TIMARU DISTRICT COUNCIL

Te Kaunihera ā-Rohe o Te Tihi o Maru

FINANCIAL STRATEGY

10 YEAR PLAN 2024-34

Introduction

The Financial Strategy sets forth our guiding principles for managing the Council's finances and making budgetary decisions.

The 2024-2034 Long Term Plan (LTP) budget was developed to prioritise core services, business operations, and Council-approved priorities. Council has committed to sustaining current service levels, upgrading community facilities, and addressing climate change. As such, the LTP budget allocates more funding to asset renewal and replacements that will directly enhance the district's infrastructure and livability. The increases invest in renewing assets and replacing ageing facilities to improve amenities for the community.

Our district faces significant challenges from ageing infrastructure, insufficient investment in depreciation and renewals, upcoming regulatory changes for water services, and rising community expectations for high-quality, affordable service. On top of escalating service demands, Council must address emerging policy and legislative mandates around resource planning, water quality standards, transportation, climate change, wastewater, and stormwater management. The confluence of deteriorating assets, tightening budgets, and heightened regulatory scrutiny requires strategic leadership and fiscal prudence from Council. A coordinated, proactive approach is needed to upgrade critical infrastructure, comply with new regulations, and deliver value to ratepayers.

As Council focus for this 10-year plan is investing in infrastructure asset renewals, our asset maintenance costs will decrease. However, investing in new assets or any delays in the planned renewals will result in higher maintenance costs . The ageing asset base drives increasing renewal expenses through the next decade.

The Financial Strategy aims to get the balance right so that we can achieve our goals of:

- Maintaining long-term financial resilience;
- Providing high-quality infrastructure and facilities;
- Ensuring our services are affordable and meet the wellbeing needs of our community.
- Our Strategy responds to the challenges Council and our District is facing including: Ageing infrastructure, requiring a large capital renewal programme;
- Increasing operating costs for our activities across the board; Increasing regulatory requirements and community expectations;
- The need to maintain infrastructure and services that are resilient to natural disasters and the impacts of climate change;
- Impending regulatory changes for water services.

This Financial Strategy complements our Infrastructure Strategy and relies on our Significant Forecasting Assumptions and Activity Statements. Together, these documents elaborate on Council's plans to achieve its key outcomes and address the pressing challenges outlined above. The Infrastructure Strategy and forecasting assumptions outline the context, while the Activity Statements detail steps for realising our financial and infrastructural goals. This integrated planning supports Council in delivering results.

Debt

The long-term debt-to-revenue limit is raised to 250% for the 2024/2025 fiscal year and remains at that level for the rest of the Long Term Plan.

Over the 10-year period, Council is allocating $650 million towards capital projects, with the majority of investment going into water services and roading, but also including community infrastructure. The focus is on asset renewals and initiatives that advance key priorities. This capital investment delivers on objectives to upgrade assets, improve amenities, and enable quality services.

Compared to the previous Financial Strategy, the debt-to-revenue limit has been raised from 210% in the LTP 2021-31 to 250% for this next LTP. Although our maximum allowable debt level is 280% of operating revenue, this Financial Strategy caps our normal debt operating limit at 250% or lower - aligned with New Zealand Local Government Funding Authority (LGFA) thresholds. By staying below a 250% limit over the 10-year period, we are likely to uphold Council's strong AA- credit rating.

Council infrastructure and community facilities are long-term assets that serve residents across multiple generations. Debt financing spreads the costs equitably over present and future beneficiaries. This intergenerational equity allows Council to address infrastructure needs expediently rather than deferring costs to tomorrow's ratepayers. With long asset lifetimes, debt enables each generation to collectively fund the shared capital assets they will utilise together as a community.

hile leveraging debt financing for major capital investments, Council remains fiscally prudent through planned operating surpluses to gradually repay debt obligations within this Long Term Plan period. Projected net debt will increase from $277 million in 2025 to a maximum of $412 million in 2030 before declining to $387 million by 2034. Council has developed a sustainable debt servicing approach through allocating surplus cash to repay debt principal – this prudent strategy maintains strong fiscal standing over the long term.

Graph 1 below compares the budgeted net debt to total revenue ratio with the limits established in the financial strategy for each fiscal year.

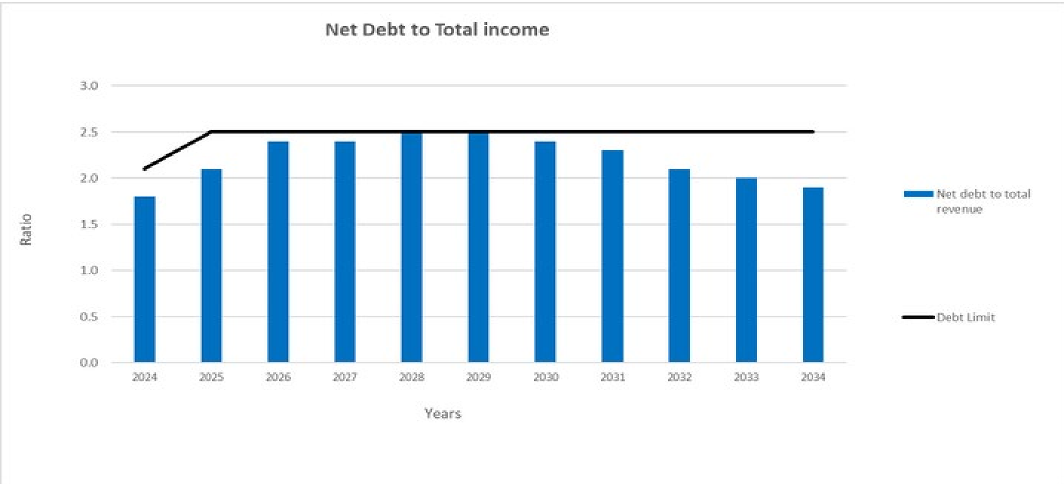

Figure 1: Debt to Revenue Limits

Debt (continued)

Graph 2 presents the budgeted net debt figures for the financial years ending June 30, 2024 to June 30, 2034.

Figure 2: Net Debt

Forecasts indicate net debt will rise to a high of $412 million in 2030. From 2030 onward, rates increases will generate budget surpluses to pay down debt over the last four years of the Long-Term Plan.

By 2034, there will be $127 million of available debt capacity (headroom) based on the 250% debt-to-revenue threshold, and $188 million based on the 280% limit. These conservative limits ensure borrowing ability remains for unforeseen events like natural disasters. The lowest projected debt headroom occurs in 2028 at $5.7 million per the 250% ratio, and $53 million at 280%. Restricting borrowing preserves the capacity for contingencies whilst exercising fiscal restraint. However, should any repetitive emergency events requiring over $5.7 million of borrowings occur in 2028, it is anticipated that Council will, through formal resolution, raise its debt cap to the statutory limits to enable access to funds if necessary.

The Council has set the following limits on its total borrowing:

- Net annual interest expense as a percentage of rates revenue limit is 30%
- Net annual interest expense as a percentage of total revenue limit is 20%
- Liquidity limit is 110%

Council's 2024-2054 Infrastructure Strategy identifies substantial infrastructure investments needed beyond 2034 to address ageing assets such as bridges near end-of- life, and to upgrade community facilities like CBay and Timaru Library. The debt limits in this Financial Strategy provide future debt capacity and flexibility for the district's long- term interest. This headroom enables future councils to determine spending priorities important to their communities. The strategy empowers future decision-making for critical infrastructure and facilities.

Balanced Budget

Ongoing operating expenses should be funded by steady operating revenues. Insufficient revenue sources lead to rising debt burdens to subsidise current costs – meaning today's ratepayers do not fully cover services received, while future generations inherit added interest expenses. This imprudent leverage is unsustainable.

Generating consistent budget surpluses is imperative to service existing debts and continue investing in infrastructure for the district's future. This Financial Strategy targets a balanced budget or surplus from the fourth year onward.

Throughout the plan timeframe, Council will persistently pursue expenditure control and efficiency gains across all services.

In determining true operating surpluses or deficits, capital items like vested assets, financial contributions, capital subsidies, and gains/losses are excluded. This yields an accurate picture of sustainable everyday finances.

Projected rates increases from 2030 forward will produce growing surpluses to pay down existing debts.

Graph 3 shows the projected everyday operational costs against revenue.

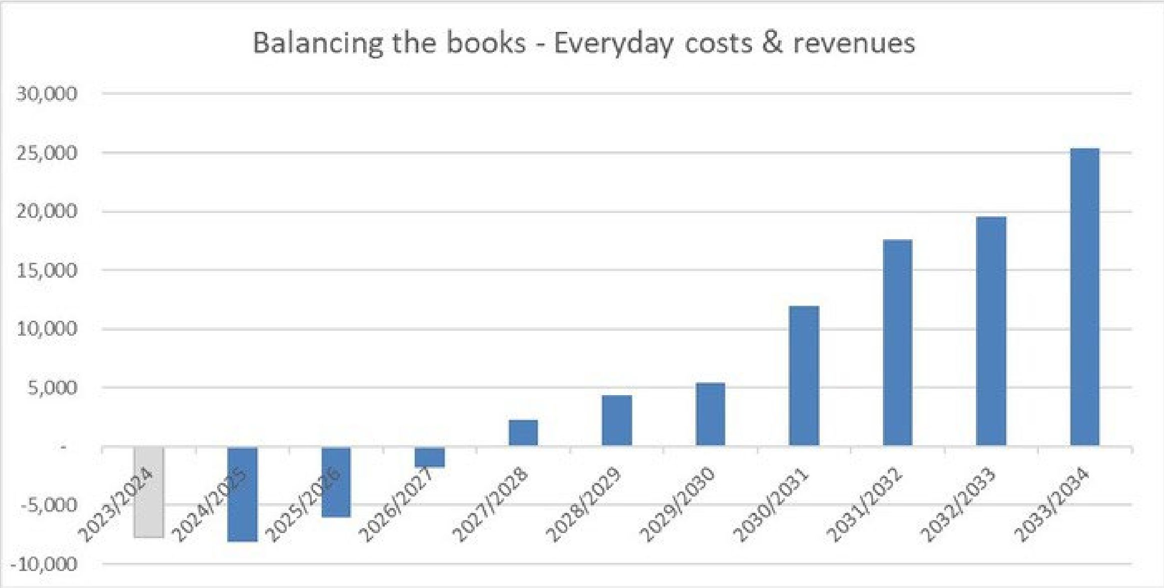

Figure 3: Deficits and Surpluses

Rates

For context, Timaru District Council currently has the third lowest rates of all 23 provincial councils as per the 2023 Ratepayers Report. While service levels do vary, this indicates historical under-rating across the district. With rising costs of living the nation is facing, our lower comparative rating base from the historical practice of keeping rates artificially low has resulted in a community expectation to keep rates low and puts further pressure on Council's available rate income.. However, we have room to make judicious adjustments coming from this low starting point to put rates at a level that better reflects the service levels Council provides, whilst still being comparatively modest in our rankings nationwide for our rate levels.

Rates Increases

Average rates increases to existing ratepayers are proposed to be 15% in 2024/25, 12% in 2025/26 and a further 12% in 2026/27. From 2027/28 onwards, rate increases will not exceed 5%. The 2021/31 Financial Strategy had a rates limit set at 7%, it is proposed to increase this to maintain this level. Note the 7% limit is the limit that applies over the 10 year LTP period, and is not an annual rates limit.

After making budget decisions, capping debt and agreeing that paying for everyday costs with everyday revenues was a priority, we have determined our rates limits. The Council's rating system has been considered with the intention that it represents the most appropriate rates options to address the present and future needs of the city (see Graph 4 below).

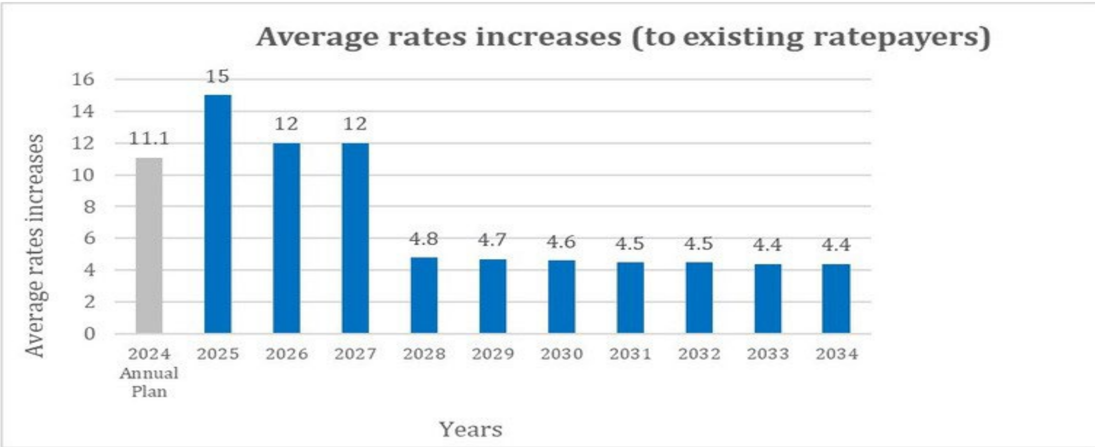

Figure 4: Average Rates Increases

One new targeted rate has been introduced for 2024/25 onwards, and a change to the Community Board Targeted Rate:

The Timaru CBD Group, in partnership with the Timaru District Council has developed a Business Improvement District (BID) that aims to create a stronger town centre and business district which maximises economic opportunities and enhances the lifestyle and wellbeing of the local community. A targeted rate will be established to fund promotional initiatives within that area.

The three Timaru District Community Boards (Geraldine, Temuka, and Pleasant Point) are proposing to increase their targeted rates by $1 each per annum. This is to fund community-specific projects managed by each Community Board.

Rates (continued)

The average rates increases represent the minimum viable levels to fund planned capital investments. Since borrowing capacity depends on debt ratios, rising interest costs would necessitate higher rates obligations. These budgets allow completing capital projects, sustaining services, and generating surpluses for debt payments within debt constraints. Council struck a prudent balance enabling investments for the future while maintaining affordability.

Rates from district growth (new housing and business investment) are pivotal within the financial strategy. Inclusive of this anticipated growth, total rates revenue grows an average 0.5% annually over the 10-year span. Slowing growth would constrain capital plans, as baseline rates from existing properties could not solely fund intended investments. Based on the preceding 10-year growth rate, new commercial and residential ratepayers are thus factored materially into budgeting and affordability considerations, as shown in Graph 5 below.

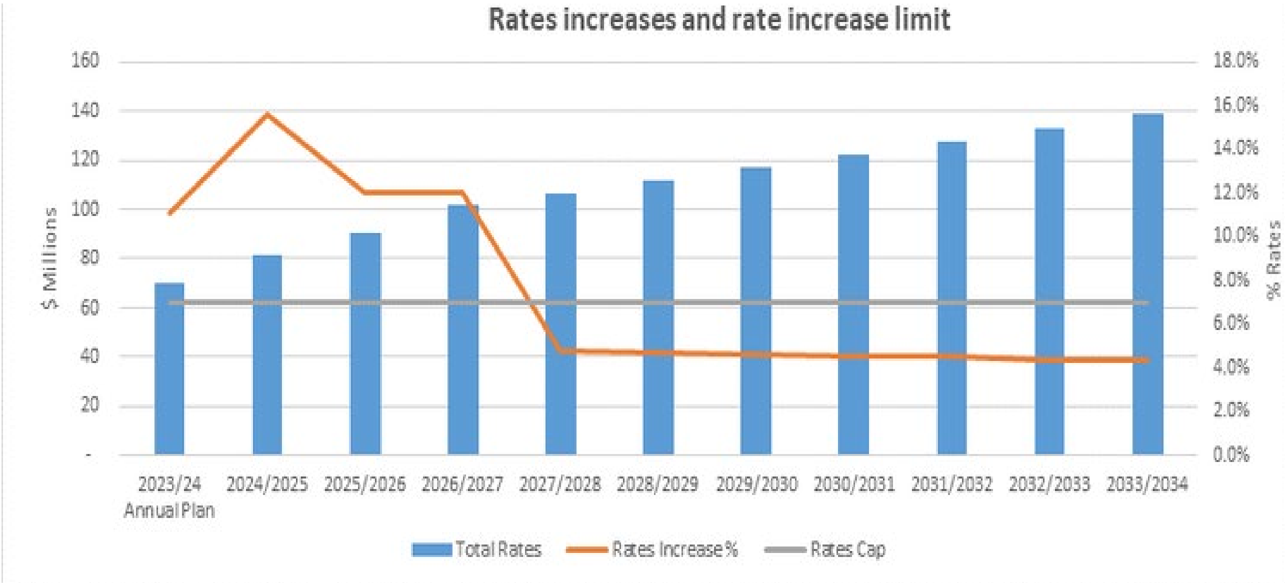

Figure 5: Rates Increase Limits vs Projected Rates Increases

Capital Expenditure

To achieve its vision and foster community wellbeing, Council furnishes both vital infrastructure and enriching assets that improve quality of life. In addition to basic water and transportation systems, Timaru provides libraries, recreation centers, cultural hubs, the port, and the airport. These amenities help attract residents and businesses, driving economic growth and cementing Timaru's reputation as a vibrant, inviting place to live. Council's strategic investments in infrastructure and public assets cultivate social, economic, and cultural wellbeing across the community.

Council has budgeted $650 million towards capital projects over the next decade. All costs include future inflation estimates. The bulk of capital investments centre on renewing and upgrading foundational infrastructure such as water, sewer, roads, footpaths, and the landfill. This will enable Council to uphold and elevate service levels guided by its Activity Management Plans.

Graph 6 exhibits the 10-year capital expenditure categorized by investment drivers. Growth spending provides new and upgraded assets supporting future population increases. Service level improvements deliver new assets for existing residents. Renewals restore assets to original function. Added assets incur operating costs (like depreciation) which are factored into rates increases.

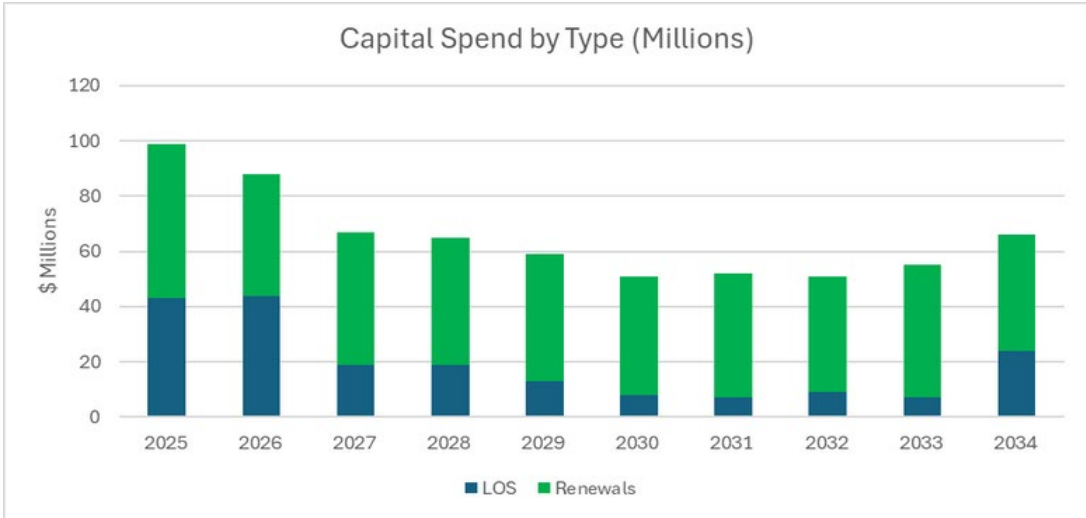

Figure 6: Capital Expenditure Drivers

Additionally, Council acknowledges the value of cherished community venues such as the Theatre Royal, Museum, Stadium, and Art Gallery for bolstering wellbeing. This Strategy supports funding key facility upgrades and initiatives over the next decade to elevate lifestyles across the district's communities. Graph 7 overleaf exhibits capital spending plans categorised across each core Group of Activities. Investments in these spaces aim to enrich community wellbeing and enrich our lifestyle.

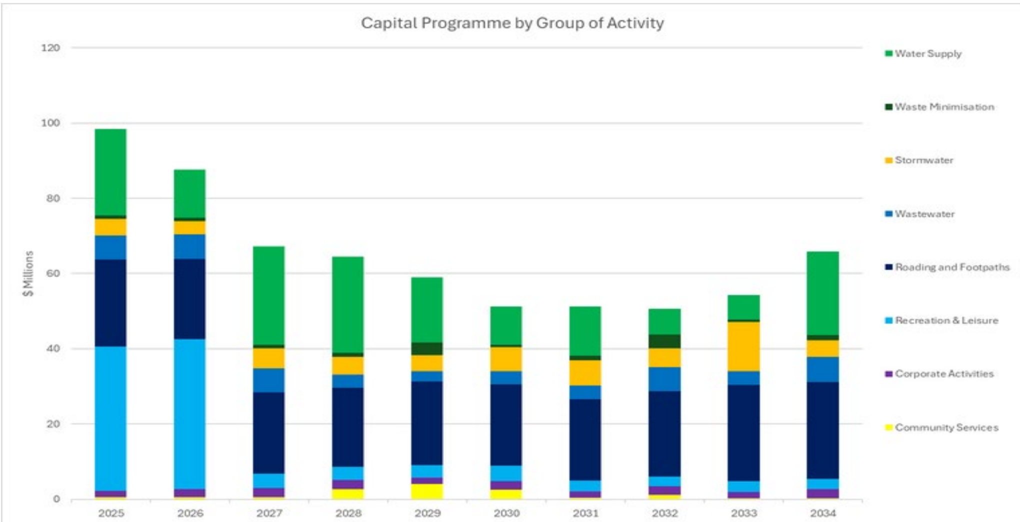

Figure 7: Capital Expenditure Split by Group of Activities

Capital Expenditure (continued)

Council prioritises its capital investment into providing the core services to the community that provides the foundation for the district's vitality and community wellbeing. This includes the three waters (water supply, wastewater, and stormwater), roading and footpaths, and waste services. The diagram below shows that for the next ten years, over 3/4 of the capital expenditure is in these areas, with the remaining funding going into the non-core services such as recreational facilities, cultural facilities, the airport, and public amenities such as toilets, campgrounds, and community halls. Note the District Libraries are considered core services as defined under the Local Government Act 2002.

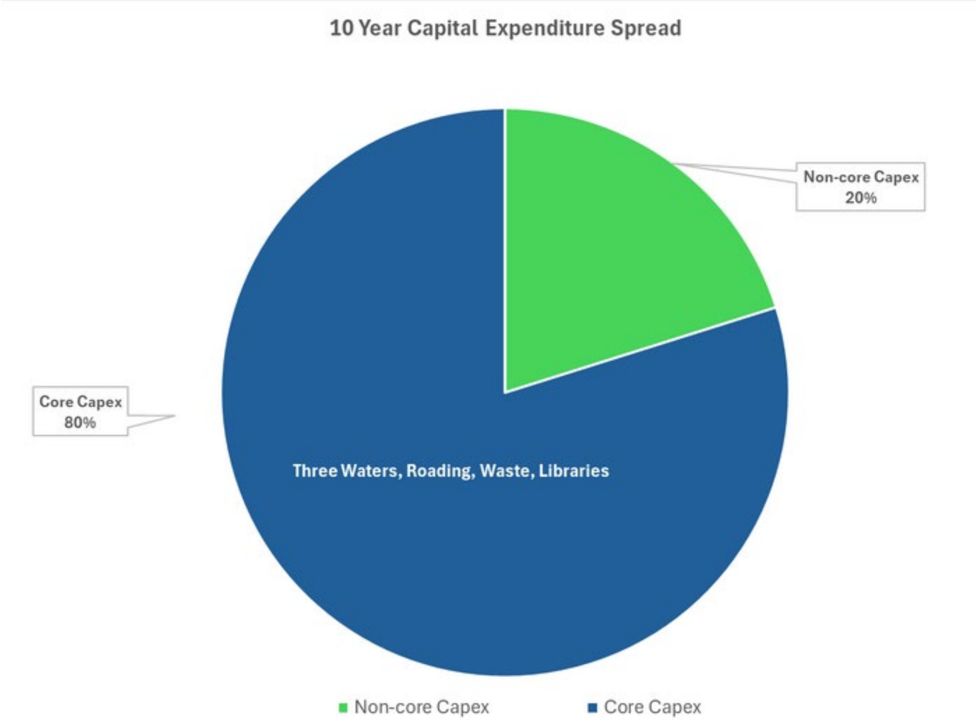

Figure 8: Capital Expenditure Split Between Core and Non-Core Services

Depreciation Funding

Responsible financial management necessitates planning and budgeting for asset replacements and renewals at end-of-life to maintain service levels. The intergenerational equity principle suggests each generation of ratepayers should fund their fair share of asset lifecycles consumed. Councils can achieve this in three key ways:

Pay as you go

- Capital can be funded through annual rates charges that existing ratepayers cover in a given year. This approach works best when capital spending remains steady over time, reducing the risk of today's ratepayers paying less than their fair share versus future generations.

Saving for asset replacement (charge rates over the life of the asset – spend later)

- One option is to charge ratepayers annually to build up depreciation reserves, which would fund future asset replacements. However, this approach becomes difficult if ratepayers are still paying off debt from the initial purchase of those assets. In such cases, current ratepayers would essentially pay twice - both servicing present debts and saving for future replacements, which is unfair. An alternative could be to postpone aggressive depreciation savings until initial debts are first repaid, thus avoiding double-charging the present generation of ratepayers.

Borrowing to fund asset replacement (spend now – charge rates over the life of the asset)

- Ratepayers can be rated annually to service debt tied to assets' useful lives based on asset valuations, covering both interest and principal payments. Future asset replacements could utilise similar debt financing models. This approach works if overall debt levels can accommodate the necessary borrowing without overleveraging.

Legally, councils need not accumulate dedicated depreciation reserves. However, under the Local Government Act 2002, they must achieve balanced budgets where revenues exceed operating costs (including depreciation). Since budget balance applies at the whole-authority level, an activity-level deficit can occur if offset by a surplus elsewhere. Therefore, retaining standalone renewal funds annually is unnecessary provided financial strategies demonstrate rates can amply future-fund asset renewals as needed.

In setting rates, affordability implications for various community groups are weighed carefully. Where principles collide, redistribution through the financial strategy may provide balance.

This Strategy phases in fully funding depreciation by 2028, as shown. Once achieved, excess rates can service debts. This approach still supports renewals while considering affordability.

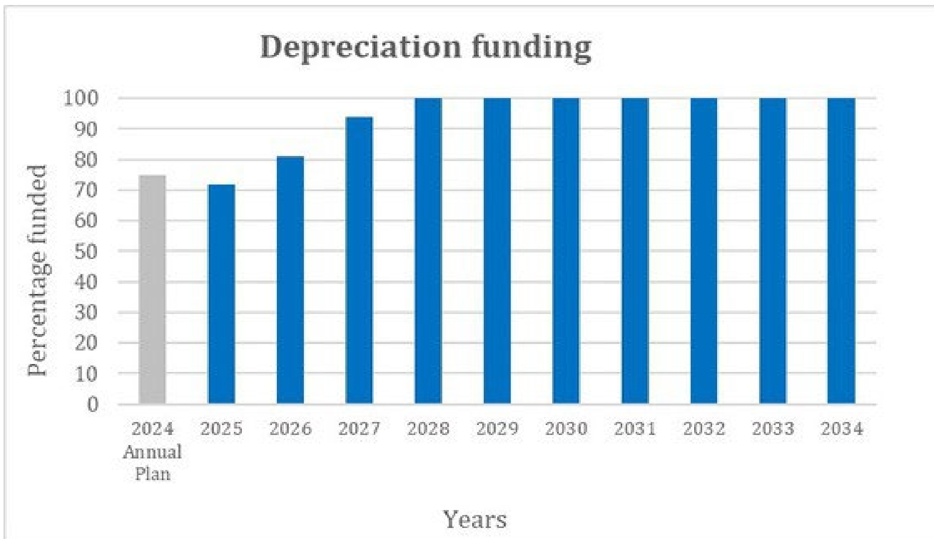

Figure 9: Depreciation Funded Over 10 Years

Investments

Our primary investments are in equity, property, and cash. We intend to maintain the value of these investments in the long term.

Equity Investments

We have shareholdings in a number of entities primarily to achieve efficiency, to help meet our community wellbeing outcomes, and for a financial return on our investment.

The largest equity investment held by Council is its investment in Timaru District Holdings Limited (TDHL) which in turn holds the Council's interests in Alpine Energy Limited and PrimePort Timaru Limited as well as a property portfolio.

We also have a shareholding in Civic Financial Services which is a local authority collective providing insurance and Kiwisaver services to its members.

Our target for returns on these investments is a dividend of $1 million per annum (minimum) from TDHL, with any potential surpluses aligned to the annual Statement of Intent.

Property Investments

Council also owns a number of properties that we don't use for Council business. Our objective is to only own property that is required to be held or necessary to achieve our strategic objectives and meet operational requirements. We will be reviewing our property portfolio in Years 1-3 of the LTP.

Cash Investments

Investments of cash held for specific purposes (special funds) are usually held as short- term deposits or in bonds.

The Council maintains cash investments for the following primary reasons:

- To provide liquidity in the form of readily available cash in the event of a natural disaster. This cash is intended to bridge the gap between the disaster and the reinstatement of normal income streams;
- To invest amounts allocated to special funds, bequests, and reserves;
- To invest funds allocated for approved future expenditure, to implement strategic initiatives or to support intergenerational allocations;
- To invest proceeds from the sale of assets; and To invest surplus cash, and working capital funds.

Our target for return on these investments is between 1.1% and 1.5%.

Other Investments

Council also holds 235 hectares of forestry woodlots which is held as a long-term investment to support cashflow, and to help maintain the Council land where the woodlots are situated.

We assume no return on our forestry investments in the short-term due to the state of maturity of the current forestry stock in the growth cycle. In the longer term (beyond this LTP timeframe, there may be future cashflows that accrue.

Disclosure Statement

We have included the Disclosure Statement in this LTP in accordance with the Local Government (Financial Reporting and Prudence) Regulations 2014. The purpose of this statement is to disclose our planned financial performance in relation to various nationally consistent benchmarks. These benchmarks enable the assessment of whether we are prudently managing our revenues, expenses, assets, liabilities, and general financial dealings. Our LTP budget meets or exceeds all measures of financial management as determined by the government. Our target of everyday revenues paying for everyday costs is more appropriate than the regulation measure for balancing the books. This is because it excludes capital revenue. Capital revenue is used for building assets and not to pay for everyday costs. The result is a more transparent view of what it would normally cost to run the city. The following benchmarks are reported against in this LTP (details of which can be found within the Financial Section of the LTP itself):

- Rates affordability benchmark - how rates compare to the financial strategy limit imposed
- Debt affordability benchmark – planned debt compared to financial strategy debt-to- revenue limit
- Balanced budget benchmark - planned revenue as a proportion of planned expenses - shows surplus/deficit at a cash level. Revenue is defined as (Revenue less development contributions, financial contributions, vested assets, gains on derivative financial instruments and revaluations of property plant and equipment)
- Essential services Benchmark – planned capital expenditure on network services as a proportion of expected depreciation on network services
- Debt servicing benchmark – planned borrowing costs as a percentage of planned revenue

Other Considerations

Local Water Done Well

Over the next ten years, legislative changes regarding the ownership, management and delivery of three waters are inevitable, but it is unclear what the final outcome will be. We have assumed that delivery of three waters will continue as usual, but with more changes required to meet new standards and compliance requirements.

If water services are ultimately delivered by larger entities such as Council-Controlled Organisations or other means, it is expected that funding will be available to renew or replace ageing water assets.

Climate Change

Climate change is primarily affecting our infrastructure through extreme weather events such as floods, fires, droughts, heat waves, cold and wind. Sea-level rise is already impacting some of our coastal areas such as roading, with flooding impacts impacting a broad array of infrastructure such as bridges, culverts, water pipes, and closed landfills in danger of breaching into waterways.

Our wastewater and stormwater networks are more likely to overflow and flood during wet weather. Warmer weather puts more demand on our water supply, and increased fire risk can also strain our rural water supply network. As a result of seasonal weather pattern changes, our “green” assets, such as parks, forestry, and gardens may need enhanced pest control, new planting schemes, and more irrigation during droughts, stressing water supply systems.

Managed retreat is not a key focus for the life of this Long-Term Plan as coastal erosion or sea-level rise projections are not indicating a risk to any key infrastructure assets near coastal areas.

Unplanned Events

This Long-Term Plan provides for the everyday maintenance of assets and the renewal of assets at the end of their economic life. Unplanned events require earlier than planned investment (e.g. Civil Defence emergencies, natural events, river slips, fire, theft, and safety concerns). These events, if they occur, could result in significant unplanned operating and capital costs.

The Council has mitigations that can be executed in the case of such an event. Over the life of the LTP, the Council has budgeted $1 million for civil defence emergencies and $5 million for Roading emergency works (based on the $2.6 million spent in the June 2022 floods) and can call on an additional $5 million bank facility. Council has the ability to urgently reprioritise and reduce capital spending.

Inflation Costs

All financial forecast in this strategy include inflation unless otherwise stated. There is a high degree of uncertainty due to long-term inflation forecast that are likely to change over time. A change in inflation could have a significant impact on financial forecast accuracy. This would require either decreasing or increasing funding to continuing the same levels of service. The Long Term Plan assumptions for 2024-34 outline inflation rates for the first 10 years.

Other Considerations (continued)

Growth and Land Use Changes

Population and household growth in the Timaru District is slow and steady. We are projecting a 0.2% annual population growth over the next ten years. The number of households in the district is projected to increase from 21,000 in 2023 to 23,800 in 2043. The average household size will decrease from 2.34 individuals per household in 2023 to2.30 in 2043. We have factored the rates contribution of this growth into our forecast rates increases.

While Council is not assuming significant land-use change over the next ten years, past and future land use change has, and will continue to impact on Council's delivery of services particularly for road maintenance in rural areas and the provision of services for new development on urban fringes.

Dwelling projections have been used to prepare a 30-year demand forecast for the 2024-2054 Infrastructure Strategy and the related capital expenditure programme for the Long-Term Plan has been prioritised from this forecast.

Should growth be lower than forecast, revenue budgets for rates, building consents and resource consents may not be met. This will constrain borrowing as the debt limit is calculated based on revenue levels. We would need to reconsider the appropriateness of the capital programme. Should growth be higher than forecast, then revenue would be higher. We would then need to consider the speed and timing of the capital programme. These impacts are further considered in the Significant Forecasting Assumptions section of this Long-Term Plan.

Other Revenue

Council has a number of other sources of revenue aside from rates, including fees and charges, and funding assistance from Waka Kotahi (New Zealand Transport Agency), and interest and dividends from investments. The NZTA FAR amount is 51%, but we assume the actual revenue from NZTA will be between 30-40% of approved project costs. Previous funding requests versus what has been eventually approved by Waka Kotahi would demonstrate that this approach would be a more prudent one, enabling a refocusing of available investment from NZTA onto continuous programme activities, without needing to do a plan variation and reduce the Level of Service provided under the asset management plan.

Our Revenue and Financing Policy details how these revenue streams contribute to all the services we provide. Our Financial Strategy is based on an assumption that these revenue streams will remain consistent.

Security of Borrowing

Council provides security on its borrowing. This provides our lenders with a charge over the Council's rates income and means that, if we defaulted on a loan, the lender would have the ability to set a rate and recover the sums owed. In practice, it is the ability of local authorities to set rates that makes it very unlikely that a local authority would default on its obligations.

Council has obtained a credit rating from Fitch Ratings. This is currently AA- with a stable outlook. It is expected that this will be maintained as a minimum during the 10- year period.