Draft Financial Strategy

2024-34

Kāpiti Coast
DISTRICT COUNCIL
Me Huri Whakamuri, Ka Titiro Whakamua

Contents

1. Introduction

“Building a resilient future for Kāpiti” is the focus of Council’s financial strategy for the next decade, from 2024 to 2034.

This is because together we must be prepared for, respond to, and recover from more certain frequent and severe weather events, we must navigate our way through Aotearoa New Zealand’s continued resource-constrained and tightening economy, and we must help protect, invigorate, grow, and enrich our community on the Kāpiti Coast.

We need to be bold and act fast now to strengthen our resilience for the known challenges we face today and be best positioned for both certain and unknown challenges in the future.

Previously, Council’s financial strategies focussed on “Achieving a Balance” and “Investing for Growth.” These strategies properly addressed the natural and economic environments and challenges faced by the Council between 2015 and 2024.

“Building a resilient future for Kāpiti” is a hybrid of these previous financial strategies. From 2025/26 (Year two), it positions us to fund our everyday operations from everyday revenue and to actively start reducing our debt, whilst at the same time, it provides us with financial capacity to effectively manage our existing assets and build new assets for growth.

Actively reducing our debt means that over the next decade, our borrowing costs will be less than they would otherwise be if we don't start tackling our rising debt now. In 2033/34, our annual interest costs will be $17 million, which is $6 million less (or $115,000 less per week), for ratepayers.

Lower debt levels increase our resilience because this provides us with the capacity to borrow more money if needed, (up to our maximum debt limit), so that we can respond to unplanned natural disasters and maximise affordable growth opportunities for the Kāpiti Coast.

“Building a resilient future for Kāpiti” considers where we are now, sets out where we want to be in 2034 and how we intend to get there.

2. Where are we now...

2.1 Our rates, debt, and capital works programme snapshot

Council’s total rates revenue for 2022/23 was $81.4 million, which makes up 70% of total revenue. The average rates increase for 2022/23 was 7.5% and is 7.8% for 2023/24.

As of 30 June 2023, Council’s net worth was $1.9 billion, made up of total assets worth $2.2 billion less total liabilities of $310 million. Our net debt was $200 million, and we have a AA (negative outlook) credit rating from S&P Global. At 31 December 2023, our net debt was $221 million.

Despite resource and supply shortages, council achieved its biggest spend of $61.5 million (against a full year budget: $89.5 million) on its capital works programme (capex). $23.2 million was carried over to 2023/24 and later years to ensure we deliver what we have planned to do.

2.2 We're facing some big Challenges

- **sharp-cost increases:** Like most households and other businesses, Council is also struggling with sharp cost increases across its operations as high inflation and resource and supply shortages continue to affect all operational areas.
- **Highly competitive work-force market:** Transmission Gully and the completed expressways (McKay's Crossing to Ōtaki) have made commuting between Kāpiti both faster and safer and remote working flexibility offered by most employers means that the Council is increasingly competing with the more lucrative Wellington job market to attract and retain highly experienced and qualified staff.
- **Carbon emission target reductions**: Council recently adopted new carbon emission reduction targets towards net zero emissions by 2040. Several important projects designed to help achieve the mid-term target to reduce category 1 and 2 emissions by another 15.5% by 2032 are included in this Long-Term Plan (LTP), and they will need to be completed and measured by 2031 to hit the target.
- **High insurance costs:** Council is part an insurance syndicate with other councils in the Wellington region. This arrangement allows us to get the best possible domestic and offshore insurance cover. However, with an increase in severe weather events in Aotearoa and global natural disasters, we continue to experience year-on year premium increases of approximately 15 to 20%. Our current insurance premiums cost us approximately $2.5 million every year, and this is funded by rates.
- **No three waters reform debt repayment:** This legislation has now been repealed and central government are indicating further change to the three waters will be through their initiative "Local Water Done Well". Council had received confirmation from the Crown that payment of $110 million of debt relating to three waters assets at 30 June 2022 would be repaid to council. We were expecting a similar arrangement for additional debt related to three waters assets incurred up to 2026. This was an unprecedented opportunity for Council to significantly reduce its debt, which is no longer going to happen.

3. Where we want to be in 2034...

Our three goals

As quickly as possible, we want Kāpiti to be a resilient, prosperous, and thriving district.

As an organisation, we want Council to always be well-positioned to best serve the community by providing excellent and affordable services and facilities that meets the needs and expectations of our customers.

Our financial strategy is bold. It is intended to achieve the following three goals:

1. **Everyday costs are met from everyday revenue** – we currently underfund our annual depreciation charge by $3.5 million. Depreciation is an operating cost that spreads the total cost of our assets over their useful service lives. We debt fund this shortfall every year. We intend to fully fund our annual depreciation by rates from 2025/26 (year two) onwards.
2. **Actively reduce council debt –** an average rates increase of 7% year-on year from year two to 10 of the LTP will enable us to reduce our net debt by $144 million to $271 million at 30 June 2034, to

- provide significant new debt capacity to respond to unplanned shock events; and
- affordably respond to growth and/or enrichment opportunities across the district for our community.

3. **Strong asset management** – Ensure our assets are fit-for-purpose, achieving their optimal performance service levels and fully meeting the needs and expectations of our community. "Building a resilient future for Kāpiti" aligns with and enables our infrastructure strategy to be delivered. Our rates and debt levels enable us to invest in and maintain our assets properly through a carefully considered capital works programme.

4. How we will get there...

Like Council's previous financial strategies, our new strategy will continue to use the three "levers" - rates, debt, and capex to build a resilient future for Kāpiti. Each "lever" will be discussed separately.

4.1 Lever 1 - Rates

Quantified limits on average rates increases per year (after growth)			
Period	**Lower Limit**	**Preferred Limit**	**Upper Limit**
Year 1	12%	17%	17%
Years 2 to 10	6%	7%	8%

Balanced budget

The Local Government Act (2002) requires Council's to have a balanced budget, (this is where operating revenue is equal to operating expenditure), unless it is considered prudent not to be balanced.

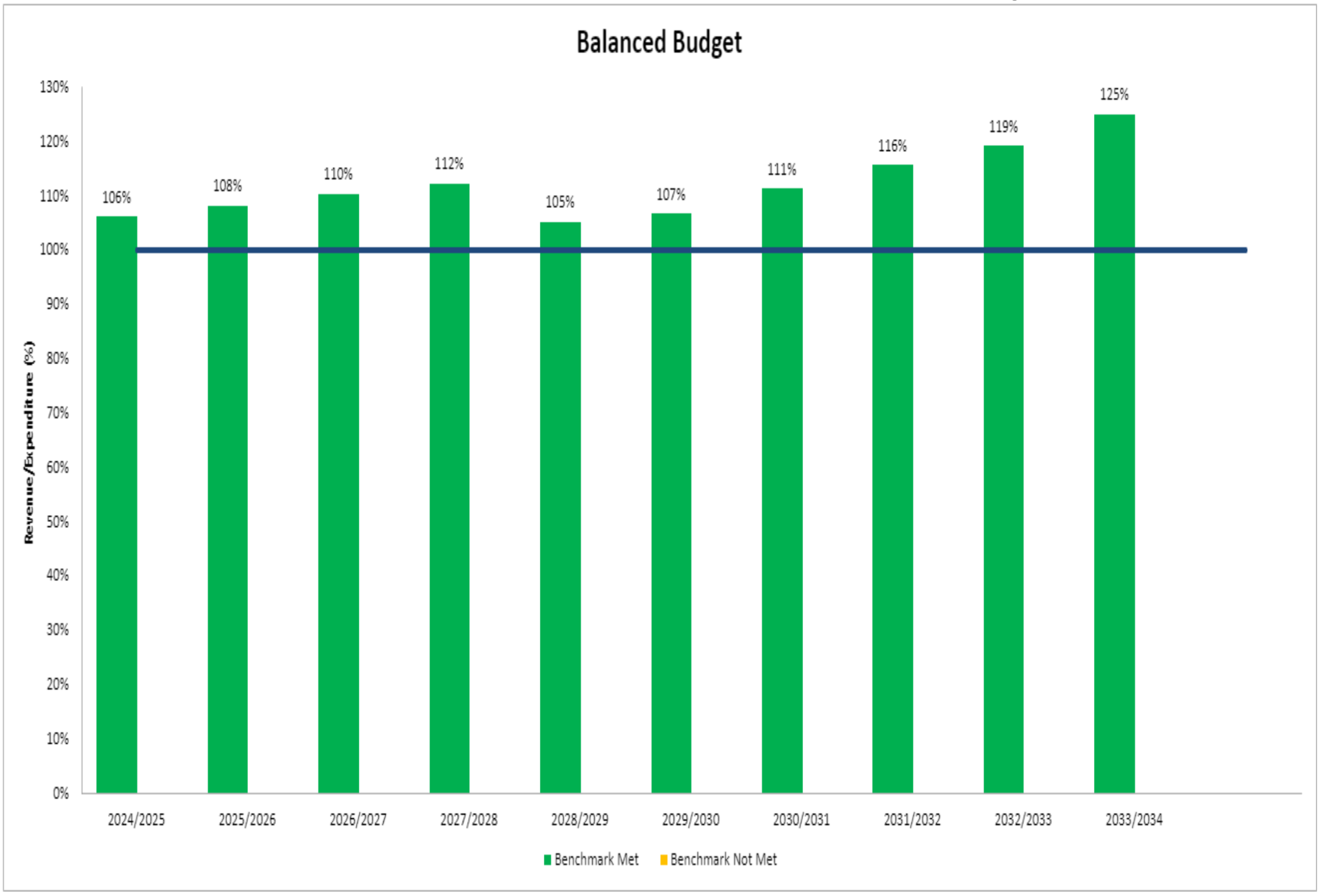
From year two, (2025/26 onwards), everyday operating costs will be fully funded from everyday operating revenue. This means that our operating revenues (rates, fees and charges, grants, petrol tax, maintenance subsidies etc.), must cover our everyday operating costs (staff costs, inflation increases, maintenance and operations, utility costs, finance costs, depreciation etc.).

Deliberately “Building a resilient future for Kāpiti” does not achieve a balanced budget for this LTP. Instead, we achieve a surplus every year. Mainly this surplus is because we are increasing our rates revenue from year two onwards to actively reduce our debt. The remaining surplus reflects our grants and subsidies that we receive from Waka Kotahi. Whilst this is treated as operating revenue, we apply all of this revenue to fund at least half of our Access and Transport capital works programme.

To ensure that our everyday operating costs are funded by everyday operating revenue, we will be making a few changes over the coming years.

- We intend to fully fund our annual depreciation by rates from 2025/26 (year two) onwards.
- There waters assets and services remain the responsibility of Council and are included in this LTP. We prefer to fully fund our three waters operating costs from rates from 2024/25 (year one) but this is a key change proposal that we are consulting on with our community.

As discussed, chart 1 below shows that Council does not meet the balance budget for this LTP.



We believe that it is prudent to achieve a surplus each year for the following reasons:

- Part of this surplus is artificial as it represents external funding from Waka Kotahi to fund at least half of our Access and Transport capital works programme. This reflects that everyday operating costs are funded from everyday operating revenue which means we are not borrowing money to pay for operating costs.
- Actively reducing our debt means that over the next decade, our borrowing costs will be less than they would otherwise be if we don't start tackling our rising debt now. In 2033/34, our annual interest costs will be $17 million, which is $6 million less (or $115,000 less per week), for ratepayers. Lower debt levels increase our resilience because this provides us with the capacity to borrow more money if needed, (up to our maximum debt limit), so that we can respond to unplanned natural disasters and maximise affordable growth opportunities for the Kāpiti Coast.
- We plan to actively reduce our debt by average rates increases (after growth) of 7% per year from year two to 10. We believe this approach achieves the right balance between building a resilient future for Kapiti and keeping rates affordable for our community.

Average rate increases explained

Chart 2 below shows the proposed annual rates percentage increase (after growth) both with and without actively reducing council debt. This chart clearly shows that for us to actively reduce council debt, we are “increasing rates funding to our preferred limit of average rates increases of 7% year-on year from 2025/26 onwards.

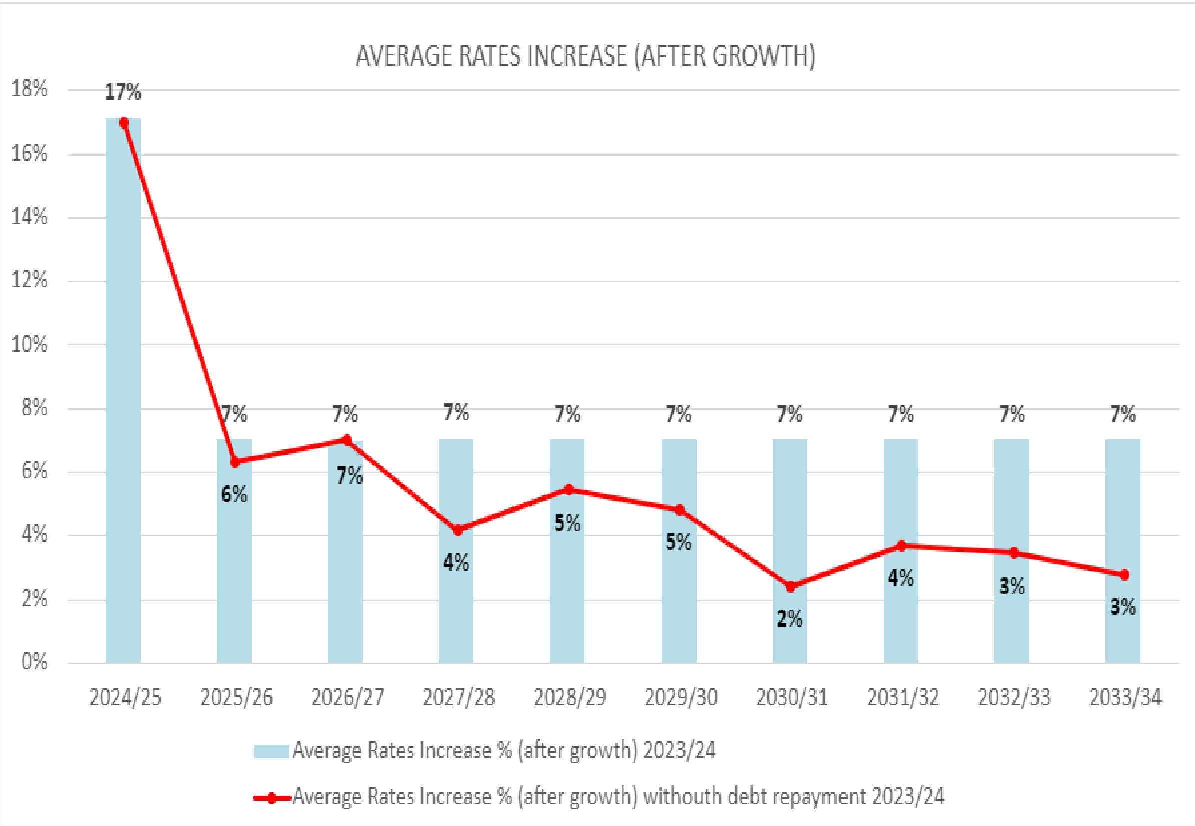


Chart 2 – Shows average rates increase with and without active debt reduction.

Year on year, Council faces real and definite cost increases. These include increased depreciation from asset investment and/or asset revaluation from the prior financial year, personnel cost increases, increased interest costs from increasing debt in the prior year, inflation, increased utility costs, additional activities mandated by central government etc.

Without increasing rates year on year, Council would need to either reduce levels of service or fund everyday costs through borrowing more money.

Chart 3 shows the definite cost increases between 2023/24 and 2024/25 and explains why council is proposing an average-rates increase of 17% in year one of the LTP.

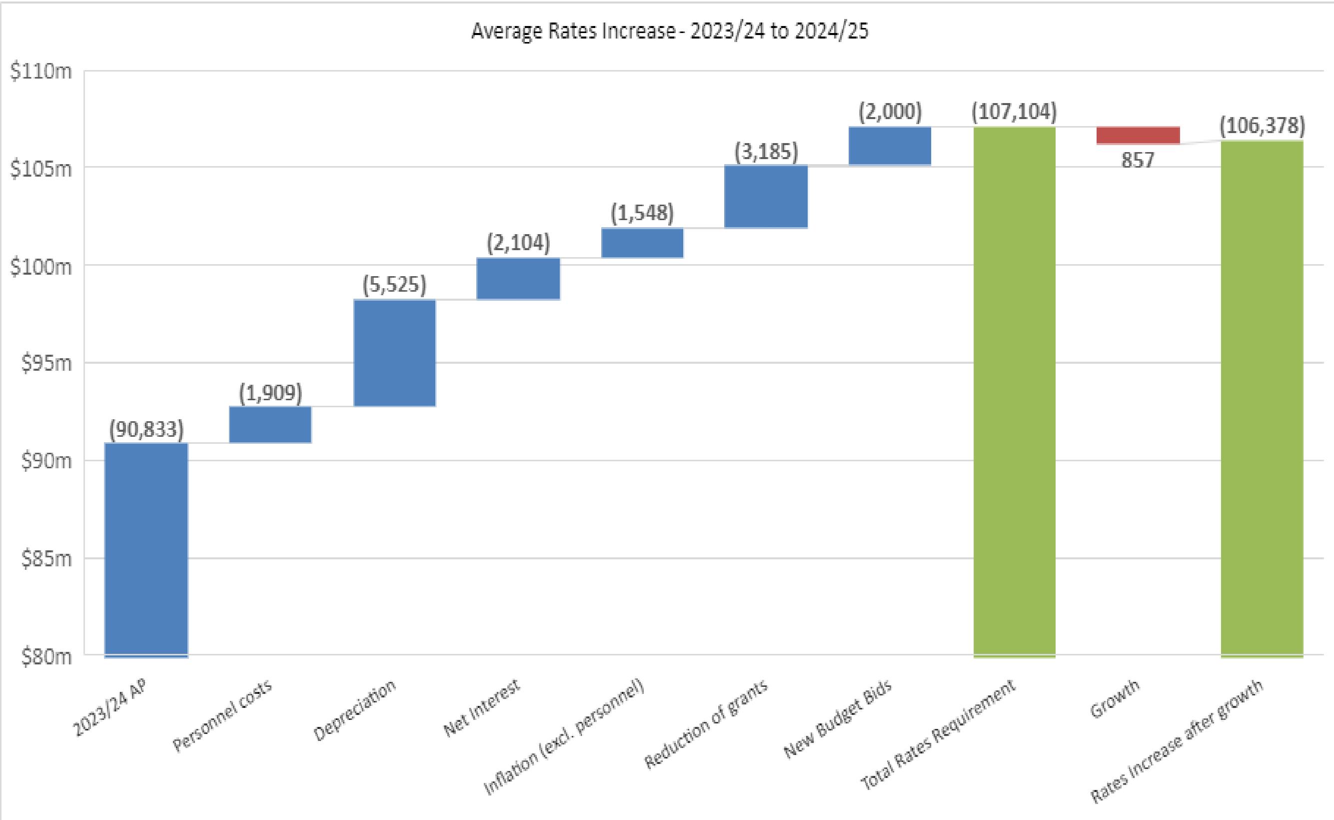


Chart 3 – Definite cost increases from 2023/24 to 2024/25

The main cost increases for 2024/25 include depreciation and reduction of grants.

For both 2022/23 and 2023/24, Council decided not to rates fund increases to depreciation of its three waters assets. Instead, this was debt funded as Council believed these assets would be transferred from Council ownership from 1 July 2024 and the debt would be repaid by central government. Now that Council will retain ownership of the three waters assets, Council needs to fund this increased depreciation. We prefer to rates fund this like we did previously.

Reduction in grants relates to the previous governments "Better Off Funding" of $3.2 million, This funding was used to reduce rates and fund the three waters operating costs in 2023/24 on the basis that Council would not be providing these services from 1 July 2024. Essentially, this was one-off funding. Council needs to fund these operating costs. We prefer to rates fund this like we did previously.

Chart 4 shows the average rates increases per year from 2024/25 to 2033/34 and includes a breakdown of what is causing these average rates increases each year.

The Chief Executive has capped personnel staffing levels at 436 for the next three years. Personnel cost increases reflect inflationary increases to staff salaries in line with the Council's collective bargaining for 2024/25. Personnel increases are in line with inflation across years two to 10.

Notably, debt reduction starts to increase from 2030/31, and as debt starts to reduce significantly, so too does the annual net interest cost and so this no longer drives rates increases in subsequent years (shown as a negative 2031/32).

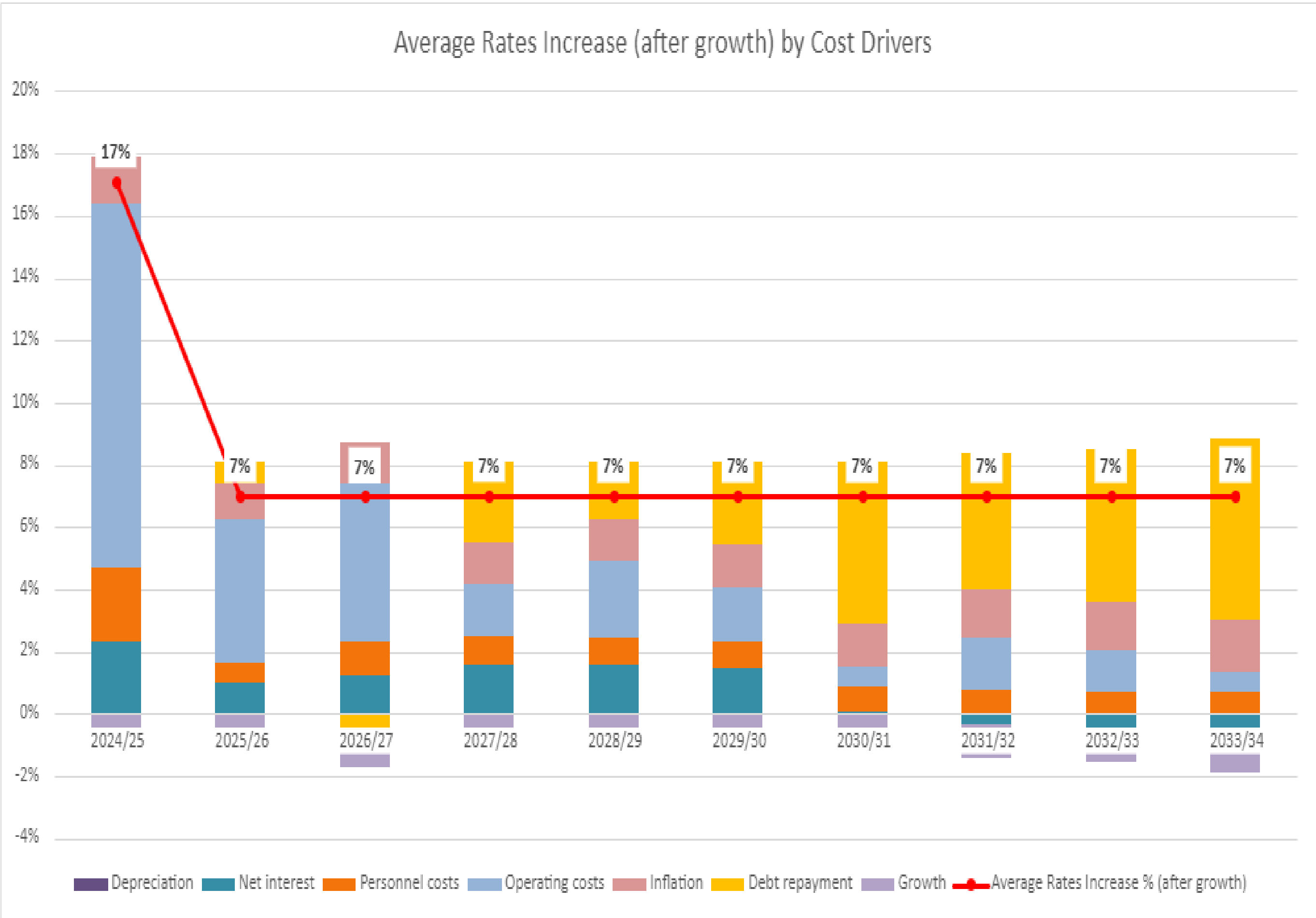


Chart 4 – A breakdown of average rates increases per year.

Ratepayers often like to see what their annual rates are paying for. Chart 5 shows council's annual rates revenue for the LTP (excluding Greater Wellington Regional Council) and includes a breakdown of what makes up the total rates revenue each year bu cost type/driver.

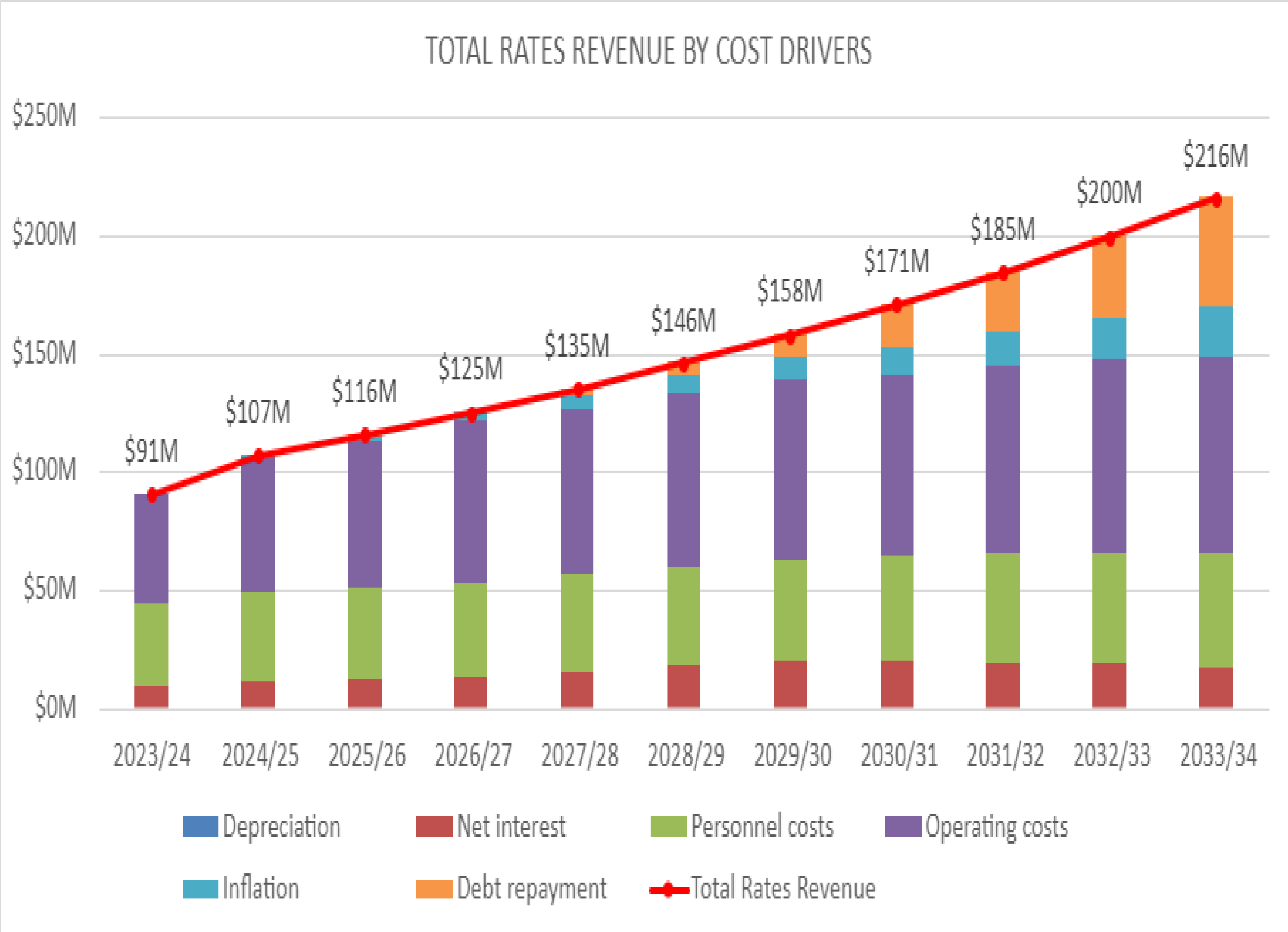


Chart 5 – Breakdown of total rates revenue per year by cost type/driver

As expected, we see debt repayment make up more of the total annual rates revenue in the outer years from 2030/31 onwards. Conversely, we also see that net interest costs start to reduce and makes up less of the total annual rates revenue in the outer years from 2031/32 onwards.

Similarly, Chart 6 below shows Council's annual rates revenue (excluding Greater Wellington Regional Council) and includes a breakdown of the public funding requirements for each major activity, for this LTP. "Other" activity mainly includes actively reducing council debt. As expected, we see the additional rates revenue required for us to actively reduce our Council debt.

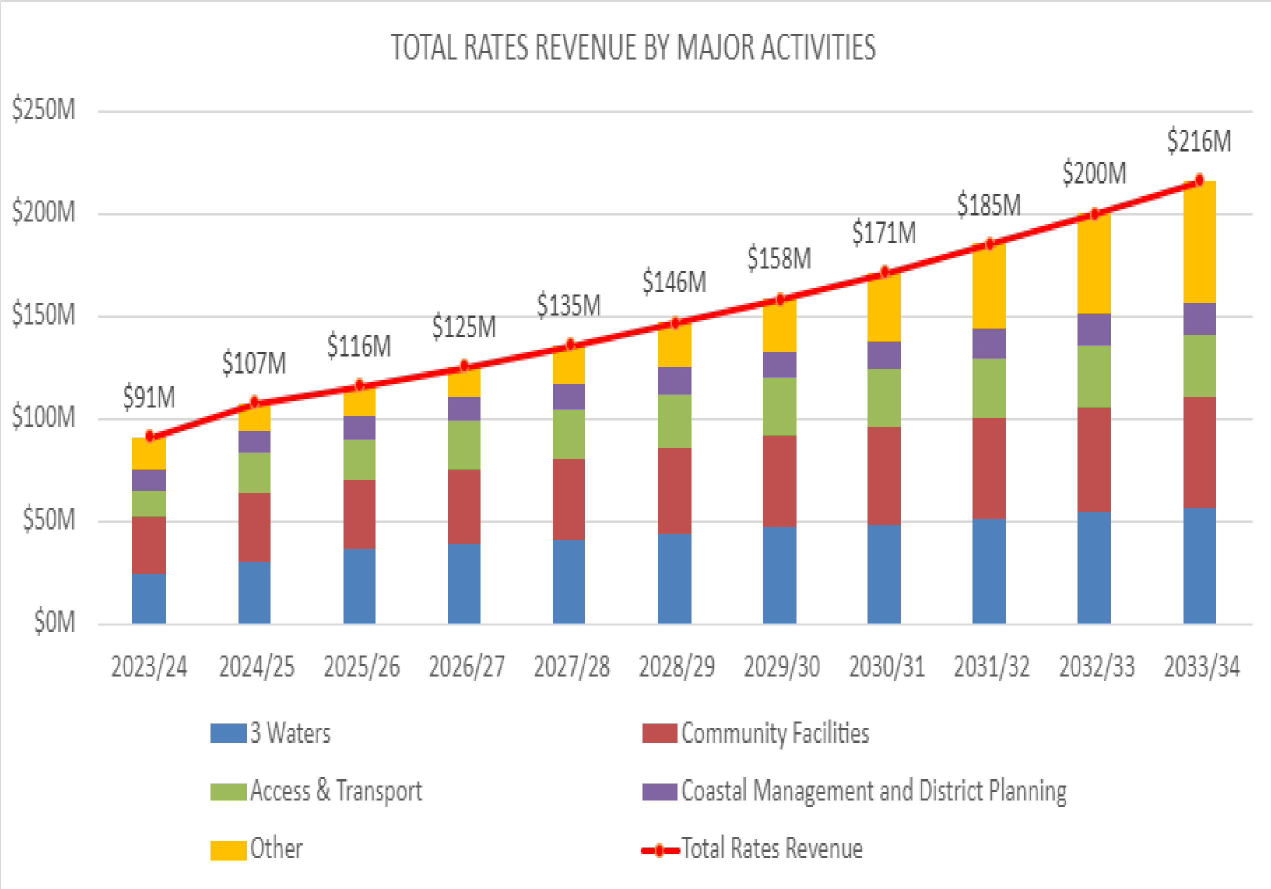


Chart 6 – total rates revenue per year broken down by public requirements for each major activity. An activity represents a group of services provided by the Council.

Projected growth of our rateable properties

Population growth and household size forecasts are done as part of informing our Infrastructure Strategy and Asset Management Plans. We use this same information to forecast growth in our rateable units. The following table shows our assumed growth rates for rateable units for the next ten years.

	2024/25	2025/26	2026/27	2027/28	2028/29	2029/30	2030/31	2031/32	2032/33	2033/34
GrowthRate	0.80%	1.1%	1.1%	1.1%	1.1%	1.1%	1.1%	1.1%	1.1%	1.1%
Rating Units	25,969	26,255	26,544	26,836	27,131	27,429	27,731	28,036	28,344	28,656

Chart 5 and 6above reflect a 137% increase in rates revenue from years one to 10, which includes public funding for growth related costs as per our revenue and finance policy, across all ten years. If we compare average rates in 2024/25 to the proposed average rates in 2033/34. average rates in 2024/25 is $4,120 ($107 million / 25,969 rating units) compared to 2033/34 of $7,538 ($216 million / 28,656 rating units). This indicates that the average rates bill across the next decade will increase by $3,148 or 82%. This leads us nicely into how we considered affordability in developing and setting this strategy of “Building a resilient future for Kāpiti”

Rates affordability

Our independent affordability study determined that currently, the median household income in Kapiti is $101,362, our median rates are $4,734, which represents 4.7% of household income. The Shand Report, published in 2007, established a rates affordability benchmark of no more than 5% of household income, we are always mindful of this benchmark, but given this is now 17 years old, we used approximately 7% as our rates affordability proxy for this LTP.

The table below considers rates affordability for three separate scenarios. We project median household income to increase 3% year on year to $136,222 in 2033/34 and then applies average rates using year-on year rates increases of 6%, 7% and 8% and applies an average rate using the expected growth in rating units in 2033/4.

We determined that applying an average rate increase of 6%, 7% and 8% across years two to 10, returned rates affordability results of 6.9%, 7.5% and 8.1% against median household income in 2033/34. Refer to the table below for more details.

	2023/24	2024/25	2025/26	2026/27	2027/28	2028/29	2029/30	2030/31	2031/32	2032/33	2033/34
Estimated salary increase		3%	3%	3%	3%	3%	3%	3%	3%	3%	3%
Median Household income	101,362	104,403	107,535	110,761	114,084	117,506	121,032	124,662	128,402	132,254	136,222
Rates increase @8%		17%	8%	8%	8%	8%	8%	8%	8%	8%	8%
Rates increase @7%		17%	7%	7%	7%	7%	7%	7%	7%	7%	7%
Rates increase @6%		17%	6%	6%	6%	6%	6%	6%	6%	6%	6%
Median rates in Kapiti (8% Increase)	4,734	5,539	5,982	6,460	6,977	7,535	8,138	8,789	9,492	10,252	11,072
Median rates in Kapiti (7% Increase)	4,734	5,539	5,926	6,341	6,785	7,260	7,768	8,312	8,894	9,517	10,183
Median rates in Kapiti (6% Increase)	4,734	5,539	5,871	6,223	6,597	6,993	7,412	7,857	8,328	8,828	9,358
Rates / Household income ratio @8%	4.7%	5.3%	5.6%	5.8%	6.1%	6.4%	6.7%	7.1%	7.4%	7.8%	8.1%
Rates / Household income ratio @7%	4.7%	5.3%	5.5%	5.7%	5.9%	6.2%	6.4%	6.7%	6.9%	7.2%	7.5%
Rates / Household income ratio @6%	4.7%	5.3%	5.5%	5.6%	5.8%	6.0%	6.1%	6.3%	6.5%	6.7%	6.9%
If 5% affordability, what rates would be	4,734	5,220	5,377	5,538	5,704	5,875	6,052	6,233	6,420	6,613	6,811

If 7% affordability, what rates would be	4,734	7,308	7,527	7,753	7,986	8,225	8,472	8,726	8,988	9,258	9,536
What rates increase would be if taking 5% affordability into account		10.3%	3.0%	3.0%	3.0%	3.0%	3.0%	3.0%	3.0%	3.0%	3.0%
What rates increase would be if taking 7% affordability into account		54.4%	3.0%	3.0%	3.0%	3.0%	3.0%	3.0%	3.0%	3.0%	3.0%

Our self-imposed rates affordability proxy is 7%. When we considered the difference in debt reduction and interest charges in 2033/34 of the 6% and 7% scenarios, we believe that the 7% average rates increase scenario strikes a far better balance for ratepayers between rates affordability and ensuring we have a s resilient future in Kapiti,

4.2 Lever 2 - Debt

Quantified Limits on Net Debt / Total Operating Revenue		
Period	**Lower Limit**	**Upper Limit**
Year 1	Nil	285% (LGFA)
Years 2 to 10	Nil	280% (LGFA

“Building a resilient future for Kāpiti” includes a goal to actively reduce council debt. Average rate increases of 7% year-on year from year two to 10 of the LTP will enable us to reduce our net debt by $144 million to $271 million at 30 June 2034, to

- provide significant new debt capacity to respond to unplanned shock events; and
- affordably respond to growth and/or enrichment opportunities across the district for our community.

We currently have a AA (negative outlook) credit rating from S&P Global. By funding everyday costs from everyday revenue and actively reducing council debt, we hope to strengthen our credit rating to AA (stable outlook) in the future. Whilst this credit rating uplift won't result in any further reductions to borrowing costs, it does establish us more firmly within the AA credit rating hierarchy.

Chart 7 shows council’s net debt profile against its quantified upper limit in dollars (NZD). Similar to the rates charts above, we can see that it takes approximately six years before debt starts to noticeably reduce from 2030/31and achieves borrowing headroom/capacity of $411 million (being quantified upper limit of $682 million minus net debt of $271 million) in 2033/34.

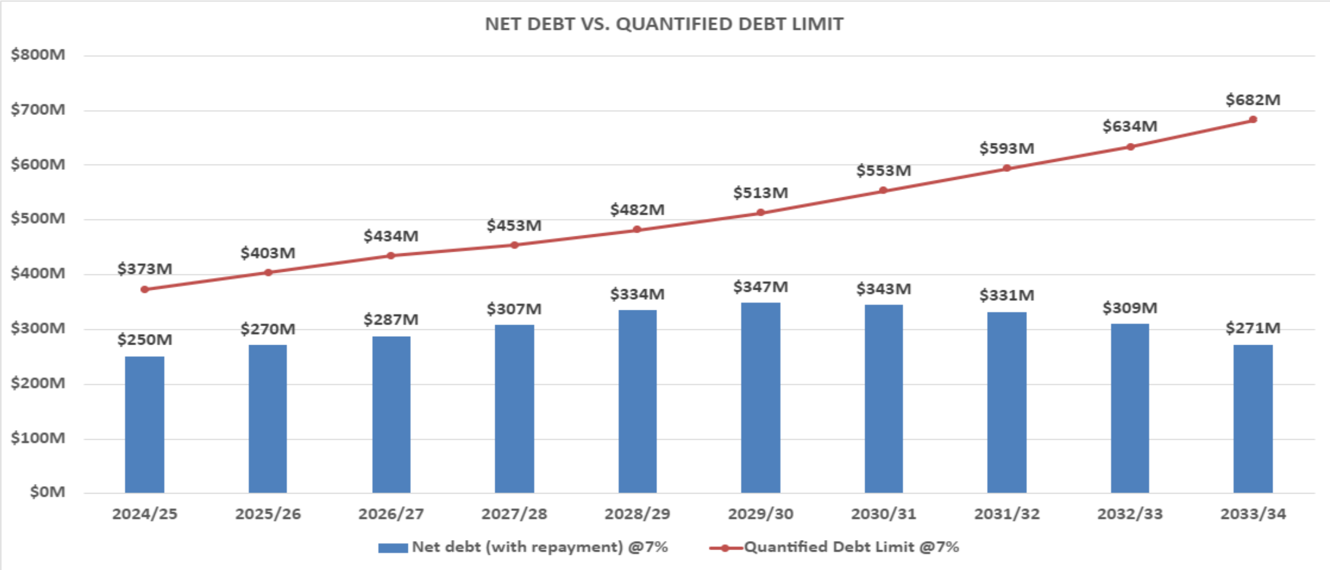


Chart 7 – Council's debt profile and quantified upper limit in dollars (NZD)

Chart 8 shows council's net debt profile against its quantified upper limit in dollars (NZD) both with and without active debt repayment applying a 7% annual rates increase.

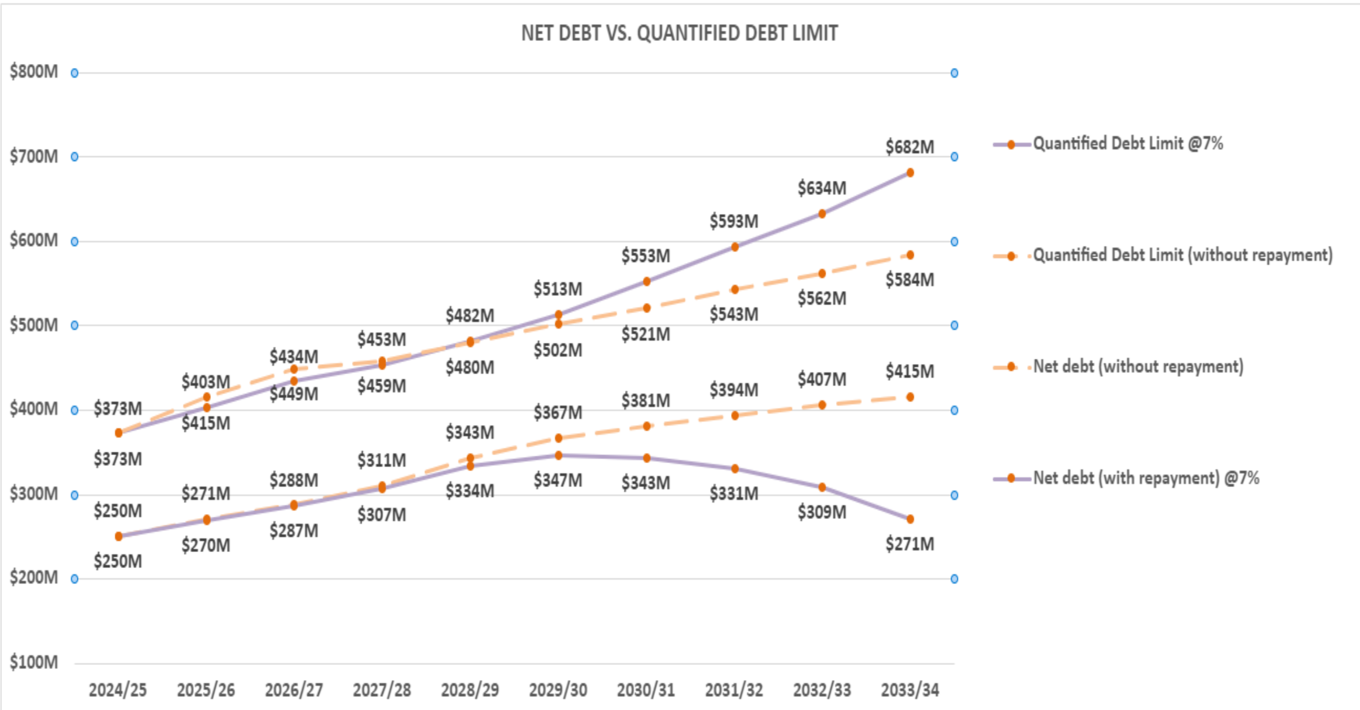


Chart 8 – Net debt and quantified limits in dollars (NZD) with and without active debt repayment at 7% average rate increases from year two to 10.

This clearly illustrates that average rate increases of 7% year-on year from years two to 10 result in lower net debt and more borrowing capacity in 2033/34 than if we do nothing to reduce our debt. Table 1 shows us that this achieves $144 million less net debt, an increase of $98 million to our quantified upper limit and $242 million more borrowing capacity in 2033/34.

Scenario	Proposed Net debt in 2033/34	Quantified Upper Limit in 2033/24	Borrowing Capacity in 2033/34
7% Rates funded debt reduction	$271 million	$682 million	$411 million
No rates funded debt reduction	$415 million	$584 million	$169 million
Difference	**$144 million**	**$98 million**	**$242 million**

Table 1 – Net debt, upper limits and borrowing capacity scenarios

Chart 9 shows council's net debt profile against its quantified upper limit in dollars (NZD) both with and without active debt repayment applying a 6% annual rates increase.

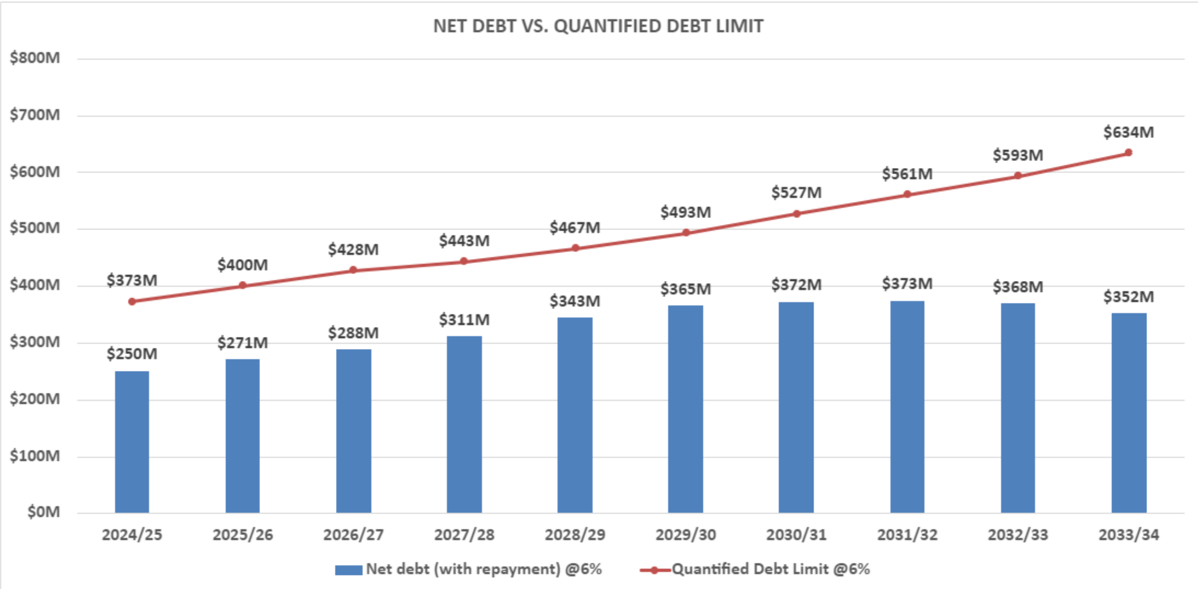


Chart 9 - Net debt and quantified limits in dollars (NZD) with and without active debt repayment at 6% average rate increases from year two to 10.

Table 2 summarises the difference between the average rate increases of 6% and 7% scenarios. We can see that whilst the 7% average rates increase scenario sits just outside our self-imposed rates affordability proxy of 7.5% in 2033/34, it reduces net debt by a further $81 million, further increases our quantified upper limit headroom by $48 million and provides us with $129 million more burrowing capacity in 2033/34.

Scenario	Proposed Net debt in 2033/34	Quantified Upper Limit in 2033/24	Borrowing Capacity in 2033/34
Rates funded debt reduction (7%)	$271 million	$682 million	$411 million
Rates funded debt reduction (6%)	$ 352 million	$ 634 million	$282 million
Difference	**($81 million)**	**($48 million)**	**($129 million)**

We therefore considered an average rate increase of 7% year-on-year from year two to 10 to achieve our goal to actively reduce council debt to be affordable and prudent.

Council borrows entirely from the Local Government Funding Agency (LGFA). We have aligned Council's Net Debt / Total Operating Revenue quantified upper limit to align with the upper limit imposed by LGFA on the local government sector.

Chart 10 shows that a 7% average rates increase from years two to 10 is fully compliant with our quantified upper limit on debt.

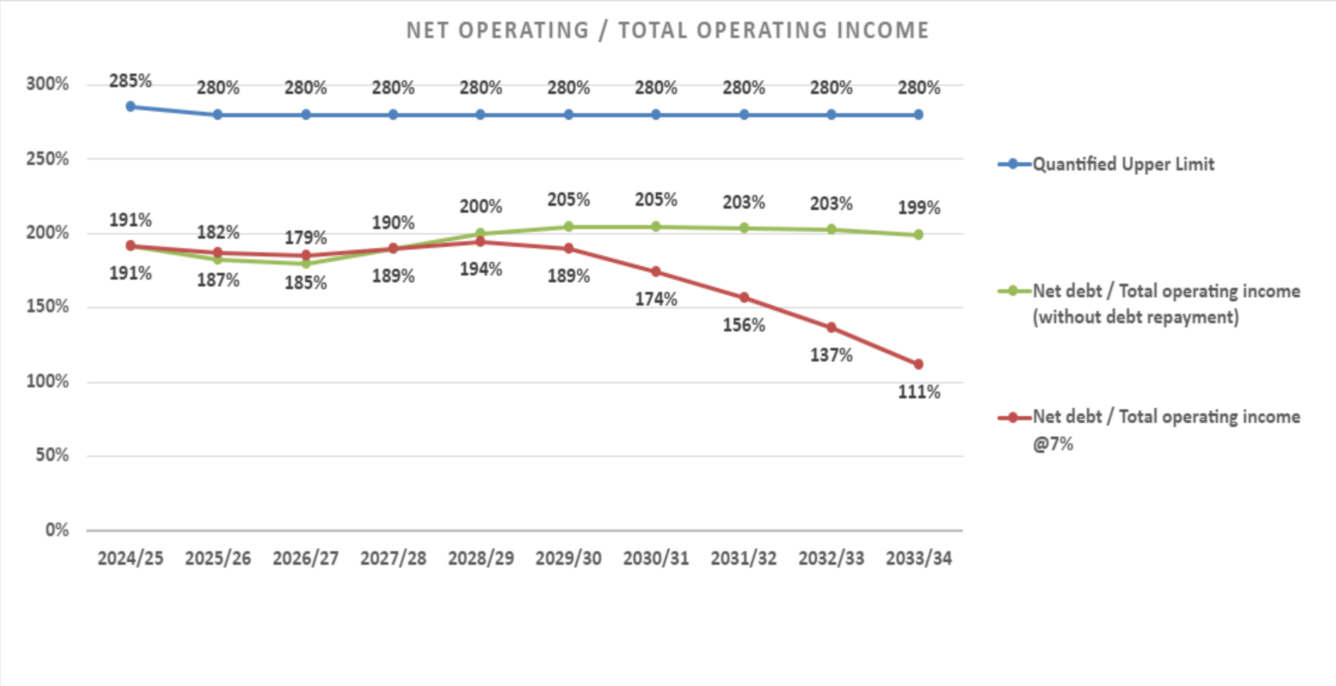


Chart 10 – Nebt Debt / Total Operating Revenue vs. Quantified Upper Limits applying 7% average rates increases from years two to 10.

Each year, Council will need to issue new debt to help fund its planned capital works programme (capex).

Chart 11 shows how much new debt is required every year for this LTP both with and without actively reducing debt.

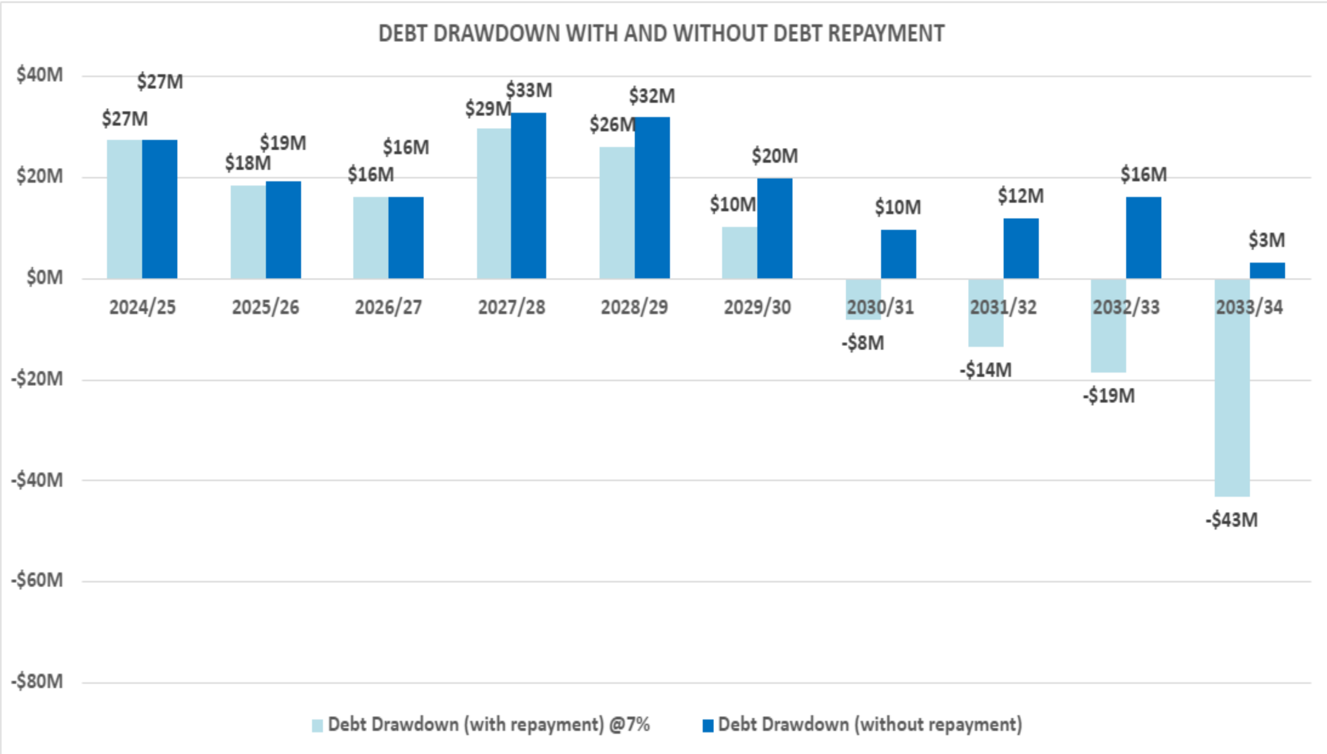


Chart 11 – new debt requirements year-on-year with and without actively reducing debt

It will take Council six years (until 2029/30) to start making meaningful reductions to its debt. Between 2025/26 and 2028/29, we can see that Council will draw down less debt each year than it would otherwise need if it was not actively reducing debt by increasing rates revenue.

From 2030/31, Council will fully fund the capital works programme from rates funded depreciation, external capital subsidies (i.e. from Waka Kotahi) and development contributions and will start to pay down debt from the additional rates revenue. Notably, council will reduce its debt by $84 million between 2030/31 and 2033/34 if this strategy is applied/maintained.

Net interest costs will reduce as net debt is reduced. Chart 12 shows that net interest costs continue to rise, peaking at $20 million between 2029/30 and 2030/31 but start falling beyond that as debt is notably reduced. Net interest costs are projected to be $17 million in 2033/34 compared to $23 million in the same year if there is no active debt reduction.

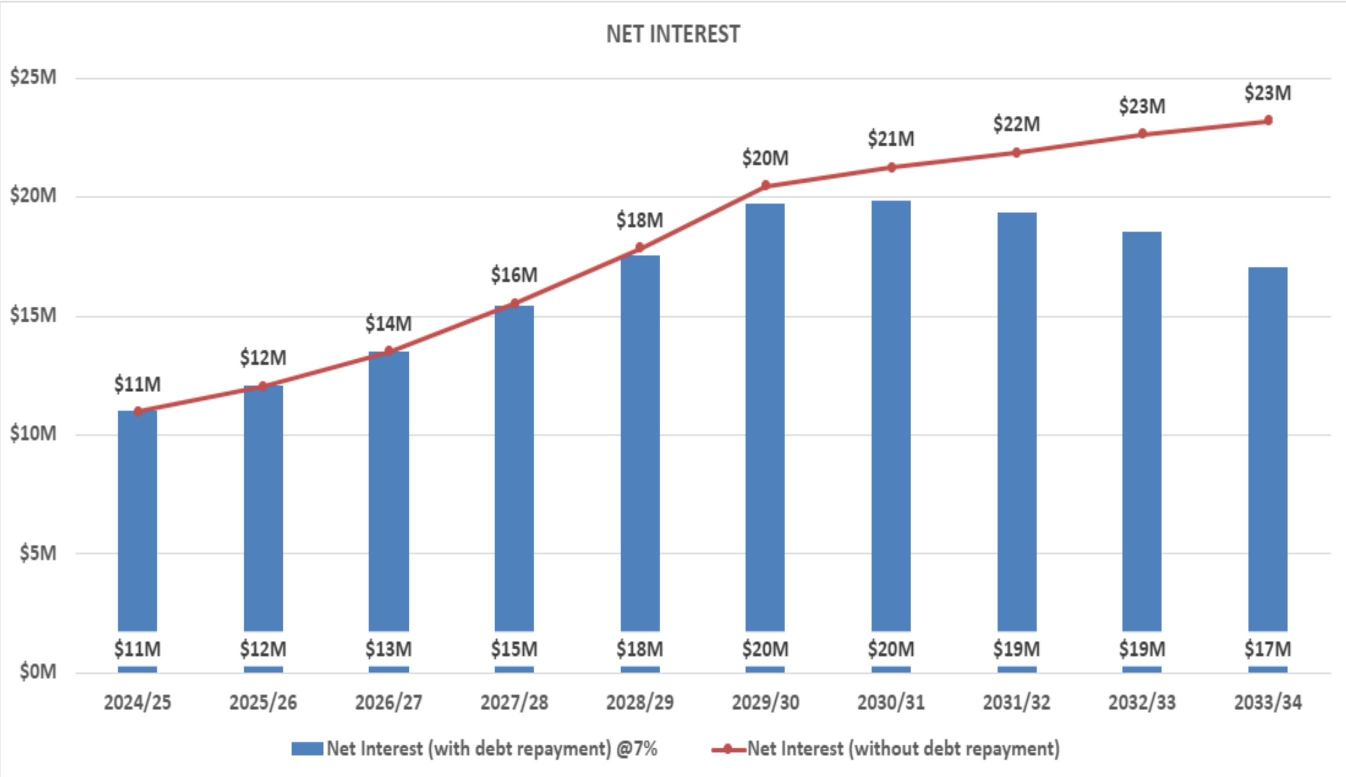


Chart 12 – Net interest costs per year with and without active debt reduction.

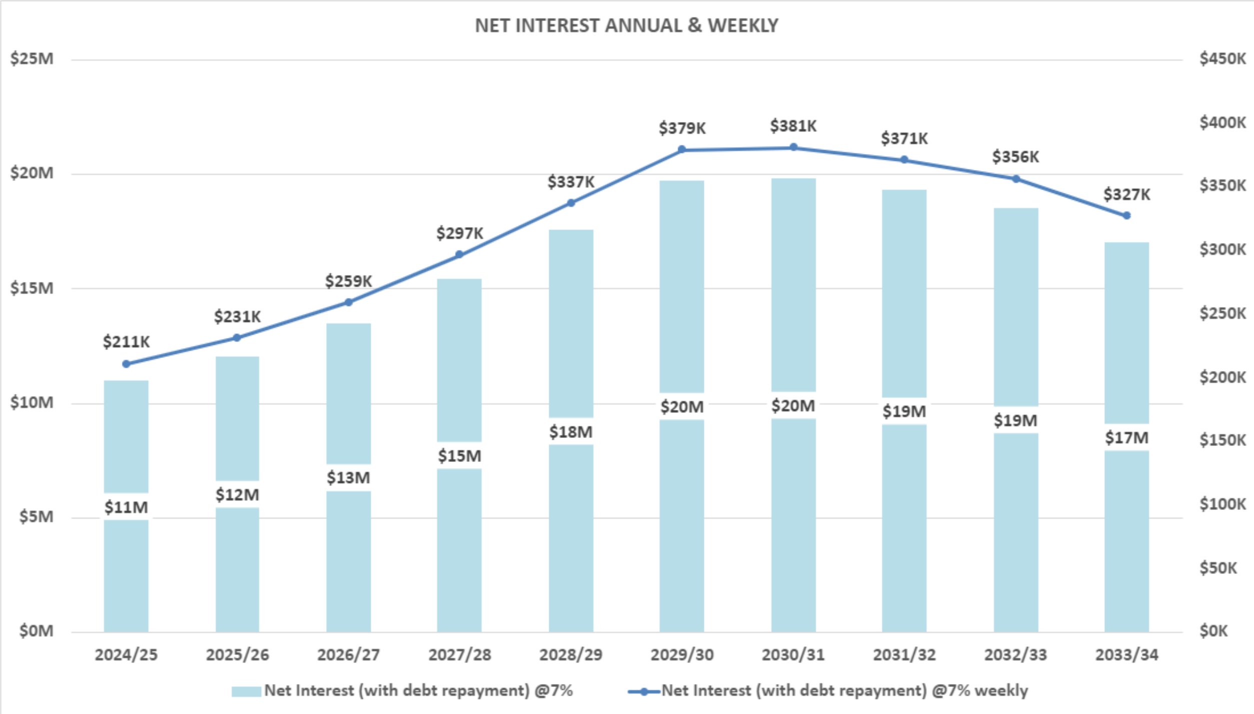


Chart 14 – Projected annual net finance costs with and without debt reduction

Lastly, chart 13 shows us that net interest costs of $17 million in 2033/34 will cost ratepayers $327,000 per week. This would be $442,000 per week (based on net interest costs of $23 million) without actively reducing rate, representing a saving t ratepayers of $115,000 per week.

Once again, we considered an average rate increase of 7% year-on-year from year two to 10 to achieve our goal to actively reduce council debt to be affordable and prudent.

Intergenerational equity

Intergenerational equity is simple in principle but difficult to achieve properly in practice. We achieve this when ratepayers pay their share, and only their fair share of the cost of the assets they consume today. We don't believe we are getting this right. Right now, we don't fully rates fund our asset depreciation. Fully rates funding depreciation from 2025/26 gets us closer to achieving intergenerational equity.

The next consideration is our debt. We refinance our existing debt when it matures, and year-on-year we increase our debt to help fund our capital works programme (capex). The key issue here is that we never reduce our debt. Therefore, we don't feel we are properly achieving intergenerational equity but instead we are pushing increasing debt and higher net interest costs onto future ratepayers.

We need to take a much closer look at we fund our assets and properly achieve intergenerational equity in the coming years. For now, taking an affordable measure to actively reduce council debt to lower the debt burden on future ratepayers and fully funding our asset depreciation from rates is a positive and necessary step towards being confident we are fully achieving intergenerational equity for our ratepayers, today and in the future.

4.3 Lever 3 – Capex

Quantified Limits on Annual Capex Spend			
Period	**Lower Limit**	**Preferred Limit**	**Upper Limit**
Year 1 to 10	$70 million	$80 million	$100 million

Chart 15 shows council's planned capital works programme (capex) for the next decade. This includes all of Council's assets, including the core assets as set out in council's infrastructure strategy.

This chart shows capex spend by category (i.e. replace existing assets (asset renewals), new and existing assets to increase service levels (asset upgrades) and new assets.

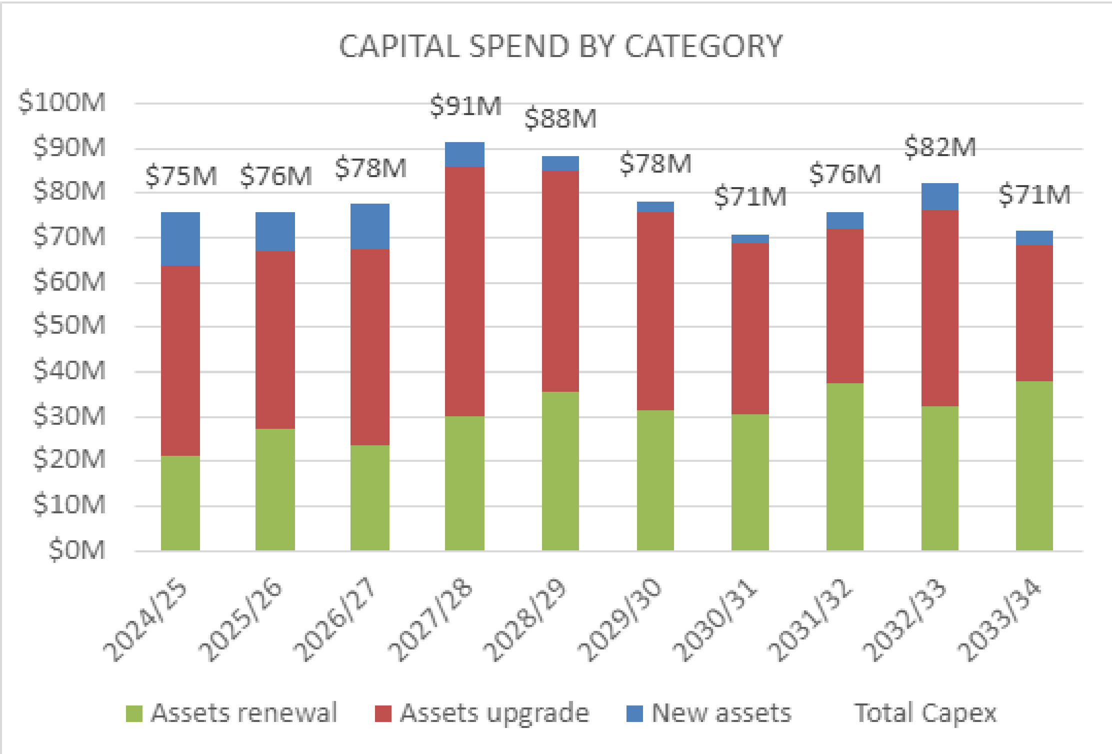


Chart 15 – Planned Capital Works Programme

Chart 16 shows council's capital works programme by major activity so that ratepayers can see what the capital works programme mainly includes. Not surprisingly, most of council's significant capex relates to its core infrastructure assets, being access and transport, three waters and coastal.

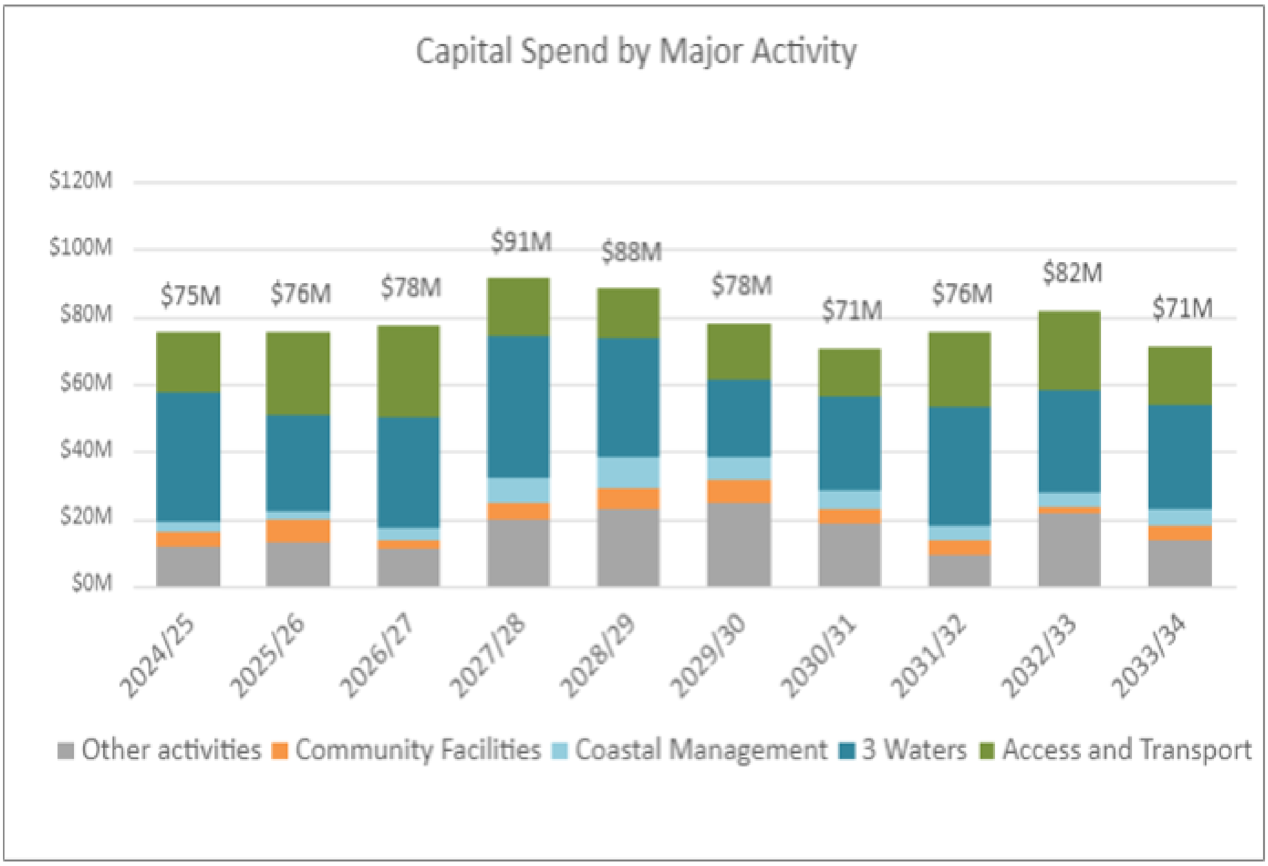


Chart 16 – Planned capital works programme

Alignment with our infrastructure strategy

Chart 15 below is included in our infrastructure and illustrates the consolidated operating and capex spend identified for our core assets for the next 30 years.

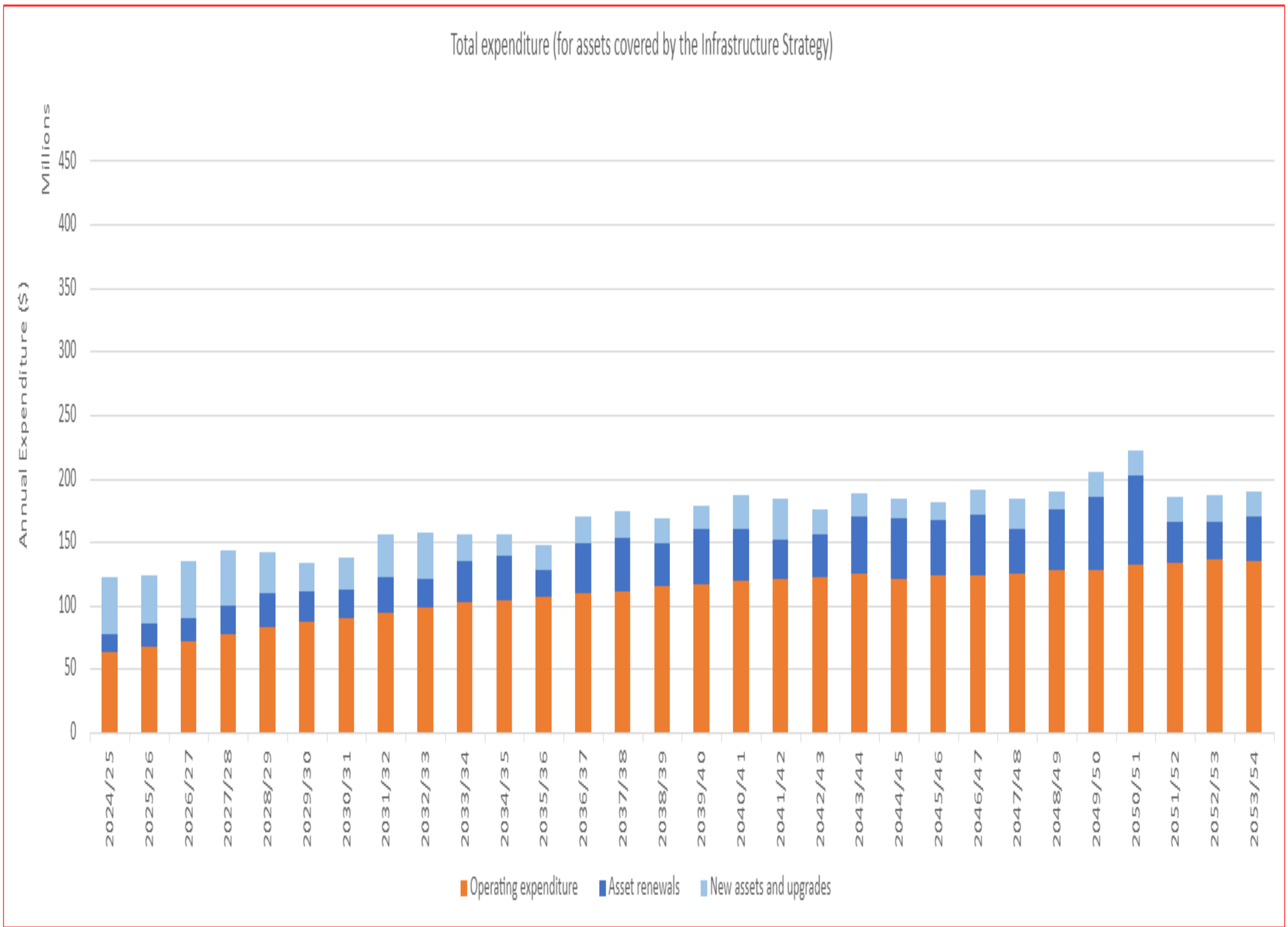


Chart 15 – Total expenditure related to core assets for 30 years.

The primary focus of this financial strategy is to achieve its three goals: everyday operating costs are funded by everyday operating revenue, actively reducing council debt and strong asset management. The primary focus of the infrastructure strategy is strong asset management of council's core assets, being access and transport, three waters and coastal.

The quantified limits in the financial strategy on rates, debt and capex create financial capacity to help enable the infrastructure strategy to be delivered. Importantly, because the financial strategy ensures that asset depreciation is being fully funded from rates from year two onwards, less new debt is now required to help fund the infrastructure strategy capital works programme than previously thought. So not only can we afford to deliver our capital works programme, including the infrastructure strategy, but we will also be more resilient for certain challenges in the future.