

DRAFT FINANCIAL STRATEGY

OUR VISION
LIVEABLE, THRIVING
+ CONNECTED
COMMUNITIES

Financial strategy

Balancing Affordability, Increasing Expectations and Growth

The Council is achieving this by:

- Moving costs of services to those who use them.
- Maintaining existing assets.
- Modernising and improving infrastructure.
- Supporting growth.

Forecast growth will see a 21 percent increase in the number of homes (6,600) over the next 10 years. This is substantial and requires a significant investment in all the Council activities to achieve our vision for liveable, thriving and connected communities.

Alongside this maintaining existing service, in an environment of increasing regulation and weather events is challenging.

Within this context the Council has developed a financial strategy that balances affordability for those paying, with the rising compliance expectations and community desires while supporting investment to allow for and arising from population growth.

Sustainable Growth

The Waikato district has been growing rapidly, our proximity to Auckland and Hamilton making us an attractive proposition for both business and residential development. Growth will occur in the Waikato due to factors outside of our control. How the Council responds to growth drives whether that growth enhances the council vision for liveable, thriving and connected communities.

There is uncertainty around the potential economic impacts on the district as the global Covid-19 pandemic continues. The potential economic impacts on the Waikato Region as indicated in Waka Kotahi's study dated October 2020 are:

- The south of the Waikato District around Hamilton is expected to perform reasonably well due to relatively low reliance on international tourism (25% of total tourism spend), links to surrounding agriculture, and the city's role as a hub for education, healthcare and other government services.
- The north of the Waikato District is expected to experience slower growth rates due to lower business and population movements out of Auckland, with flow-on impacts on the construction sector.

The Council's forecast growth will mean 6,600 new homes for over 14,000 more people. Much of this growth will occur in towns (42:58 urban to rural population in 2021, rising to 45:55 by 2031), changes in population and land use on rural properties is not forecast to be significant. This requires significant planning, working with the community and other agencies. It will result in an investment in roads, water, wastewater, stormwater and community infrastructure often in advance of the people arriving. By providing this trunk infrastructure investment in advance of growth it will avoid adverse consequences to public health, safety and the environment.

Growth capital will initially be funded by borrowing, including the Housing Infrastructure Fund (\$38 million) and each project drawdown will be interest free for 10 years. Where subsidies and external funds can be earned, this will reduce the initial debt. Development contributions will be paid when developments are completed, and this revenue will reduce debt. The remainder will be paid over 25 years by existing ratepayers and by new ratepayers as they arrive.

The capital investment in growth is shown in Figure 1. This chart shows a large investment in trunk infrastructure in the first 4 years of the plan. With the trunk infrastructure in the right place, it will create sufficient capacity to

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support forecast growth in our main urban areas, which allows for local developer investment to continue in those later years.

The day-to day costs resulting from population and land use changes will cost \$366 million over the 10 years, which is around 25% of total operating costs.

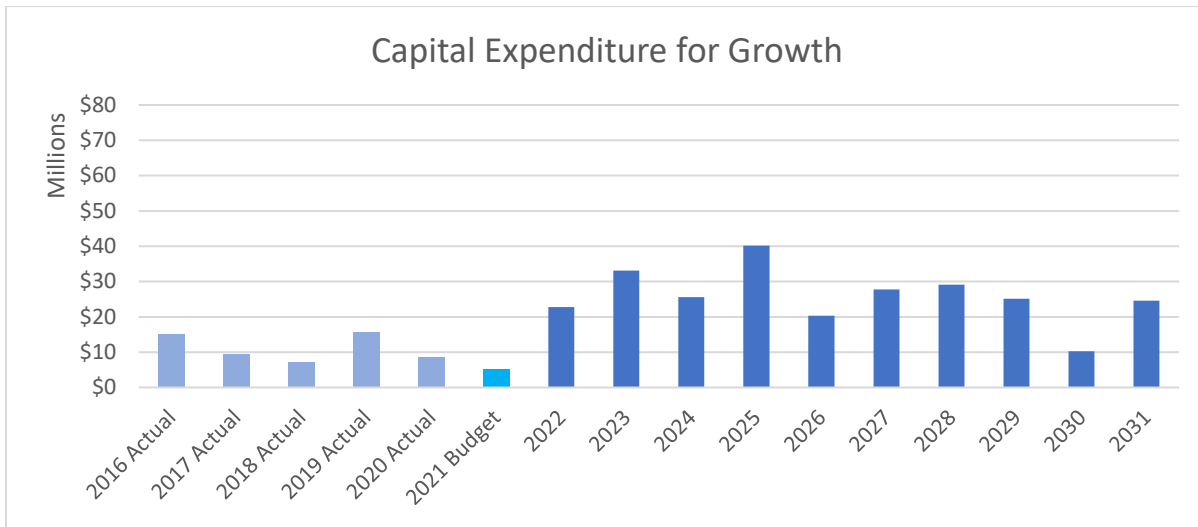


Figure 1: Capital Expenditure for Growth (\$million)

Maintaining Existing Assets

The Council looks after \$1.7 billion of assets, 86 percent of which are infrastructure assets. These assets have been the backbone of our community’s services for decades. The quality of these services contributes a lot to whether a community is liveable and thriving.

The Council invests a lot of resources in professional asset management practices to ensure they are well maintained to the end of their economic lives and are renewed at that moment when it is most cost effective to do so. Getting this right has a big influence on the affordability of services.

For Roading there have been great efficiencies resulting from the Council’s innovation of its Roading Alliance. With the waters activities the Council partnered with Watercare Services and Waikato Tainui in October 2019 with the aim of delivering further efficiencies. However, the underlying condition of the assets no longer meet the rising standards for consent renewals on treatment facilities and significant investment is required over and above that previously planned.

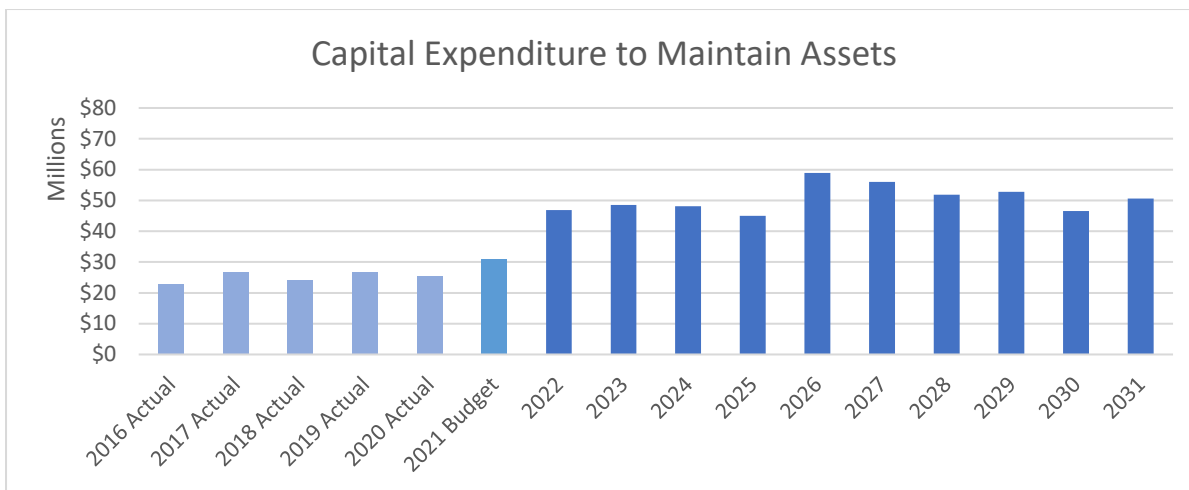


Figure 2: Renewal Expenditure to maintain asset service levels (\$million)

Figure 2 above shows the Council is providing for a consistent investment between \$45 to \$59 million in each year of the Plan. This level of investment is more than annual depreciation (forecast at \$33 to \$56 million) reflecting the scale of asset replacements budgeted in this 10-year period some of which are earlier than planned for due to the need to address upgrades to support growth and changing consent conditions.

The chart shows an increased investment from 2022 onwards across all infrastructure classes, with a sizeable change in 2026 largely due to wastewater renewals.

A significant element of the Council’s financial strategy is for infrastructure assets to maintain up to date asset valuations which recognise the current replacement cost of assets and then fund the consequential depreciation cost. This provides for an appropriate allocation of cost to those who benefit from the services the assets provide each year and overall is the most cost-effective approach to ensure current and future generations pay an affordable share of the asset renewal. For each asset type any funds are accounted for in asset replacement reserves.

Along with everyday maintenance this capital renewal budget will ensure that service levels remain constant.

Better Services

Communities that are thriving have a high degree of liveability through a good range of modern services. Communities often desire many improvements which need prioritising to balance affordability with service levels.

Figure 3 shows an increased investment in the first two years of the plan. 60 percent of the investment being on better services on the roads and three waters services. Investing in better service levels on core infrastructure is essential to building modern communities, however communities need access to other services like playgrounds and libraries if people are to feel their community is liveable and thriving. The Council must therefore balance investment choices between core infrastructure and community infrastructure and services.

Capital expenditure for better services will initially be funded by borrowing. Where subsidies and external funds can be earned, this will reduce the initial debt. The remaining debt will be paid over 25 years by existing ratepayers and by new ratepayers as they come into the district.

The regulatory environment is imposing more cost to protect people and the environment including healthy rivers, drinking water standards and consent conditions. Pending three waters reform work has meant that the standards associated with running water and wastewater services will inevitably increase. It is not yet clear what the reforms will mean for our communities but the type of treatment plants that need to be built to achieve regional consent conditions will cost more and are included in the plan.

Providing better service levels will add cost which is included in the graph below.

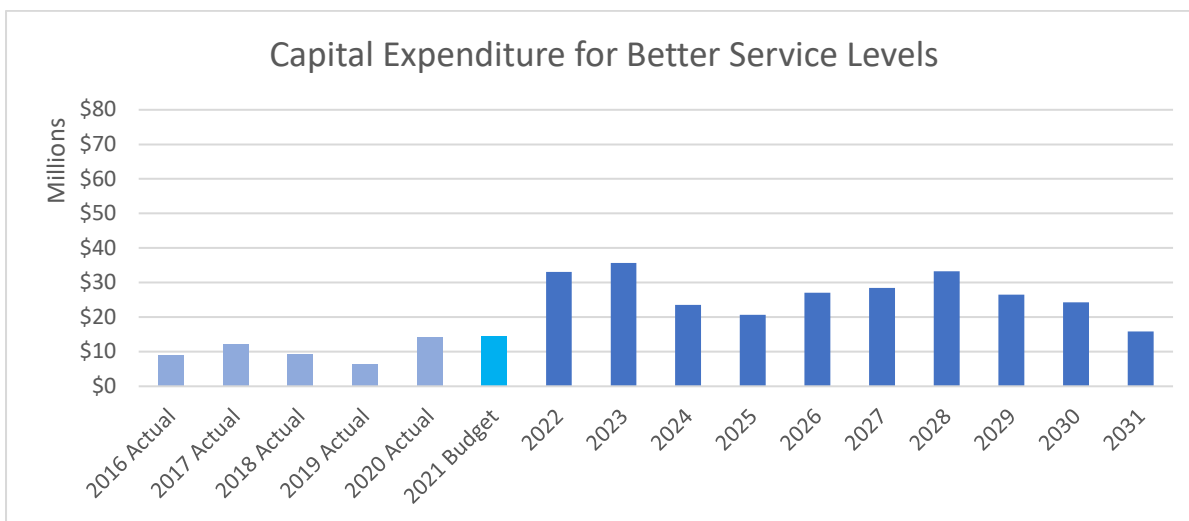


Figure 3: Capital Expenditure for Better Service s (\$ million)

Managing Debt

The increased investment in the next three years in growth, renewals and service levels has the consequence of increasing debt (see Figure 4). Debt rises by \$175 million in the first 5 years reflecting the level of investment. From 2027 the level of new debt decreases and by 2030 debt repayments exceed new investment. The Council will repay \$293 million of debt over 10 years.

The Housing Infrastructure Fund (HIF) loan was approved in 2020 with borrowing to be drawn down over the first three years of this Plan as investment on HIF approved projects is made. This borrowing is interest free for 10 years (saving approximately \$17 million in interest payments over the duration of the plan). The borrowing is recognised as debt in Figure 4. and on the Council balance sheet.

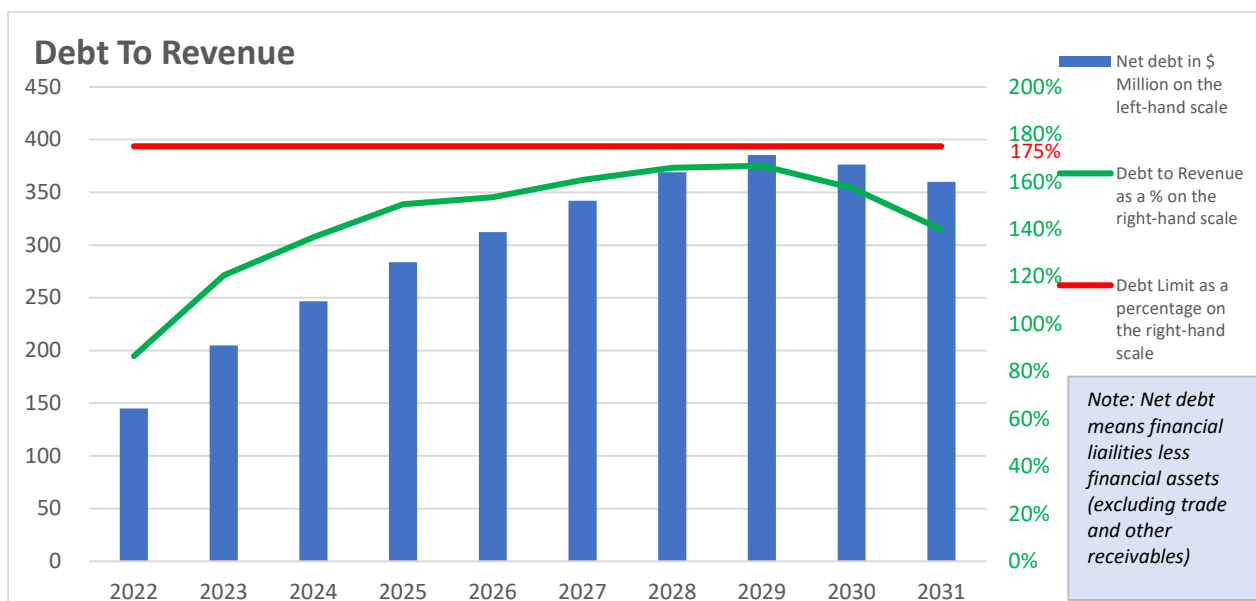


Figure 4: Debt levels (\$million) and Debt limits

Debt Limit

Net debt will not exceed 175 percent of revenue.

Net debt equals total external debt net of related borrower notes. Revenue is net of developer contributions and vested assets.

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The Council has set its debt limit using a debt to revenue ratio. This is one of the main methods used by the Council's funders to determine the affordability of debt. People who have borrowed home mortgages will know how important income is to the banks decision to lend money.

The Council's primary lender, the Local Government Funding Agency (LGFA), has determined that it will only lend to the Council up to 175 percent of revenue.

Although the debt limit has been set equal to our borrowing capacity, the Council has \$11 million of capacity it could spend before it would reach the 175% in 2022. Additionally, the Local Government Funding and Financing toolbox has been extended to include off-balance sheet options. There would still be the challenge of repayment so in the first instance Council has planned a programme that fits within LGFA limits.

Council's borrowing is secured by either a debenture trust deed or a floating charge over all Council rates levied under the Rating Act.

Affordable Rates

Rates income ranges between 61 and 69 percent of income and is Council's main revenue source. During the next 10 years there will be a 21% increase in the number of properties. This will create extra income to offset some of the costs of growth.

Limits Rates Increases

Average annual rate increases to existing ratepayers*, are set at 10 percent in the first year reducing to 8 percent from 2023 onwards.

*Based on 2017 rating valuations and property information.

The Council has set its limits on rates increases as a measure of the impact on the average existing ratepayer. This measure shows the impact of rates on typical properties by including all rates (general and targeted) charged to a property and is based on 2017 rating valuations due to the re-scheduling of Council's 2020 district valuation.

This measure is relatable to what people pay and therefore can be considered as a measure of affordability. The challenging economic environment created across the world because of pandemic response measures, may mean for some in our community that these limits still feel too high. However, the relative size of our district does not lend itself to economies of scale as our large geographic spread, means we have multiple critical assets with high compliance and operational costs. These are not costs we can 'opt out' of.

The measures are calculated based on those ratepayers that paid rates in the previous rating year. Allowing the Council to focus on how the majority of ratepayers are impacted by the increased price of rates. By doing this the Council can better grow the rates from new ratepayers, which is very important in the high growth situation the District is forecast to have.

The Council has set limits that are real and consequentially could be challenging in the event of unplanned event or compliance costs. In setting the limits this way the Council is challenging itself to be good financial managers for the District. This is a better approach than setting limits so high they never become relevant to decision making.

Balancing the Books

Good financial practice is to manage the business so that operating revenues exceed operating costs. This ensures that each year the users of services are paying for what they use. Having a surplus position ensures funds are available for asset purchases and debt repayment.

The figure below shows that after removing development contributions and vested assets from revenue the Council is on the whole forecasting to make surpluses that allow for debt repayment.

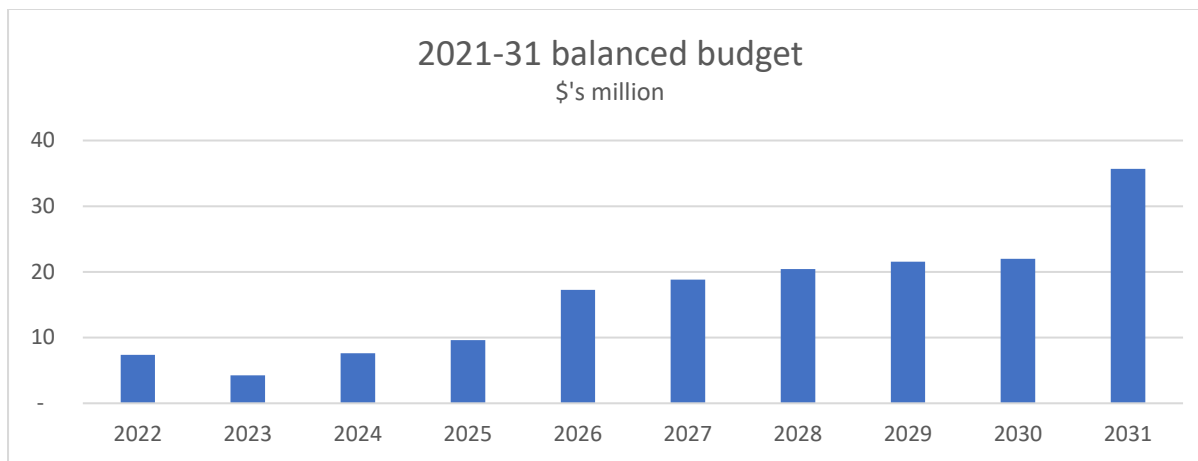


Figure 5: Balanced Budget (\$)

Good Investments

The Council has financial, property and equity investments which are managed in accordance with the Treasury Risk Management Policy.

Investment	2020 (actual)		2021-2031
	Value \$(000)	Return	Return (forecast)
Financial	90	7%	7% year 1 only
Investment Property	560	8%	8%
Equity			
Waikato Regional Airport Ltd	16,744	0%	0.18% p.a. from 2024
Waikato Local Authority Shared Services Ltd	219	0%	0%
Civic Financial Services Ltd	38	0%	0%
Waikato District Community Wellbeing Trust	0	0%	0%

The council holds investments for a strategic reason, not just for a financial return on investment. These reasons include where there is some community, social, physical or economic benefit accruing from the investment activity. The council has the following objectives in holding the above investments.

Financial

Cash is held for liquidity purposes, not to make a financial gain. The Council is a net borrower and will convert surplus cash to reduce debt costs as appropriate to maintain liquidity. Any returns from cash investments are offset against the general rate. The financial investments outlined in the table above relate to a small number of community loans which will be fully repaid by 2023.

Investment Property

The Council has one investment property in Ngaruawahia that receives a modest commercial lease return. It also has a small portfolio of non-reserve land and buildings. These properties are predominately owned for operational efficiency including offices at Raglan, Huntly and Ngaruawahia. No return on these investments is planned for.

Waikato Regional Airport Ltd

The company operates Hamilton International Airport and promotes the region to tourists. The Council shareholding is 15.625 per cent.

The Council's shareholding is considered a strategic asset. While Council's ownership is largely for economic development reasons and not for financial return, the company has no dividends forecast for the first 2 years of the plan due to the coronavirus pandemic and the flow on impact to travel. An annual dividend of \$30,000 has been included from year 3 onwards.

Waikato Local Authority Shared Services Ltd

The company has been established to cost effectively provide councils with a vehicle to procure shared services. It is an investment which aims to reduce the cost of providing generic services. The company does not provide a financial return by way of dividend.

Civic Financial Service Limited

The company, established in 1960, is owned by local government to provide a range of financial services including Riskpool, LAPP and Supereasy Kiwisaver scheme. The Council's holding is historic, and no return is forecast.

Waikato District Community Wellbeing Trust

The Waikato District Community Wellbeing Trust was formed from the winding up of the Waikato Foundation. The funds held by the trust are retained for the trust's purposes and distributed to the community. The Council's reason for holding this investment is to support projects that deliver on the aspirations and community outcomes of the Waikato district as identified and promoted by the community. The objectives of the Trust align with the delivery of community blueprint projects and community identified initiatives.

Planning for the Unexpected

Events such as the Wellington and Canterbury earthquakes and locally Cyclone Debbie and the March 2017 weather event have a significant impact on infrastructure. Much of the Council's \$1.7 billion of assets is vulnerable to local weather events and the impacts of events affecting the Waikato River.

The Council has purchased commercial insurance for assets under the ground such as water, waste water and stormwater infrastructure. This was achieved through partnering with a number of the Local Authority Shared Services council's in a group insurance programme. In the event of a natural disaster affecting water, waste water, stormwater and arterial bridges the council will be able to secure a proportionate amount of the group's insurance proceeds to pay for the repair and replacement of these assets.

In addition to this cover, council is proposing to increase the investment in our own disaster recovery fund to self-insure for events that may not trigger the natural disaster insurance policy claim criteria. A specific budget has been set aside each year to re-build the balance of the disaster recovery fund. \$1.12 million has been set aside over the first 3 years. This fund will continue to be replenished and built upon throughout the ten years. Additionally, a roading budget of \$800,000 per annum is included for emergency works in the event that the network sustains heavy or prolonged rainfall and a further \$300,000 of minor event emergency works budget per annum. This \$1.1 million of annual budget is additional to funds held in the disaster recovery reserve.

For really big events Council expects external financial assistance for the emergency response and recovery. Council will be expected to initially fund these costs.