

BUDGET ASSUMPTIONS

It is a requirement of the Local Government Act 2002 to present forecast financial statements that span 10 years, and that these are presented in the Council's Long Term Council Community Plan (LTCCP). This provides an opportunity for ratepayers and residents to review the projected financial results and position of the Council. As year two of the Council's LTCCP, the forecast financial statements outlined in the 2004/05 Annual Plan indicate how council will be funded for the next 9 years and how that money will be spent.

The forecast financial statement on pages 173 to 180 have been prepared in accordance with the Council's current accounting policies as specified on pages 203 to 208. The Council is aware that it may have to alter some of its accounting policies in the future as a result of the Accounting Standards Review Board's decision to adopt International Financial Reporting Standards as the basis for new New Zealand financial reporting standards, for periods commencing 1 January 2007. However, the forecast financial information presented does not take into account of the potential impact on the Council of the new New Zealand financial reporting as this impact is not yet known.

General assumptions

The financial information disclosed in the draft Annual Plan is forward-looking and based on a number of assumptions (outlined here) that may or may not eventuate. Should any of the assumptions prove to be invalid this may have a direct effect on the projected average rates funding requirement.

The figures for individual years are subject to final ratification as part of each year's consultation process.

Should any amendments to the financial statement be required, these will be actioned in accordance with section 93(5) of the Local Government Act 2002.

No general (overall) inflation allowances have been made.

Assumptions about revenue

- The Council has set its projected operating revenue (including rates) at a level sufficient to meet the projected operating expenditure, except where the Council has resolved that it is financially prudent not to do so.
- The total rates split between sectors, and the basis for both general and targeted rates, are all determined by the Revenue and Financing Policy.

- The Tawa driveway and Marsden Village levies will remain constant.
- The application and level of user charges are all determined by the Revenue and Financing Policy.
- The Government will continue to pay Transfund subsidy at current levels. The amount is determined by the level of capital expenditure that attracts Transfund subsidy.
- Dividends are based on projections supplied by Council Organisations and Council Controlled Organisations in which the Council has an equity investment. It is assumed the Council will maintain its existing investments.
- No allowances have been made for groundlease rental where a groundlease sale is currently being negotiated.
- Where there is a signed rental agreement applying to the year, the agreed groundlease rental is included. For all others an estimate has been made based on current market conditions.
- The Council will continue to hold its subordinated debt investment in Wellington International Airport Limited and is assumed that the interest income received each year will remain constant.



- The Council will continue to earn interest on investments with third parties.
- It is assumed that petrol tax will continue to exist in future years and the level forecast remains constant.

Assumptions about expenditure

- The expenditure shown for programmes and projects reflects only those programmes and projects that the Council has approved through the Planning and Performance Committee. Costs are expressed as gross costs before user charges and subsidies. All costs are expressed in 2004 dollars, with no inflation allowances made.
- The average cost of borrowing is 6.1 percent on existing debt. The same rate has been applied on new borrowings for the full 10 years. No allowance has been made for movements in interest rates whenever loans are refinanced.
- Rates funded depreciation can only be used to fund renewal of assets, with any excess depreciation being used to repay borrowings.
- The Council will continue not to rates fund certain depreciation, in accordance with the Council's Revenue and Financing Policy, for as long as the principles for non-rates funding remain valid – we have assumed this is for the duration of the Annual Plan.

- No allowance has been made for the depreciation implication of infrastructural and other asset revaluations that are carried out on a periodic/cyclic basis.
- Organisational costs remain constant over the 10-year period except for reallocations between programmes and projects.
- No allowance has been made for one-off redundancy and other costs that may arise from any change management or competitive tendering initiatives.
- Business Outcomes KAA (\$17.295m in 03/04) previously included in the Council Plan 2003/04 was disestablished as determined by the Revenue and Financing Policy and those projects were either transferred to other KAA's or allocated to other Council outcomes and activities.

Assumptions about capital expenditure

- Money to fund depreciation comes from rates. If the capital expenditure is to replace an asset (this is known as "renewals"), that expenditure will be funded by depreciation. Any surplus depreciation will be used to repay borrowings. Any shortfall in funding requirements will be met through new loans.

- If the capital expenditure is on a new asset or an upgrade of an asset then the capital expenditure will be funded from new loans.
- If an approved capital expenditure project is not completed by year end, the unspent funds will be carried forward to enable the project to be completed the following year.

Assumptions about assets

- All assets, excluding property, plant and equipment remain constant except for the growth in the self insurance reserve.
- With the exception of the Living Earth joint venture (see following section about non-funded depreciation), it has been assumed that all other assets will be replaced at the end of their useful life.

Assumptions about liabilities

- All liabilities, other than borrowings, are assumed to remain constant for the 10-year period.
- All borrowings are assumed to be for the full term of the loan.
- All borrowings will be in accordance with the parameters detailed in the Treasury Policy.

- Debt will be repaid from a combination of:
 - (i) excess depreciation over and above renewals
 - (ii) roll over of borrowings
 - (iii) sale of surplus assets on a case-by-case basis
 - (iv) operating surpluses.

Assumptions about non-funded depreciation

Since the 2000/01 financial period, the Council has applied exemptions provided by Section 122J(e) of the Local Government Act 1974 in respect of the non-funding of depreciation on specific assets. The exemption allowed the Council to identify strategic assets where either there was no intention to replace the asset at the end of its useful life or where a third party was already responsible for the funding of the asset replacement programme through an alternative funding or contractual mechanism.

In the 2003/04 Council Plan a portion of the depreciation on the following assets was not funded through rates:

- Clearwater sewage treatment plant
- Living Earth joint venture
- Transport projects funded by Transfund income.

The provisions in Section 122J(e) of the Local Government Act 1974 were not carried forward into the new Local Government Act 2002. Instead, section 100 of the Local Government Act 2002 requires the Council to set a balanced budget except where it is financially prudent not to do so.

In accordance with section 100 the Council has satisfied itself that it is not financially prudent to fund all/part of the depreciation on the assets identified above. The principle of non-funding depreciation expenditure is now embodied in the Council's Funding and Financial Policies. The rationale for the continuation of non-funding depreciation expenditure for each asset is outlined below.

Clearwater Sewage Treatment Plant

Anglian Water International (AWI) has a 21-year contract to operate and maintain the Clearwater plant, so the Council has no need to put aside extra maintenance money. AWI is required to fund any repairs over this period. AWI is also required to return the plant to the Council after the end of its 21-year contract with a future life expectancy of at least 25 years. Despite this contractual arrangement, the Council still owns the Clearwater plant assets and is required to cover all operating expenses associated with the plant, including depreciation and financing costs.

The mismatch between the life of the asset (46 years) and the term of the \$80 million loan (21 years) means that the Council would only be charging financing/borrowing costs and loan principal repayment during the first 21 years. This would create an inequity, as ratepayers during the first 21 years would pay all financing costs as well as repaying the \$80 million loan, while ratepayers during the next 25 years would pay no such costs.

The Council has estimated that \$2.288 million of depreciation charged on the Clearwater assets should not be funded through rates as the obligation is on AWI to fund the replacement of these assets.



Living Earth joint venture

Living Earth Limited is expected to have only a short life (21 years) and during this time the Council will have no maintenance costs, as these are being covered by the contractors. In addition to maintenance costs there are also costs associated with the depreciation of the asset.

The Council has elected not to fund \$680,000 of depreciation on these assets for the following reasons:

- The Council has considered that the Living Earth asset is not critical to the Council's long term treatment and disposal of sewage
- The Council has not planned to replace it at the end of its useful life, and
- Not funding depreciation will not alter the planned life of the Council's landfills, nor will it affect the environmental objectives the Council is achieving with Living Earth Limited.

Transport assets funded by Transfund

Each year the Council receives funding from Transfund as part of the overall replacement and renewal programme for the City's roading infrastructure. While it is appropriate for the Council to recognise the depreciation on these assets it would be inequitable to place the funding burden on ratepayers when Transfund is already contributing the overall cost of replacement.

It has been estimated that in the 2004/05 financial period the Council will receive \$1.765 million from Transfund specifically to provide for the replacement and renewal of the City's roading infrastructure. It is therefore financially prudent to deduct this from the total depreciation expenditure that must be funded through rates.

Assumptions about the rates differential

In 2000, the Council voted to alter the rates differential (the rates split) that decides the share of General rates paid by residents and by businesses. Over a 10-year period the balance will shift so that a non-residential sector ratepayer (such as commercial property owners or utilities) will end up contributing 2.8 times more to the general rate than the residential ratepayer (for a property with the same value).

In the draft Annual Plan, the general rate has been split between the *Base differential rate* (which applies to residential ratepayers as well as community organisations and rural land) and the *Commercial, Industrial and Business differential rate* to show the gradual shift in the respective share of the rates burden by the two sectors over the period to 2009/10 at which time the target split will be reached.

Assumptions about rates growth

The number of residential ratepayers in Wellington is expected to grow each year as more dwellings are built or properties divided. This growth means that the total rates burden is shared across more people. The estimated growth in the city's ratepayer base between 2003/04 and 2004/05 is 2.6 percent. As a result, the real average rates funding increase will be reduced by an equivalent amount.

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Notes on some fundamental concepts

Asset management planning

Asset management is all about how the Council looks after its assets (for example parks or landfills). It involves balancing desired levels of service and asset standards against costs and risks – for example, balancing the cost of maintaining a smooth footpath against the safety risks of a cracked footpath.

Asset management plans are the guidebooks the Council uses to manage its assets in a cost-effective manner, while also providing a quality service.

While some assets require little maintenance, others are more expensive to maintain, and this can mean the risk of problems occurring with these assets is greater. The Council has asset management plans for buildings, sewerage, solid waste, stormwater, roads, footpaths, parks, swimming pools, recreation centres, libraries, water supply assets, and so on.

Asset management plans:

- ensure that assets are managed to deliver the Council's strategic outcomes
- ensure that assets provide a specified level of service in the most cost-effective manner
- provide assurance to stakeholders that the asset is being managed appropriately
- anticipate, plan and prioritise spending on the asset
- optimise the life of an asset at the most economic cost over time
- ensure the smooth operation and continued sustainability of the asset
- identify and minimise environmental risk and liability resulting from the operation of the asset.

Depreciation

All assets the Council buys or builds have a fixed life. As an asset's life is used up, some of its value (or service potential) deteriorates. This is what's meant by the accounting concept *depreciation*. It doesn't mean that the owner of the asset has lost money; it is just that part of the value of that asset has been used up.

It's a bit like buying yourself a washing machine for your home. You know its working life will probably be around 10 years. So this means that every year it uses up one tenth of its value. (See the Budget Assumptions section for more information about how the Council deals with depreciation issues.)



Operating and capital expenditure

Throughout this draft Annual Plan expenditure is divided into operating and capital expenditure. It is important to make this distinction as these are funded in different ways.

Operating expenditure pays for the Council's day-to-day operations and services, from collecting rubbish and providing street lighting to maintaining gardens and issuing building consents. Operating expenditure is funded from our operating reserve, which comes primarily from rates and user charges.

Capital expenditure pays for purchasing, building or developing the Council's assets (for example, bridges, libraries, the Wellington Regional Aquatic Centre). Capital expenditure is funded out of depreciation, asset sales and borrowing.

Allocations

Overhead costs are apportioned to operating projects on the basis of the level of internal labour and plant resources used in the delivery of that project.

Where debt servicing costs can be directly attributed to a project (for example the Clearwater loan) those costs are reflected in the cost of that activity. Where such costs cannot be directly attributed, debt servicing costs are allocated to projects based on the proportion of physical assets used by that project.

Depreciation is apportioned to each project based on the net book value of the assets used in the delivery of that project.

Asset sales

In line with the Council's financial principles, assets that are declared surplus to strategic or operational requirements are sold. If asset sales in any one year exceed the target identified in the draft Annual Plan, the proceeds are either invested or used to repay debt.

Utilising prior year surpluses in the 2004/05 financial period

The Council has agreed that \$5.000 million of the unutilised surplus from 2002/03 will be used to offset the rates funding requirement in 2004/05. It has determined that using past surpluses in this way is financially prudent and therefore meets the requirements of section 100 of the Local Government Act 2002. It also considers that this approach is consistent

with the principle of intergenerational equity, as the benefit is – in general – being passed back to those ratepayers who contributed to the surpluses being generated.

The rates differential

The 2004/05 financial period will be the fifth year of a 10-year process to adjust the relative amounts contributed by Commercial, Industrial and Business ratepayers and those paying the Base rate. This adjustment follows a Council decision made in 2000. In 1999/2000, a commercial ratepayer paid \$7.10 in General Rates for every \$1 paid by a residential ratepayer (for a property of the same value). By 2009/10, the ratio will be approximately \$2.80 for every \$1. The proposed differential for 2004/05 is \$5.50 to \$1.

Changes to the project mix

In line with the "business as usual" approach, the Council has made no major changes to the project mix for 2004/05. However some minor revisions have been made to the draft Annual Plan where new information has enabled the Council to better forecast the cost of providing services in future years.