's population recovered to its pre-earthquake level in June 2017, and house prices have stabilised (in contrast to the increases seen in many other urban centres). Although numerous vacant spaces remain in the smaller CBD, a substantial number of major commercial tenants have re-established their central presence.

New Building Consent volumes have declined significantly towards pre-earthquake levels, indicating that a substantial portion of private sector rebuild activity has been completed.

New Building Consents (historical annual volumes)



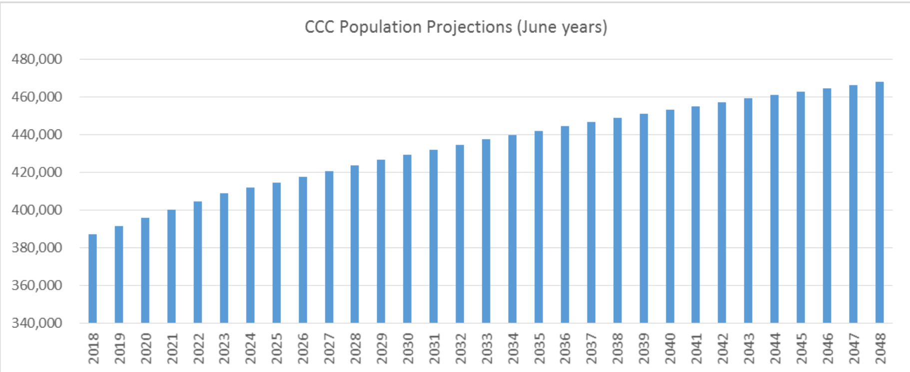
However, this gradual normalisation of residential and commercial development activity will place additional pressure on Council's budget, as its on-going cost pressures will need to be met without the benefit of a fast-growing rates base – the natural growth in Council's rates revenue is projected to decline back towards a pre-earthquake population-driven pace over the ten years covered by this LTP.

4 Population and land use

All population figures and projections in this section are sourced from the Department of Statistics unless otherwise stated.

The estimated population of Christchurch at June 2017 was 381,500 (National Population Estimates release, August 2017). This population is projected to rise to 387,200 by June 2018, to 423,800 by June 2028, and to 467,900 by June 2048 (Subnational Population Projections release, December 2016). This equates to average growth of around 0.9 per cent each year for the 2018-2028 LTP period, compared with national population growth of around 1.03 per cent each year over the same period.

Christchurch Population Growth (Statistics New Zealand Subnational Population Projections, December 2016)



The neighbouring districts of Waimakariri and Selwyn are expected to continue their rapid population growth over these periods (by 27,900 new residents combined by 2028, or 2.1 per cent per year on average), increasing commuter pressures on Christchurch's transport infrastructure due to work, shopping, and leisure travel demand.

The Christchurch population projection is significantly higher than in the 2015-25 Amended LTP, which had projected the June 2017 population to be around 365,000. However, this increase is effectively a post-earthquake re-population of the city rather than "new growth" – the actual June 2017 population is only slightly higher than before the earthquakes.

Population increases over the LTP period are expected to be slightly front-loaded, with annual growth levels of around 1.1 per cent per year expected to persist until June 2023 before dropping back to a more normal growth rate of around 0.7 per cent per year thereafter.

Such population growth, along with a significant portion of the replacement housing stock being developed in greenfield areas, will tend to increase demand pressure on infrastructure and services. There is currently around 2,385 hectares of vacant land available for residential development, and around 1,098 hectares for commercial and industrial development.

A key demographic challenge for the city in future will be the impacts of an aging population, which may impact both the size and value of new dwellings and residents' ability to pay.

5 Capital Programme

The capital works programme reflects the analysis of the city’s infrastructure requirements which was undertaken in preparing the Infrastructure Strategy, Service Plans and Asset Management Plans. These plans link the forecast asset renewal requirements, growth demand, levels of service requirements and the imperatives of Council strategies such as the Greater Christchurch Urban Development Strategy and the Government’s Land Use Recovery Plan.

The Infrastructure Strategy proposes a 30 year plan for the Council’s infrastructure that provides the services of water supply, wastewater, stormwater (including flood protection), transport, parks, facilities, solid waste and communication technology.

The 2018 Infrastructure Strategy is based on consideration of the four most significant issues impacting on Council infrastructure planning and delivery:

- Asset renewals – the proportion of Council infrastructure in poor condition and/ or approaching the end of economic life is increasing. Under investment at this stage will create a “bow wave” of required infrastructure investment in future years. This issue is most acute in the water, wastewater and stormwater networks and to a lesser extent roads and footpaths.

- Climate change – the effects of climate are likely to require changes to infrastructure requirements, particularly for stormwater and flood protection.

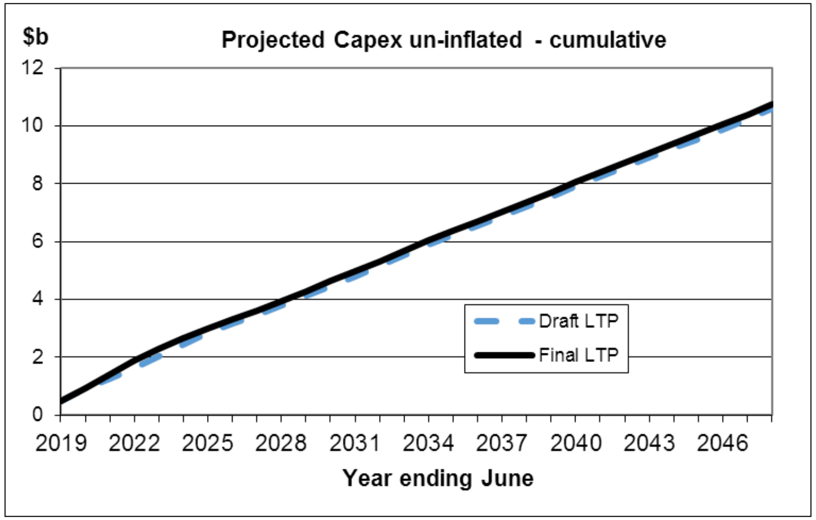
- Post-earthquake recovery and regeneration – the SCIRT repair programme mostly used a patch-repair approach to reinstate network function rather than replacement of all damaged infrastructure. There remains significant proportions of infrastructure networks that will require more permanent repair treatment.

- Affordability - the Council is conscious of the effect increasing rates can have on residents and on the ability to attract and retain new residents. A balance of quality infrastructure, facilities and services with an affordable cost is required.

These issues closely reflect and build on the significant issues identified in the 2015 Infrastructure Strategy. The key difference between the 2015 and 2018 strategies is that the understanding of the impact of them on infrastructure has improved. This is due to greater information about both the current condition of Council infrastructure and the issues themselves.

The capital works programme is the largest area of Council expenditure where there are clear options available around the level of investment, albeit with consequences on the Council’s ability to provide reliable infrastructure, meet the demands of growth and meet the community’s expectations in terms of the levels of service provided.

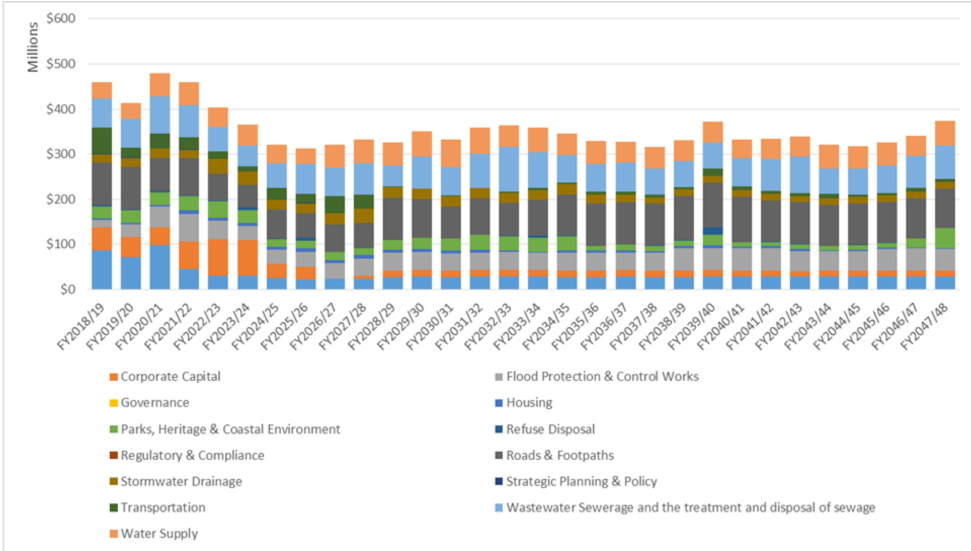
Graph of capital expenditure



The capital expenditure programme for the next 30 years is shown in the graph below, and reflects the asset programme included in the Infrastructure Strategy, work programmes and budgets of the LTP. This includes the replacement of post-World War II infrastructure which is near the end of its useful life. This asset renewal programme has always been known and planned for, but has been accelerated by the reduction in useful life of many assets as a result of the earthquakes. 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 capital spend for the next 30 years, by Group of Activity

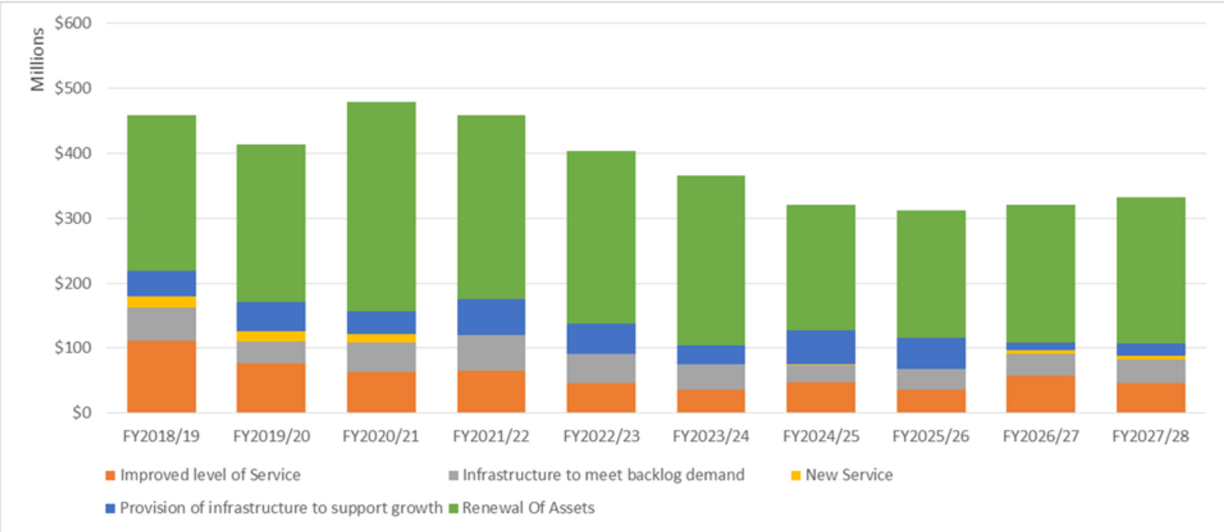
Capital Spend (2018/19 dollars)



The total capital programme for the ten years of the Long Term Plan includes infrastructure, as well as non-infrastructure programmes for community facilities and internal services such as Information Technology, vehicle fleet and corporate accommodation. It includes a provision for the renewal of existing assets, plus additional capacity to meet demand growth and increasing levels of service. This planned capital expenditure is summarised by these categories in the graph below.

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

Capital Programme by Primary Driver (2018/19 dollars),



6 Other factors impacting the financial position

Levels of Service

The Long Term Plan details the levels of service proposed to be provided for each activity. These levels of service were consulted on with the community through the Consultation Document.

There is normally a close correlation between cost and level of service. More investment will normally enable a higher level of service to be delivered, with the opposite being the case for a reduced investment. Achieving a balance between community expectations and willingness to pay lies at the heart of the trade-offs necessary when the Council prepares its work programme and budget.

There are two aspects to investing to deliver levels of service. Firstly there is investment in maintaining and replacing existing assets, normally to maintain the level of service currently provided. The other is investment in new capital assets to cater for growth demand and/ or increase the level of service provided. This section looks at the considerations the Council has made in terms of balancing the cost of service with the level of service provided.

Roads and Footpaths

Renewal works will be prioritised across the whole network to ensure delivery of the levels of service at the lowest lifecycle cost. The level of investment proposed will see levels of service gradually increasing over time. The annual number of deaths and serious injuries on the road network is expected to decrease from 120 to 100 over the next ten years, and road roughness is expected to improve to a level similar to other New Zealand cities over 20 years. Resident satisfaction with road condition is expected to improve as a result.

To enable the community to monitor progress, the Council continues to measure the average roughness of the roading network. This measure also allows residents to benchmark Christchurch roads with those of other Councils.

The Council's roading work programme is heavily influenced by its Government funding partner the New Zealand Transport Agency (NZTA). The Council and NZTA share the costs of most roading work and therefore need to agree on an optimal programme of works. This partnership approach means there are incentives for the Council to match its work programme to the NZTA investment funding available.

Three Waters

'Three waters' are comprised of water supply, waste water and storm water.

For water supply renewals, there is a relatively steady planned spend which will maintain the overall current condition of the water supply network.

Following consultation the funding of wastewater renewals has been increased from the Draft LTP to maintain the overall current condition of the wastewater network.

It is expected that there will be a steady reduction in the number of houses at risk of flooding, a reduction in stormwater contaminants, and a reduction in complaints about stormwater system performance. As a result resident satisfaction with management of flood risk should improve.

More information around the actual level of service for each activity can be found in Service Plans. Links to specific levels of service for each activity (and their trends over time) are available at https://www.ccc.govt.nz/the-council/plans-strategies-policies-and-bylaws/plans/long-term-plan-and-annual-plans/ long-term-plan-2018-28/service-plans.

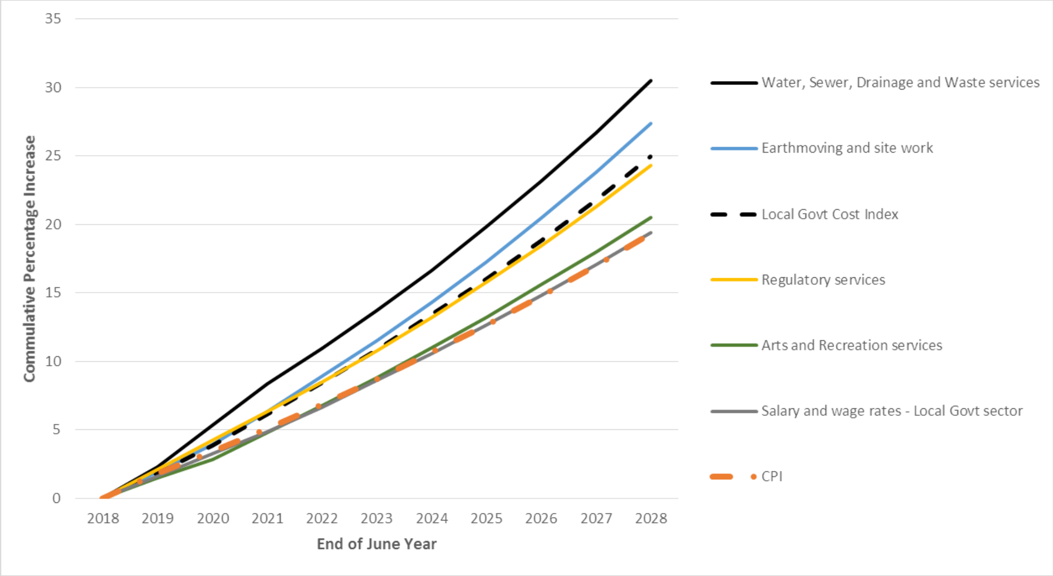
Sport and Recreation and Arts and Culture

The Council is proposing increased levels of service for these activities as a result of new swimming pool facilities in the Central City, Woolston/Linwood and the South West of the city along with new libraries in the City centre and South-West. The Council contribution to the cost of these facilities is funded through borrowing. The additional operational costs of these facilities are rated for and come on stream between 2018 and 2023.

Inflation rates

The table below shows the projected rates of inflation for the Council's main activities over the next 10 years. The overall Local Government Cost Index, based on the specific cost drivers affecting the Council is higher than CPI (consumer price index) inflation. This is due to the types of expenditure the Council incurs, (which does not include significant expenditure on manufactured goods and food which tend to moderate CPI increases), and helps explain the difficulty faced by all Councils in holding rates to the publicised inflation rate.

Council-related cumulative inflation projections, June 2019 – June 2028 (BERL)



Capital Release

$300 million of capital has been released from CCHL by way of dividends and balance sheet restructuring (increasing CCHL debt) over the past three years, and a further $140 million is planned in 2018/19. This level of capital release is deemed financially prudent, and achieves an acceptable balance between controlling the Council's need to borrow and ensuring that future dividend income from CCHL remains adequate.

The Council has is no plans to sell any assets owned by CCHL.

Rating Base Growth

The term “Rating Base Growth” refers to the expectation that Council’s rates revenue will grow each year due to the development of new subdivisions and buildings (which will tend to be worth more than un-developed land and so will attract higher rates). Such development will also increase demand for council services and infrastructure. However, existing ratepayers will not pay any more in rates until the increase in the council’s rates requirement exceeds the revenue generated by the growing Rating Base.

Growth in the Rating Base is influenced by four key factors: Population growth (which will tend to increase the need for more subdivision and building); the increasing number of households (which is likely to be slightly higher than population growth, due to an expected decline in the average number of people per household as the population ages); the increasing number of individual properties or rating units (which at least initially will be lower than household growth because of the extent of land already subdivided – a new building on an existing section does *not* increase the number of rating units because the section already existed prior to being built on); and the marginal value of future development (for example. a new house on an existing section will only have a marginal impact on the Council’s Rating Base, because rates are already being charged on the vacant section).

For planning purposes, it is assumed that:

- Growth in the district’s population and number of households will be in line with the Department of Statistics’ most recent projections (subnational population projections, December 2016).
- The number of rating units (including residential and commercial) will tend to grow at around the same pace as household growth in the long term.
- The Rating Base (council’s revenue) will tend to grow at around the same pace as population growth in the long term – i.e. slower than the growth in rating units, in part because at least some rates are already charged on undeveloped land, but also due to an expected trend towards smaller dwellings as the population ages.
- However, in the *short term*, growth in both the number of rating units and the Rating Base will be slower than projected household and population growth (respectively) due to the extent to which future development land has already been subdivided and rated.

These assumptions result in the following projections for the number of people, households, and rating units in the 2018-28 LTP period.

Growth Assumptions, 2018-28 (number of people and properties)

June Years	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027	2028
Population	387,200	391,520	395,840	400,160	404,480	408,800	411,800	414,800	417,800	420,800	423,800
Households	150,900	152,880	154,860	156,840	158,820	160,800	162,300	163,800	165,300	166,800	168,300
Rating Units	169,027	170,886	172,766	174,494	176,239	177,913	179,514	181,130	182,760	184,405	186,065

These growth assumptions are the basis for the council’s projected Rating Base growth over the period. Expressed as percentages per year, projected growth rates are as follows:

Projected Growth, 2018-28 (percentage per year)

June Years	2019	2020	2021	2022	2023	2024	2025	2026	2027	2028
Population	1.12%	1.10%	1.09%	1.08%	1.07%	0.73%	0.73%	0.72%	0.72%	0.71%
Households	1.31%	1.30%	1.28%	1.26%	1.25%	0.93%	0.92%	0.92%	0.91%	0.90%
Rating Units	1.10%	1.10%	1.00%	1.00%	0.95%	0.90%	0.90%	0.90%	0.90%	0.90%
Rating Base (revenue)	0.90%	0.85%	0.80%	0.80%	0.80%	0.70%	0.70%	0.70%	0.70%	0.70%

From 1 July 2018 earthquake-related legislation allowing the Council to increase rates on newly-developed property during the rating year will expire. In future, rates must be calculated based on the value of each property as it exists on each 1 July, in line with normal sector practice. This will reduce the Council's intra-year revenue by the amount that would have been collected from new developments through the year.

Insurance

The Council has progressively increased its level of insurance cover over the City's assets as insurance providers have re-entered the Christchurch market after the earthquakes. This extends to full cover including earthquake cover for 894 buildings, valued at $1,985 million, and cover for fire and other perils, excluding earthquake, over a further 316 buildings valued at $228 million. The remaining 654 buildings totalling $168 million, with individual values of less than $2 million, remain self-insured.

The Council has $500 million of cover on below-ground water supply, waste water and stormwater pipes and this will be further increased as additional cover becomes available. In the event of another significant earthquake Council is relying on a combination of insurance and its borrowing capacity to fund it's 40 per cent share of any damage incurred, thereby entitling it to the remaining 60 per cent under the Government's Civil Defence and Emergency Management Plan. The combination of insurance and Crown funding currently provides Council with approximately $4.3 billion of cover for assets with a replacement value of $6.3 billion. To put this into context, the Council's has spent around $3 billion on underground assets following the 2010/11 earthquakes.

7 Financial Strategy, focus and principles

The Financial Strategy needs to strike an optimal balance between: (i) the expenditure required to deliver desired levels of service; (ii) the need to limit rates increases to levels which are acceptable and affordable to ratepayers; and (iii) the need to maintain debt levels within the limits required by lenders.

These factors are inter-related and movement in one must be balanced by movement in at least one of the other variables. For example, if rates are reduced then some combination of reduced expenditure, which would likely result in a reduced level of service, or more debt will result. Similarly, if debt levels are reduced then some combination of reduced expenditure, or higher rates will result.

The focus of the 2018-28 Long-Term Plan is therefore on scheduling and delivering a level of infrastructure investment that will enable the safe and reliable delivery of acceptable services while controlling debt within financially sustainable levels and limiting rates increases to an acceptable level.

In developing this strategy, the Council believes it is important to:

- Keep debt to a level that gives the Council the capacity to borrow beyond 2028 in the event of an emergency.
- Spread the cost of new capital assets across current and future ratepayers who will benefit from the services the assets provide (intergenerational equity). The Council's policy is to achieve 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. Specifically, in the event of another disaster the Council needs to be in a position to fund its share of the repair and rebuild costs. The Government's Civil Defence and Emergency Plan covers 60 per cent of the cost but only if the Council can meet the first 40 per cent. The challenge facing the city is to do this over an appropriate timeframe while not over-burdening current ratepayers.

  The Council holds significant investments through CCHL but these are not readily convertible to cash during the first critical 12 month period following a disaster when response costs are highest. It is considered unrealistic to build a strategy which positions the Council to be in the financial position to withstand another significant disaster in the short term. The period of time to achieve this financial resilience is a key parameter of the financial strategy and realistically occurs around 2031 when the net debt/ revenue ratio falls below 170 per cent.
- Maintain a balanced budget; i.e. ensure that revenue continues to meet expenses. This financial prudence benchmark is not met in the period 2020 – 2023 as planned revenue is marginally less than planned expenditure. The difference is 1 per cent, and is due to the level of rating for asset renewals being less than depreciation expense. The rating for renewals increases steadily across the LTP period and the 4 year shortfall is not considered to be a material breach.

- Maintain rating for renewals at a level which recovers around 57 per cent of estimated depreciation, increasing to around 74 per cent of estimated depreciation by 2028. This means that the Council is increasing its rating for renewals to a more appropriate level over the period of the LTP, although it will be some years before this is achieved. Other external revenue, mainly from NZTA, funds 6% of Council's renewal programme.

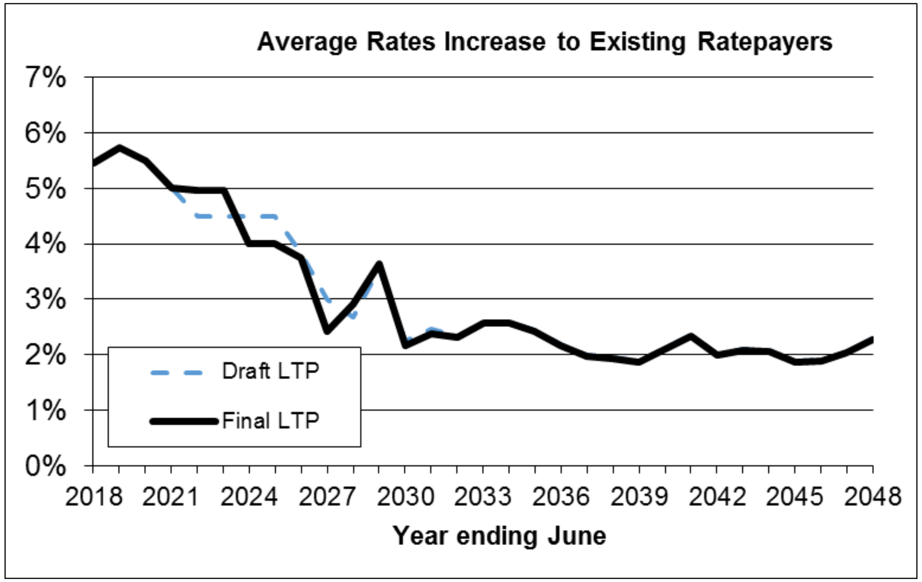
- Maintain a policy of financial prudence through managing revenues, expenses, assets, liabilities, investments, and general financial dealings prudently and in a manner that promotes the current and future interests of the community through all of the above.

8 Rates projections and limits

Annual Rates Increases

Annual rates increases are shown in the graph below, and include the 0.22 per cent ($6.52 each year for 10 years) special heritage (Cathedral) targeted rate for the $10 million cathedral grant.

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

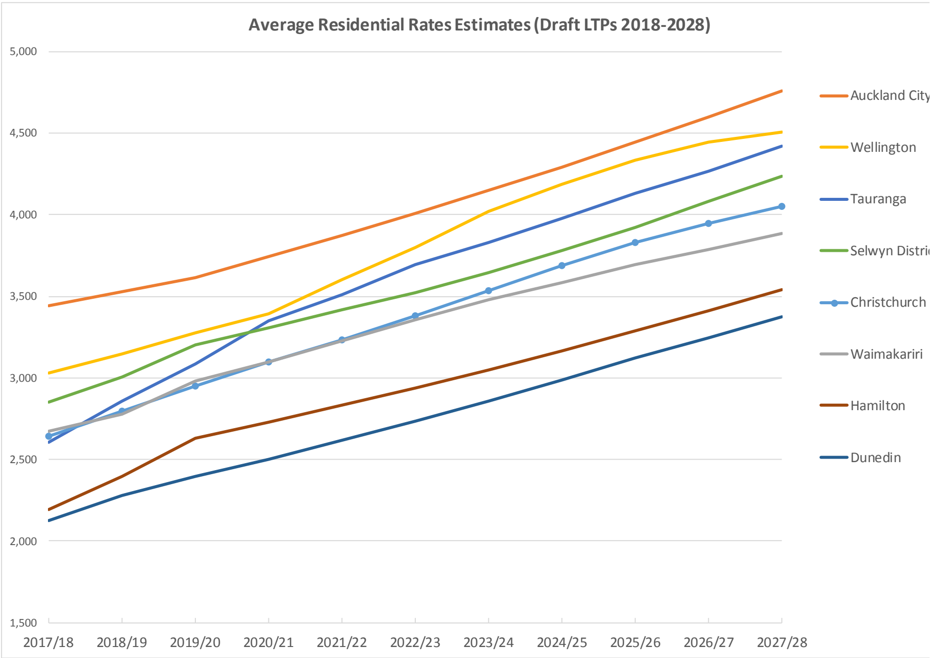


The financial strategy has a slightly higher overall rates increase over the next five years than the draft and the previous Amended LTP. The proposed rates increases to existing ratepayers over the LTP period are as follows, (inclusive of 0.22 per cent for the ten year special heritage (Cathedral) targeted rate:

Year	2018/19	2019/20	2020/21	2021/22	2022/23	2023/24	2024/25	2025/26	2026/27	2027/28
Increase	5.72%	5.5%	5.0%	4.97%	4.97%	4.0%	4.0%	3.75%	2.42%	2.92%

Although rates increases over recent years have been significant, the cost of rates in Christchurch remains comparable with that of other metro councils. The following chart shows average rates per rating unit for a range of metro councils plus Selwyn and Waimakariri – figures are estimates for the average residential property (including GST but excluding any Regional Council charges), based on information published in each council's Draft Long Term Plan 2018-28.

Average Rates Revenue per Rating Unit (selected Councils) (including GST but excluding any Regional Council rates)



Quantified Limitations to Rates Increases

Section 101A of the Local Government Act 2002 requires local authorities to fix a limit on annual rates increases for each year in the LTP period. The Council has set these higher than the rate increases proposed (and shown in the chart above), to allow for budget flexibility in the event of unexpected adverse developments in the Council's position or operating environment. Importantly, they also relate to ***total rates income*** (i.e. including natural growth from the development of new properties) – the increase to existing ratepayers will always be lower as long as the number of ratepayers continues to grow. For this reason, existing ratepayers should focus on the previous table as an indicator of likely future rates increases rather than the table below.

The limit for rates revenues and rates percentage increases is set at one per cent above the rates income and increases contained in the draft LTP financial statements.

Quantified limits for rates increases

Year	2018/19	2019/20	2020/21	2021/22	2022/23	2023/24	2024/25	2025/26	2026/27	2027/28
Rates ($m)	495	527	558	590	624	654	685	715	737	764
Increase	9.13%	7.41%	6.86%	6.76%	6.79%	5.80%	5.71%	5.46%	4.12%	4.63%

9 Debt projections and limits

Debt Projections

Ability to borrow is limited by a lenders' willingness to provide credit as well as ratepayers' ability to service future interest costs and principal repayments. Council maintains several covenants with lenders which set specific limits on borrowing – most importantly, that total net debt may not exceed 250 percent of total operating revenues.

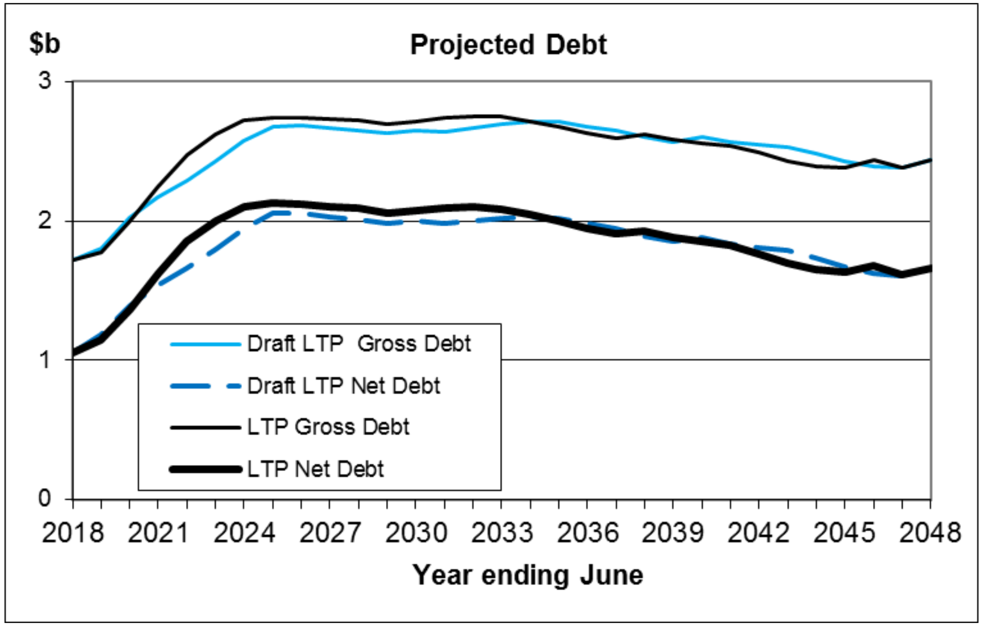
A prudent strategy should restrict planned borrowing to materially less than this covenant limit, to allow for budget flexibility in the event of unexpected adverse changes to the financial position or operating environment over the period. The maximum debt/revenue ratio in this LTP is 221.4 per cent in 2024, which provides "headroom" (the ability to borrow more if required without breaching financial covenants) for that year of $272 million, significantly less than the 2016 Amended LTP's figure of $529 million in 2020. This is largely due to Council borrowing $160 million in lieu of receiving it as a capital release from CCHL. It is also $148 million less than the Draft LTP due to bringing forward expenditure on the Multi Use Arena. In 2025 the ratio drops to 211.5%, reducing down to 189.9% in 2028.

Council is currently in negotiation with the Crown regarding allocations from the $300 million Capital Acceleration Fund. This funding is subject to an approved business case and timing and quantum are still to be determined. Because of this no provision has been made within the Long Term Plan, however any funds received will reduce the debt to revenue ratio in that year. Given the size of Council's existing capital programme over the next three years, any new projects which may result from access to this Fund are likely to be scheduled in 2024 thereby reducing the peak in the debt to revenue ratio.

Key debt and interest cost projections are shown in the following charts

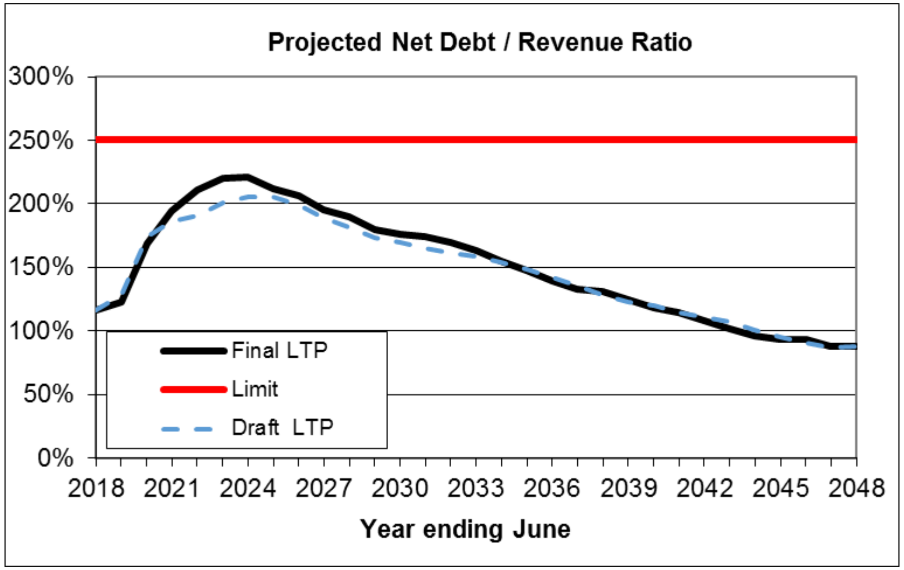
Projected debt

Debt increases through to 2025, just after the Multi-use Arena is completed. Increased rating for asset renewals through to 2029 contributes to debt levelling out after that time.



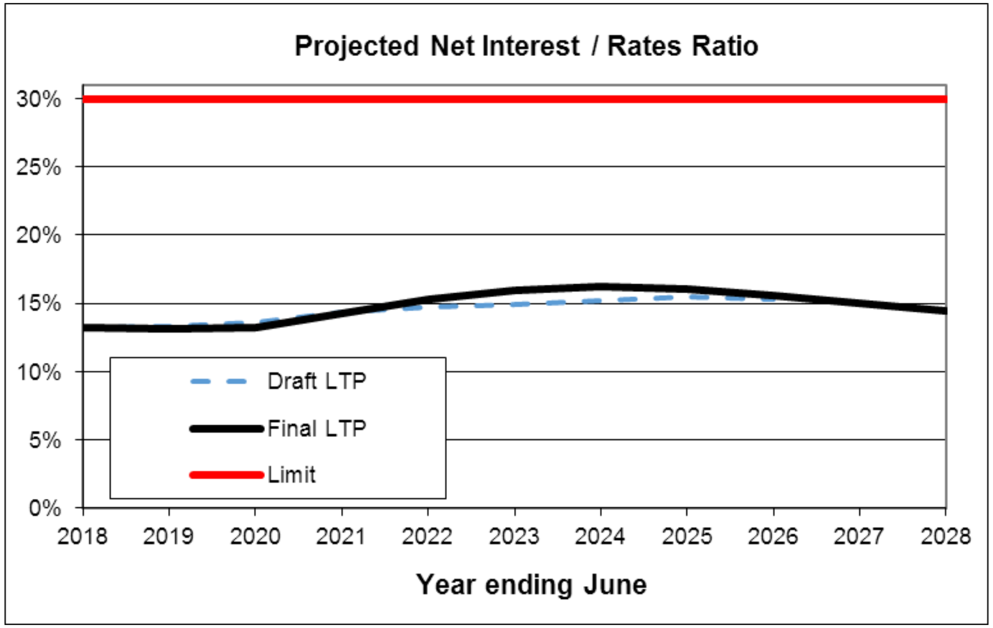
Net debt to revenue for the next 30 years

The graph below shows the projected net debt ratio. It is higher than the previous Amended LTP in the LTP period, partly due to the reduced capital release. In the longer term the net debt ratio is lower due to higher rating for asset renewals and debt repayment.

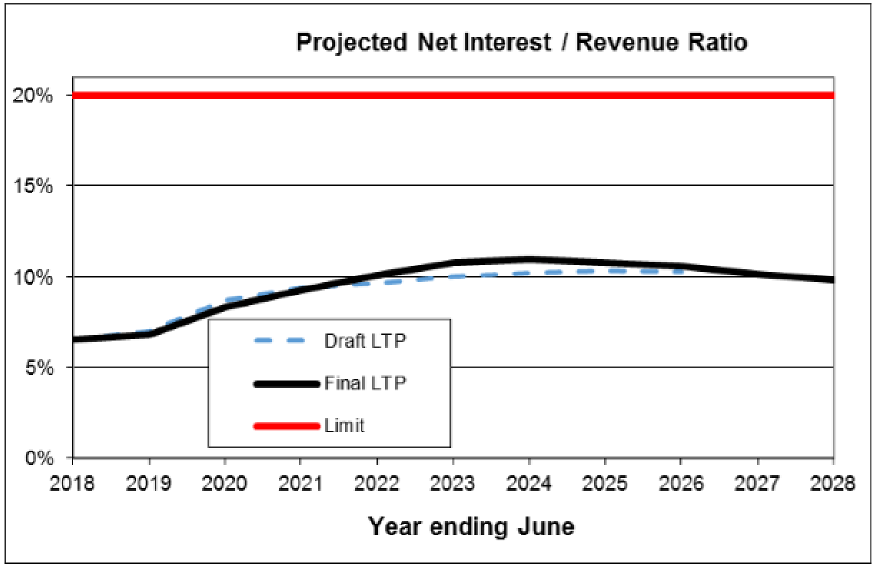


The two ratios shown below indicate the interest costs associated with servicing debt remain within the Council's self imposed limits.

Net cost of interest to rates income for the next 10 years



Net interest to revenue for the next 10 years



These charts show that the Council's total debt continues to climb until 2025 as a result of capital improvement in infrastructure improvement, anchor projects, and replacement assets. Over the longer term the net debt level decreases due to increasing rating for renewals and debt principal repayment. Interest costs remain within prudent levels and within Council's ability to repay principal amounts in an orderly manner.

Credit Rating

A credit rating affects how willing lenders are, to lend to the Council and the interest rate that will be charged. This Financial Strategy seeks to support Council's current "A+ (Stable)" credit rating from Standard & Poor's. This credit rating would likely be reviewed downwards if the overall 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 Council's lenders and consider a wider range of factors. A Standard & Poor's assessment also includes consideration of the economic environment, Council's financial management, liquidity, and budgetary performance and flexibility. It also considers the stability of governance and executive management and its willingness to make hard decisions.

Any downgrade in rating would have only a marginal impact on interest rates, but could increase interest costs by as much as $4 million per annum in the later years of this Plan. This has not been incorporated into these financial analysis underpinning this strategy. 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.

Security on borrowing

Borrowing is secured by way of a charge over future rates revenue, consistent with normal sector practice.

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 will only be 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.

Quantified Limitations to Debt Increases

The Council is proposing to raise the current debt level (as shown in the charts above), to enable the funding of the proposed capital investment programme, while retaining budget flexibility in the event of unexpected adverse developments in the Council's position or operating environment.

Section 101A of the Local Government Act 2002 requires local authorities to state a maximum limit to debt increases over the LTP period.

Proposed limits for the debt increases are shown in the table below. These have been set at 250 per cent of annual revenue, liquid assets, and on-lending to Council Controlled Organisations. The limits are a "worst case" maximum borrowing scenario, and ratepayers should focus on the graphs above for a better indication of likely actual debt increases.

Quantified limits for debt increases

Year	2018/19	2019/20	2020/21	2021/22	2022/23	2023/24	2024/25	2025/26	2026/27	2027/28
Borrowing	2,966	2,657	2,715	2,812	2,894	2,995	3,132	3,192	3,314	3,388
Debt headroom ($m)	1,191	662	467	340	269	272	387	449	584	663

10 Council Investments

Working Capital & Special Funds

Council routinely holds significant working capital cash balances, due to the timing differences between spending, which occurs relatively evenly over the year, and rates income which varies from month to month. In addition balances are maintained in various Special Funds, although these are lent internally for Council purposes wherever possible.

Investment of these balances is undertaken in accordance with the Council's the Investment Management Policy but is conservative – generally limited to cash and short-term bank deposits, to reflect the likelihood of funds being needed relatively frequently to meet on-going payments.

Borrower Notes

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. This ensures the stability of LGFA's financial position, and provides a high level of confidence that the LGFA will continue to be a cost-effective source for the bulk of the Council's long-term borrowing requirements.

The 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).

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. The total face value of these loans at 1 July 2017 was $8.1 million.

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 the Council to economic development, and community events and projects activities. 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 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 during the Long Term Plan of:

	2018/19	2019/20	2020/21	2021/22	2022/23	2023/24	2024/25	2025/26	2026/27	2027/28
Return	3.50%	3.52%	3.54%	3.56%	3.62%	3.64%	3.70%	3.83%	3.83%	3.83%

Council Controlled Organisations, (CCOs and CCTOs)

The Council's main investment is in CCHL which holds investments on behalf of the City and provides a dividend return each year which is used to reduce the Council's rate requirements. The average cash dividend yield on Council's CCHL investment, calculated using a valuation of CCHL by an independent valuer, has averaged 2.3 per cent in the last three years and 3.3 per cent in the last ten 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 17.5 per cent a year, or 25.6 per cent a year since 1996. This significant return is due to asset growth.

Capital release mechanisms used 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.

The risk to Council of investing in these companies is low.
A list and description of all of the Council's CCOs and CCTOs is provided in Appendix 2.

Appendix 1 - Major Community Facilities /Anchor Projects

The Council remains committed to the post-earthquake rebuild, construction or repair of the major community facilities listed below, either as part of the Cost Share Agreement (CSA) with the Crown or on its own. Facilities which are part of the CSA are marked with an asterisk. The CSA is the underlying document between Council and the Crown that determines the cost contribution, ownership and operating cost responsibilities for each of the Anchor Projects.

For most facilities the future ownership is clear, but where the CSA is ambiguous assumptions have been made for the purposes of this LTP:

Council Contributions to Major Community Facilities / Anchor Projects

	Council contribution ($m)	Complete?	Assumption
Christchurch Art Gallery	57.6	Yes	Council ownership and operation
Turanga: new Central library*	92.7		Council ownership and operation
Nga Puna Wai Sports Hub Stage 1 (1)	53.7		Council ownership and operation
Taiora: QEII Recreation and Sports Centre	38.6	Yes	Council ownership and operation
Christchurch Town Hall* (1)	152.2		Vbase ownership and operation
Performing arts*	31.3		
South West Library, Customer Services and Leisure Centre	35.7		Council ownership and operation
Convention Centre*	-		Crown ownership and operation
Car parking *	70.0		Council / private ownership and operation
New multi use arena*	253.0		Funded in the years 2021 – 2024
Central city metro sports facility*	151.3		Council ownership and operation
Avon river park*	6.4		Council ownership and maintenance
Transport Interchange*	29.9		Council ownership and operation from 2019/20
Transport Plan –phase 1*	27.0	Yes	Council ownership and maintenance
The Square*	4.6		Council ownership and maintenance
The Frame, (Public realm)*	6.8		Council ownership and maintenance
Earthquake memorial*	-	Yes	Crown ownership and maintenance

(1) Figures include third party contributions.

Appendix 2 Council Investments (CCOs & CCTOs)

Company	***Shareholding***	***Principal reason for investment***	***Budgeted Return***
Council Controlled Trading Organisations			
Christchurch City Holding Investments	100%	Return on capital Holding company for the Council's trading investments.	$45.1 - $68.6 million per annum as detailed in the forecast dividend table below. Plus special dividend of $140 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 those it manages (Air Force Museum of New Zealand, Hagley Oval Pavilion and AMI Stadium). The Town Hall, owned by Vbase Limited, is currently undergoing earthquake repairs and is expected to reopen in the first quarter of 2019.	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.
ChristchurchNZ Holdings Limited	100%	Economic Development Achieved through optimising economic and social opportunities that tourism, major events, city promotion and economic development can bring to Christchurch and Canterbury.	None
Tuam Limited	100%	Dormant	All capital to be returned in 2018 and company wound up.

Company	***Shareholding***	***Principal reason for investment***	***Budgeted Return***
Share Investments			
Transwaste Limited	38.9%	Regional landfill	$3.5 - $8.1 million per annum
New Zealand Local Government Funding Agency	8.3%	Borrowing	$110,000 per annum
Civic Financial Services Limited (previously New Zealand Local Government Insurance Corporation Limited)	12.9%	Supplies local government with financial services such as superannuation, Kiwisaver, and underground infrastructure insurance cover	None
Endeavour Icap	12.8%	Economic Development within Canterbury region	None

The Council provides loan funding to its 100 per cent subsidiaries as and when required. Interest is charged on this lending at a rate slightly above that at which Council can borrow.

The forecast dividend income is outlined below:

	2018/19	2019/20	2020/21	2021/22	2022/23	2023/24	2024/25	2025/26	2026/27	2027/28
CCHL	$191.5 million[1]	$45.1 million	$51.0 million	$51.8 million	$49.4 million	$58.5 million	$61.5 million	$61.0 million	$66.2 million	$68.6 million
LGFA	$110,000 per annum									
Transwaste	$8.1 million	$5.9 million	$5.6 million	$3.5 million	$3.8 million	$3.5 million	$3.5 million	$3.6 million	$3.7 million	$3.8 million

[1] includes $140 million from the capital release programme

Christchurch City Holdings Limited

The key purpose of CCHL is to invest in and promote the provision of key infrastructure assets in a commercially viable manner to assist proactively in the development and recovery of Christchurch. This involves identifying infrastructural needs and then playing a role to ensure those needs are met. CCHL encourages appropriate investment by its trading companies to ensure infrastructural assets meet community needs and are efficient and cost-effective.

The dividends paid by each CCHL subsidiary in the last five years is shown below. The focus on recovering from the earthquakes means returns over recent years have been below those of equivalent assets in other New Zealand cities. There is an expectation that returns will significantly improve over the period of this Long Term Plan. Past information is used as final Statements of Intent for the three years 2019, 2020 and 2021 are not yet available. 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[1]	Total Dividends paid last 5 years[2]
Infrastructure				
Orion New Zealand Limited	89.3%	Regional Economic Development	$810 million	2017 $49.1 million 2016 $58.0 million 2015 $50.9 million 2014 $35.7 million 2013 $29.5 million
Christchurch International Airport Limited	75%	Regional Economic Development	$862 million	2017 $24.7 million 2016 $21.9 million 2015 $7.4 million 2014 $4.9 million 2013 $6.6 million
Lyttelton Port Company Limited	100%	Regional Economic Development	$459 million	2017 $5.2 million 2016 $2.6 million 2015 $18.0 million 2014 $1.6 million 2013 nil

[1] The value of the investments was assessed by independent valuers, Ernst and Young, as at 30 June 2017.
[2] Total dividend paid to CCHL by the companies.

Company	Shareholding	Principal reasons for investment	Value of investment[1]	Total Dividends paid last 5 years[2]
Enable Services Limited	100%	Economic Development & Long Term Investment Returns	$319 million	No dividends have been paid
Contracting				
City Care Limited	100%	Investment and Certainty of supply of service	$82 million	2017 $6.2 million 2016 $4.1 million 2015 $5.7 million 2014 $5.7 million 2013 $6.3 million
Red Bus Limited	100%	Public Transport Investment	$44 million	2017 $nil 2016 $1.4 million 2015 $1.9 million 2014 $nil 2013 $nil
EcoCentral Limited	100%	Certainty of supply of service	$9 million	2017 $0.3 million 2016 $0.3 million 2015 $0.3 million 2014 $0.3 million 2013 $nil
Consultation				
Development Christchurch Limited	100%	Development consultation, and contact for sources of overseas investment	$2 million	No dividends have been paid.

Considerations of Ongoing Council Ownership of its Trading Companies

Advantages of Council Ownership	Counter-arguments to Council Ownership
Synergies. 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.	**Synergies.** 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.
Local control. While operating on a commercial basis, wider economic benefits to the region are taken into account – largely through the Statement of Intent process (for example recognition of Council strategies). 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.	**Local Control.** 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.
Asset reliability. 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).	**Asset reliability.** 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.
Investment returns. CCHL has generated an average annual return to shareholders (cash dividends and capital growth) of 25.6 per cent since 1996. The current cash dividend forecasts ($48.3 million in 2018-19) excluding dividends from a capital release have the effect of lowering Council rates required by approximately 10.6 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.	**Investment returns.** Notwithstanding that total returns (including capital growth) to Council are higher than the cost of capital, cash dividends paid to Council have averaged a 3.3% return in the last ten years. 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.

Advantages of Council Ownership	Counter-arguments to Council Ownership
Pricing. 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.	**Pricing.** This is only true where markets are not mature and in most instances of monopoly, pricing is regulated.
Future potential. 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.	**Future potential.** Council should not be exposed to unnecessary commercial risks, for example. 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.
Long-term investment horizon. 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.	**Long-term investment horizon.** 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.
Stability of ownership. 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.	**Stability of ownership.** 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.
Availability of capital. 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).	**Availability of capital.** A wider range of capital raising options is available to privately-held companies. Exposure to capital markets places stronger commercial disciplines on businesses.