# Financial Strategy
## 2015 – 2045

March 2015

# Financial Strategy

## 1. Overview

The challenge that the City faces over the 2015-2025 period and beyond is funding the rebuild and restoration of the City. This means returning the levels of service to roading and water, waste water and land drainage to at least their pre-earthquake condition, as well as meeting community expectations on facilities and services. There is the further challenge of funding the replacement of the underground pipes first installed in the building boom of the 1950s and 1960s which reach the end of their useful life within the next 30 years. This expenditure challenge is exacerbated by uncertainties around the quantum and timing of funding sources.

Fundamentally, the financial strategy needs to solve the relationship between the expenditure required to deliver levels of service, and the available funding levers of rates, debt, and sale of part of CCHL's investment portfolio. The four factors are inter-related and movement of one needs to be balanced by movement in at least one of the other variables. For example, if rate increases are reduced then some combination is required of reduced expenditure, more debt, and/or more capital released. As a further example if less capital is to be released then some combination is required of reduced expenditure, higher rates or more debt.

The proposed financial strategy that follows presents a solution to these challenges and outlines the key financial parameters and limits that the Council will operate within over the period of the Long Term Plan. For the purposes of consultation we have taken an approach that balances recovery with rates, debt, and capital release.

The draft financial strategy includes the partial sale of CCHL assets to realise a net value of $750 million[1] together with rate increases to current ratepayers over the next three years of 8.75 per cent, 8.5 per cent, and 8.5 per cent. (This is $199 million more than indicated on 5 December 2014 and is a requirement if Council is to create a solution within its known funding sources and without higher rates increases.) This proposal would result in net debt/ revenue peaking at 238% in 2020 and declining to under 150% by 2046. The Local Government Funding Authority benchmark for net debt to revenue is 250 per cent.

We have maintained $150 million of headroom, in every year except 2019, 2020 and 2021. The value of headroom is that it allows future councils a degree of flexibility if unforeseen circumstances arise.

## 2. Key Factors Impacting on our Financial Position

### 2a Christchurch's Growth and Infrastructure Needs

#### Rating Base Growth

Before the earthquakes, Christchurch City Council enjoyed steady growth in its ratepayer base of around 1 per cent a year, resulting in around $3 million increase to rates' revenue each year. However, this growth declined in recent years due to slower natural population growth (i.e. subdivisions, residential and commercial building activity) and the demolition of earthquake-damaged properties. Since September 2010 the city's capital value has reduced by $2.29 billion as a result of 4,200 residential (value $1.25 billion) and 1,350 commercial demolitions (valued at $1.04 billion). An additional $2.38 billion of capital value has been lost in the residential red zone through a combination of demolition and the revaluation of a further 7,000 properties (to 10% of their previous value) as part of the 2013 citywide revaluation. It had been expected that the rebuild/recovery from the earthquakes would have occurred at a greater rate than has occurred. Up until June 2014 the number and value of demolitions exceeded the number of properties being built or rebuilt. The outcome of this is that existing ratepayers have faced a higher rates' increase than if there had been normal growth.

The following Capital Value Growth index demonstrates the slowdown and loss in capital value with the dotted line representing the expected growth in the city before the earthquakes hit. The red line shows the growth path that is assumed through this LTP.

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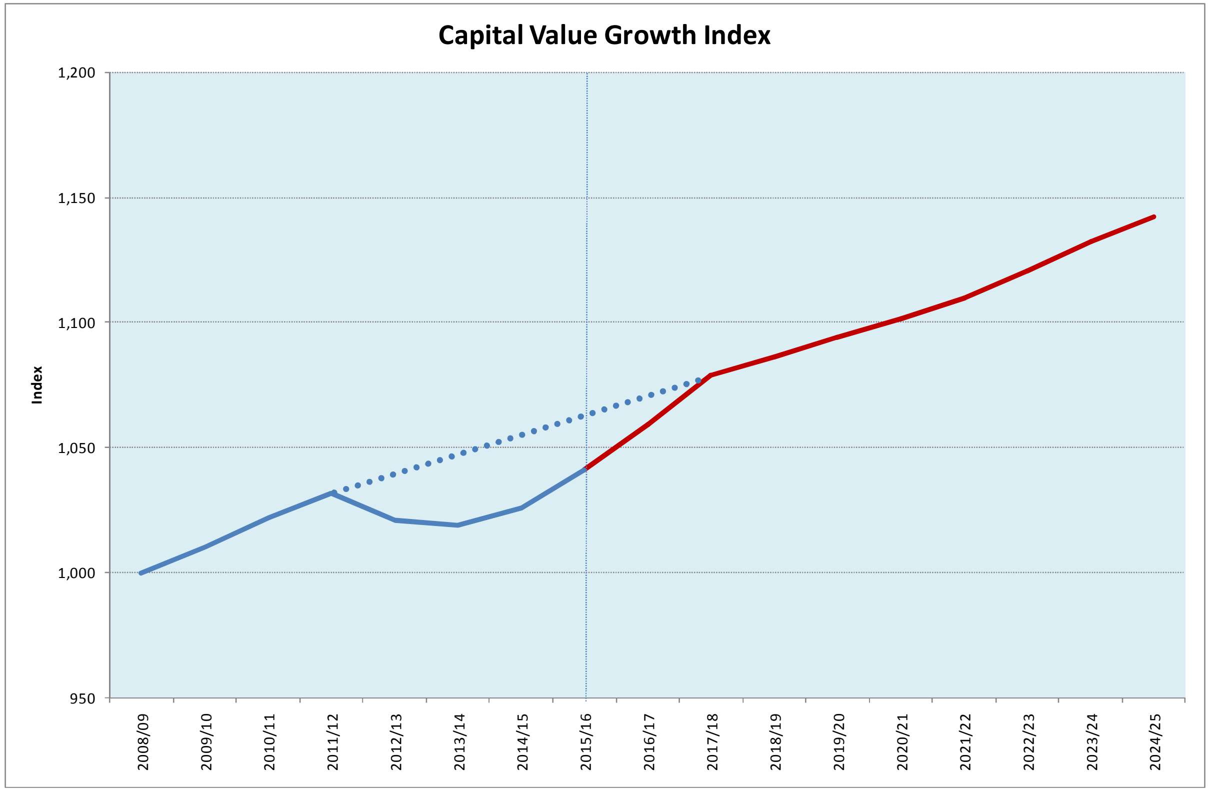
[1] Note that as at 30 June 2014 the net book value of CCHL was $1.552 billion. The solution to realising the $750 million cannot be determined at this stage but the portion sold could well gain a premium over book value if there is enough flexibility with regard to the sales process. For example the sale of a controlling interest in any company will realise a higher value per share than the sale of a smaller percentage. This in turn would mean that shares in other companies may not need to be sold at all.



Capital Value Growth Index
Index
1,200
1,150
1,100
1,050
1,000
950
2008/09
2009/10
2010/11
2011/12
2012/13
2013/14
2014/15
2015/16
2016/17
2017/18
2018/19
2019/20
2020/21
2021/22
2022/23
2023/24
2024/25

During 2014-15 growth returned to and surpassed historical levels and is expected to continue to accelerate in the early years of the Long Term Plan as both the residential and commercial rebuild of the City takes shape. In 2018-19 growth is expected to return to pre-earthquake levels when it is assumed that the residential rebuild and repair programme will be complete. Commercial capital value is expected to grow rapidly in the early years. The expected growth is centred within the Four Avenues and dominated by office, retail, industrial and accommodation sectors. From 2018-19 it is expected growth will track long-term household and population growth forecasts for the remainder of the Plan.

An offsetting reduction of $700,000 in rates revenue is assumed in 2015-16 to reflect the proposed amalgamation of residential red zone rating units acquired and subsequently cleared by the Crown.

Through an Order in Council, the Government has given Council the ability to decrease rates for a property the month after it is demolished and to increase rates the month following a rebuild or new build. Once this Order in Council expires, Council will revert to making alterations to rating unit valuations on an annual basis in line with the rest of New Zealand.

## Expected Changes in Population and Use of Land

Following the 2010 and 2011 earthquakes approximately 7,000 properties in Christchurch City were “red zoned” by the Canterbury Earthquake Recovery Authority (CERA) meaning the land is not considered suitable for urban purposes (i.e. private or public, residential or commercial use) without substantial remediation. The Council has accelerated the amount of land made available for urban purposes so that people who have had their homes and businesses destroyed and have had to relocate, have alternative sites to move to. While much of this movement has already occurred it is still having some effect on land use demand.

Land is also needed for the natural growth of the Christchurch population which is predicted to reach 383,000 by 2025, an increase of 6 per cent over 2015 with the number of households increasing 13 per cent over the same period. In addition housing is required for many of the workers coming to the Greater Christchurch region for the rebuild over the next few years. It is estimated that there could be up to 8,000 additional workers required from September 2014 until the peak at the end of 2016.[2]

The supply of industrial business land (Zoned B3 – B8) has increased steadily since the earthquakes as new land has been rezoned. Take-up of this land was low in the two years immediately following 2011-12, at around nine hectares a year. Since then, take-up has increased to around 20 hectares a year which is approaching the pre-earthquake rate. The Land Use Recovery Plan (LURP) identified:

- approximately 600 hectares of business greenfield areas available for future business development. As at January 2015, 226 hectares of this was zoned and available for take-up.
- approximately 20,000 potential residential sections. As at November 2014, resource consents were either granted or in progress for around 5,000 of these, including more than 900 where building consents have been granted for new housing.

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2 http://www.dol.govt.nz/publications/research/canterbury-rebuild/canterbury-job-matching-sep-2014.pdf

**Rating Unit Projection**

| 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 | 2023 | 2024 | 2025 |
|---|---|---|---|---|---|---|---|---|---|
| 157,369 | 159,044 | 160,719 | 161,919 | 163,120 | 164,320 | 165,521 | 167,120 | 168,719 | 170,318 |

The overall growth in rating units is not anticipated to match either the expected growth in households or capital value. The commercial rebuild is mainly taking place on existing, but demolished, rating units and the residential housing stock still includes large numbers of unoccupied dwellings.

To provide infrastructure for the growth outlined above, the Plan includes $602 million of capital projects over the 10-year planning period which together, contain a growth component of $309 million.

The breakdown by year is as follows:

| Years to 30 June | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 | 2023 | 2024 | 2025 |
|---|---|---|---|---|---|---|---|---|---|---|
| **Growth Component ($m)** | 45.3 | 40.0 | 36.1 | 37.0 | 31.4 | 31.5 | 29.4 | 23.7 | 19.6 | 15.0 |

For further details on the specific projects please refer to the proposed capital programme.

## 2b Levels of Service

All costs associated with delivering levels of service were considered during the development of the draft Long Term Plan. Some efficiencies were found that helped offset the additional costs driven by cost inflation, earthquake recovery, facilities coming on line and growth. Pricewaterhouse Coopers was engaged in January 2015 to work with staff to identify operational efficiencies which will result in further savings. These have yet to be identified, and the extent they impact on the Council's levels of service will need to be debated. As such it would not be appropriate to embed them in the draft Long Term Plan. Any changes to community expectations will be consulted on as part of the next Annual Plan process. If after consultation, the changes are agreed, they will reduce the cost to ratepayers.

Levels of Service for infrastructure assets, with the exception of water supply, are forecast to gradually improve over the period of the Plan. Water supply shows a gradual deterioration, in part due to the practical difficulties involved in putting cameras into pressurised pipes to identify any damage. (Note that the decline in levels of service for water supply does not apply to the quality of potable water itself; it applies to the frequency of pipe failures.) More information around the actual level of service for each activity can be found in the Activity Management Plans. Links to specific levels of service for each activity (and their trends over time) are available at http://www.ccc.govt.nz/ltp

Sport and recreation and Arts and culture are showing improved levels of service as a result of the new pools in the East and South West along with the new library in the South-West. The funding sources for these are set out in Appendix 1, Table 1 below. These Level of Service increases are funded mainly through additional borrowings of $40 million over the next four years. The additional operational costs of these facilities will begin from 2017 with the overall impact on rates being 1per cent spread over four years.

## 2c Cost Share Ownership and Opex

The Cost Share Agreement is the underlying document between Council and the Crown that determines ownership and operating cost responsibilities for each of the Anchor Projects.

In most instances ownership is clear but where the Agreement is ambiguous Council has assumed as follows for the purposes of this Plan:

- **Bus Exchange**
  - Private ownership with Council operation.
- **The Frame, (Public realm)**
  - Council ownership and maintenance
- **The Square**
  - Council ownership and maintenance
- **Central Library**
  - Council ownership and operation
- **Car parking**
  - Council / private ownership and operation
- **Earthquake memorial**
  - Crown/ Council ownership and maintenance
- **Metro Sports Facility**
  - Council ownership and operation.
- **Avon River Precinct**
  - CDHB and Council ownership and operation.
- **Stadium**
  - For planning purposes we have assumed this will be completed towards the end of the Long Term Plan period, (although published Christchurch Central Development Unit updates indicate a completion date of Quarter 4 2019). The decision to push the construction to the end of the Long Term Plan period was used to assist Council's capital expenditure profile and avoid additional expenditure during the most constrained years. Council is currently in discussions with the Crown on reaching mutual agreement on the delivery timetable.

We are not expecting any additional operating costs from any other anchor projects.

## 2d Capital Expenditure

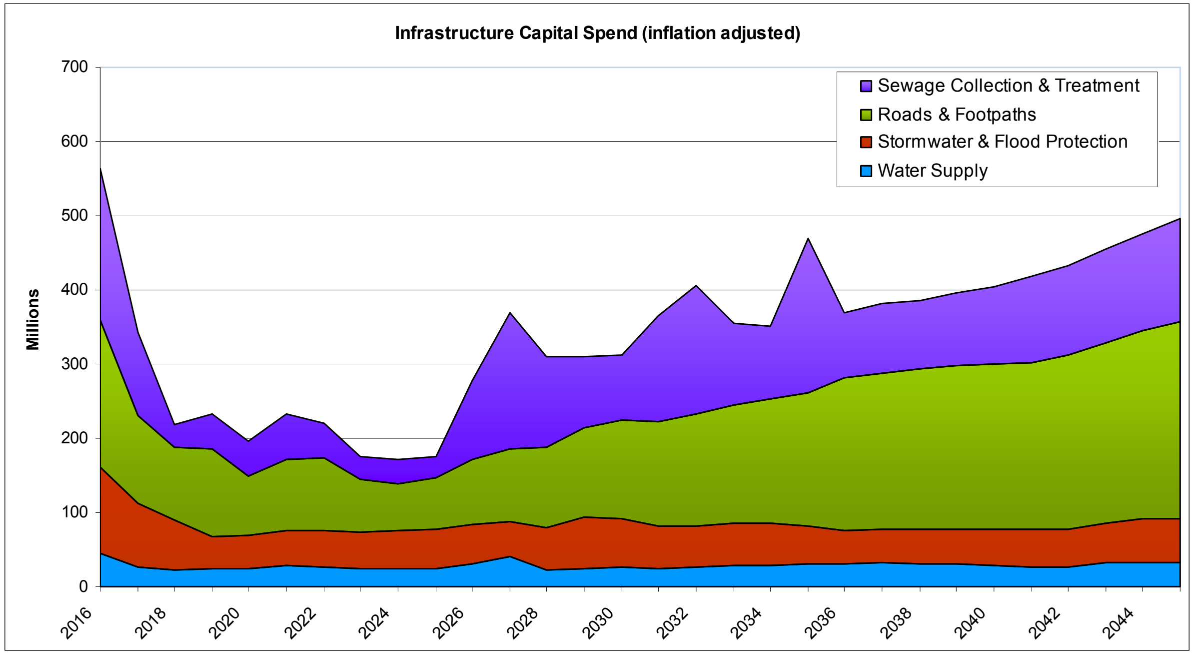
The planned capital programme has been established through the Infrastructure Strategy, Activity Management Plans and Asset Management Plans prepared as part of the Long Term Plan process. These plans link the forecast rebuild outcomes, population growth, levels of service and Council strategies such as the Greater Christchurch Urban Development Strategy and the Government's Land Use Recovery Plan.

The programme has increased since the Three Year Plan was developed. As a result of our ongoing analysis we have a clearer picture of additional costs in the areas of land drainage and transport associated with the An Accessible City project t, plus the cost to deliver the major cycleways has increased. We have provided a further $398 million of cost associated with the Horizontal Infrastructure programme, the final costs of which will become known once the Independent Assessment is released later this year. This will then need to be discussed with the Crown. The level of required Horizontal Infrastructure spend is a key uncertainty at the time of completing this proposal. If the level of spend is higher than expected, the impact to ratepayers is a 0.25% increase in rates, (spread over two years), for every $10 million of additional borrowing. This increase covers the interest cost and repayment of the borrowing.

The infrastructure programme of work for the next 30 years is depicted in the graph below, and is a summary of the findings contained within the Infrastructure Strategy. Note that Council intends to pursue an end-to-end review of its capital project delivery process. The aim is to ensure that it is fully fit for purpose and capable of delivering its programme of work effectively.

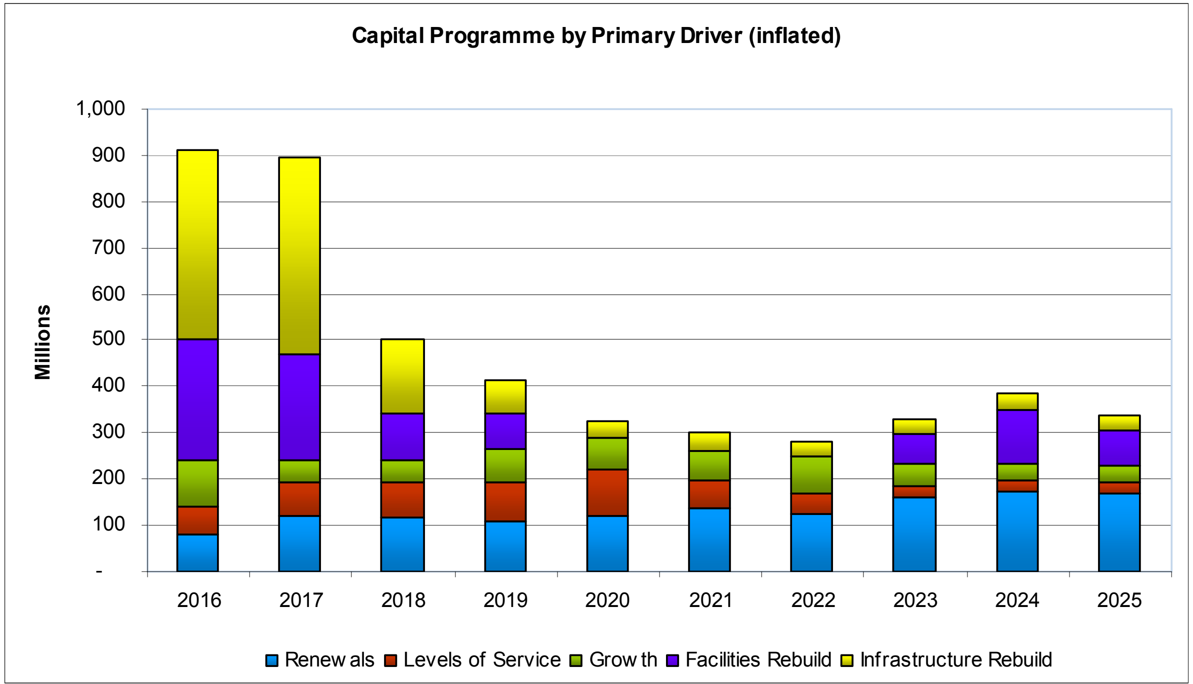
The financial strategy includes provision for this work including the cost to replace the post-World War II infrastructure. The City's engineers were always aware of, and had planned for this replacement, but recent analysis has shown that the 2010/11 events reduced the useful life of many of these assets by up to 20 years although they remain in serviceable condition. This renewal programme begins to impact the Council's capital programme from the mid-2020s as shown. For further information please refer to the *Infrastructure Strategy, Financial Estimates and Assumptions.*

## Graph of total infrastructure spend for the next 30 years, by class of asset




The total ten-year capital programme for the Long Term Plan includes the infrastructure projections above, along with the non-infrastructure programmes for community facilities and internal services such as Information Technology , fleet and corporate accommodation. It includes provision for renewal of existing assets, plus additional capacity to meet demand growth and increasing levels of service. The planned capital expenditure for the Long Term Plan is summarised by these categories in the graph below. Renewals are heavily impacted by the rebuild in the first four years of the Long Term Plan.

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




Major community facilities – the rebuild of facilities included under the Cost Share Agreement, are significantly behind schedule. Any delay in delivery reduces our borrowing and operating costs. The Council's commitment is set out in Appendix 1, Table 1.

## 2e Deferred Renewals

The Three Year Plan assumed that some of the income from rates to pay for the renewal of the City's infrastructure assets would be used instead to fund earthquake recovery costs, (referred to in the Three Year Plan as deferred renewals). The assumption was that because so much of the damage to roading and pipes was being addressed through the SCIRT programme, some of the rates funding could be used for recovery costs. However, this strategy now assumes that the deferral will stop in 2025, eight years earlier and with an associated reduction of $395 million from the deferral identified in the Three Year Plan. The renewals programme cannot be reduced as much as previously thought without seriously compromising the long-term performance of the infrastructure assets. This is mainly because many assets, while not requiring immediate repair, now have much shorter lives than was previously the case. In addition, the standard of renewal that SCIRT was achieving initially has been reduced, meaning that many of the city's roads and pipes will need to be replaced sooner than predicted three years ago. A delay in renewing them results in significantly higher operating maintenance costs.

## 2f Funding Streams Uncertainties

All potential additional funding sources are uncertain especially in comparison to those such as rates and fees and charges.

As an example, the estimates of insurance proceeds in the draft LTP reflect the advice the Council has to date. However, not all cases have been agreed with the Council's insurers and Council staff continue to work with the insurers to present and settle claims.

Should additional funding be received from any source which is above the levels assumed in the proposed strategy, the options available are to either:

- reduce the sale of assets in CCHL, or
- maintain the $750 million capital release and reduce our debt levels, or
- maintain the $750 million capital release and reduce rates[3].

For indicative purposes, receipt of $200 million under the first option would enable rates to be held to 8.25%, 8% and 8% over the next three years as a result of the extra dividends; the second option, (reduction in debt) would allow for greater financial resilience with net debt/ revenue peaking at 205% in 2020 and declining to under 150% by 2038. The third option (reduce rates) would enable rates to be reduced to 7.5% for four years. While the ratio is not breached, we remain above 200% for the next 25 years. (see below under Draft Financial Strategy for the graphed projections which help put these debt/ revenue percentages into perspective).

Accurate figures are not available until a decision is made regarding the make-up of the sale of CCHL subsidiaries. For planning purposes we've assumed a conservative dividend revenue stream.

## 2g Other Assumptions

This Draft Financial Strategy is also based on the assumptions set out in the Significant Forecasting Assumptions' companion document.

# 3. Draft Financial Strategy Considerations

In developing proposals to provide for these changes and all required expenditure we were mindful of the following.

We believe it is important to:

- keep debt levels under control throughout the first ten years in order to provide the capacity to borrow from 2025 onwards when the next asset renewal peak begins.
- choose a solution that spreads the cost across those ratepayers who will benefit from the services the assets provide (intergenerational equity). Our policy is to retain this by funding renewals through rates and borrowing for the balance of the capital programme. This additional debt is repaid over 30 years.
- build in financial resilience over time. The challenge facing the City is to do this over an appropriate timeframe while not over-burdening current ratepayers. Specifically, should another disaster event occur (a remote chance but no one was anticipating the earthquake sequence), we need to be in a position to fund our share of the repair and rebuild costs. The Government's Civil Defence Emergency Plan covers 60 per cent of the bill but only if we can meet the first 40 per cent.

  The Council holds a significant investment through Christchurch City Holdings Limited (CCHL) but this is not quickly convertible to cash during the first critical 12 month period when response costs are highest. We consider it is unrealistic to build a strategy which positions the Council to be in the financial position to withstand a significant disaster immediately after sustaining the first. The period of time to achieve this financial resilience is a key parameter of the financial strategy and realistically occurs around 2041 when our net debt/ revenue ratio falls below 180 per cent.
- set revenue at a level that will meet operational expenditure including a provision for depreciation and keep rates at a level which contributes towards the additional funding but does not unreasonably move the burden on to existing ratepayers.
- maintain a balanced budget; i.e. ensure that our revenue continues to exceed our expenses.

  We currently rate for around 60 per cent of our estimated depreciation. Because we have not been able to revalue our assets since, in some cases 2009, we have estimated their value for the purposes of this plan. There is a possibility that the current costs, increased by a shortage of contractors, has resulted in us over-estimating the long term replacement cost. This will become clearer with future valuations as the market settles at which point we can take steps to correct any under-provision. In the meantime the renewals rated for will steadily increase and be around 68 per cent of the estimated depreciation by 2025. This means that although we're moving towards fully funding depreciation, it could be some years before it's achieved. However, given the

[3] Please note the draft Financial Strategy's parameters are rates for the first three years of 8.75%, 8.5% and 8.5%, which when combined with a capital release of $750 million, all else being equal, results in the net debt/ revenue ratio peaking at 238% in 2020.

current uncertainty, we consider it prudent to achieve this over the medium to long term rather than make an immediate adjustment.

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

# 4. Draft Financial Strategy

## Capital Release Assumptions

To access sufficient funds to meet expenditure while at the same time complying with our need for prudence, financial resilience and intergenerational equity, the decision was made to consult on selling part of the investment portfolio held by CCHL.

The draft financial strategy includes the partial sale of CCHL assets to realise a net value of $750 million[4] together with rate increases to current ratepayers over the next three years of 8.75%, 8.5%, and 8.5%. (This is $199 million more than indicated on 5 December 2014 and is a requirement if Council is to create a solution within its known funding sources and without higher rates increases). This proposal would result in net debt/ revenue peaking at 238% in 2020 and declining to under 150% by 2046.

We have maintained $150 million of headroom in every year except 2019, 2020 and 2021.

To ensure that the Council gains the greatest return from any sale, it needs the flexibility to consider the sale of part , or all of its entire holdings. In comparison, sales of small shareholdings or retention of control by Council will limit the value that can be released. As part of the Long Term Plan we are therefore consulting on the potential divestment by CCHL of its interest in Orion New Zealand, Lyttelton Port Company, Christchurch International Airport Ltd, Eco Central, City Care, and Red Bus.

The process to be followed is one that ensures Council can make the best choice once it is fully informed. The Executive (and its advisors) will undertake the analysis and market testing of the capital recycling options (in parallel with the consultation and obtaining Council decisions as required). We expect this to include:

- establishing the hierarchy of strategic value to the Council
- analysing value available and the financial impact of various capital recycling options (including potential value uplift from strategic / value adding partners)
- analysing structural options and impact on value
- identifying and assessing transaction issues (engaging with key stakeholders as necessary) to confirm ease of implementation.

Council would then make capital recycling decisions having received this advice and having taken into account community views.

Appendix 2 provides the reader with a reminder of the Cameron Partners' report framework for consideration of Asset Ownership. This report was released in August 2014.[5]

## Proposed Rate Increases

The draft strategy around levels of service, borrowing, and release of capital has been formulated after considering a wide range of options (please see the following section for explanation around alternative options). It is important to ensure that we remain within our financial ratios, without burdening current ratepayers with all of the recovery costs. It is recognised that the draft option imposes a relatively high rates' increase in the first three years, but setting lower rates (for example capping rates at 5 per cent for the next five years) results in the net debt to revenue ratio exceeding its upper limit by 2019 and continuing to deteriorate to over 500 per cent by 2045. The solution is either to realise further capital from CCHL or cut back on the capital programme, neither of which are recommended. The draft option sets rates' increases over the long-term which remain within financially sustainable limits, and holds rates increases over the next three years as low as practicable given the balance that is required.

Financial projections show rates' increases stabilising at around 4 per cent a year over the long term. This is higher than the expected Cost Price Index at the same period which allows for a gradual repayment of debt.

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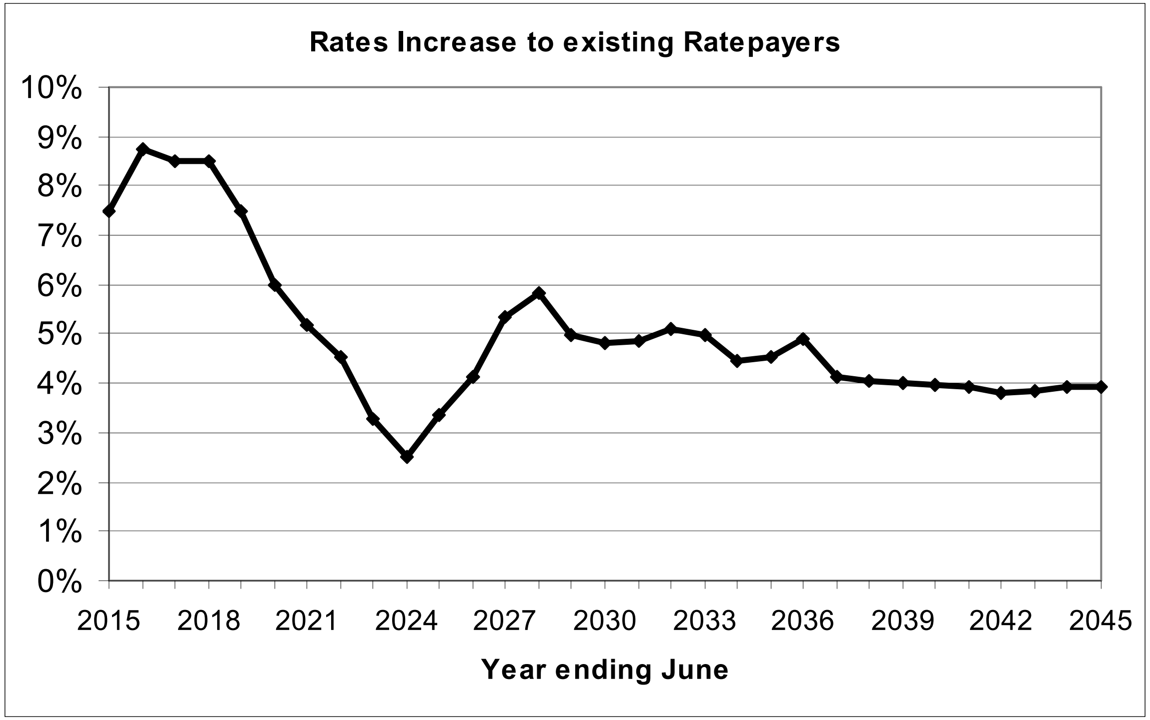
[4] Note that as at 30 June 2014 the net book value of CCHL was $1.552 billion. The solution to realising the $750 million cannot be determined at this stage but the portion sold could well gain a premium over book value if there is enough flexibility with regard to the sales process. For example the sale of a controlling interest in any company will realise a higher value per share than the sale of a smaller percentage. This in turn would mean that shares in other companies may not need to be sold at all. On average the dividend stream foregone is around 3%, before capital increase, and the interest savings on avoided borrowing would be around 6.0%

[5] http://resources.ccc.govt.nz/files/TheCouncil/policiesreportsstrategies/reports/CameronPartnersReviewAugust2014.pdf

On the issue of affordability, Christchurch City Council rates are still well below most comparative metropolitan councils and our neighbouring District Councils, (see Chart of Estimated Average Residential Rates 2014-15 to 2024-25 by Metropolitan and District Council in Section 6 below).

Rates rebates and other support mechanisms are available for those ratepayers on fixed incomes.

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

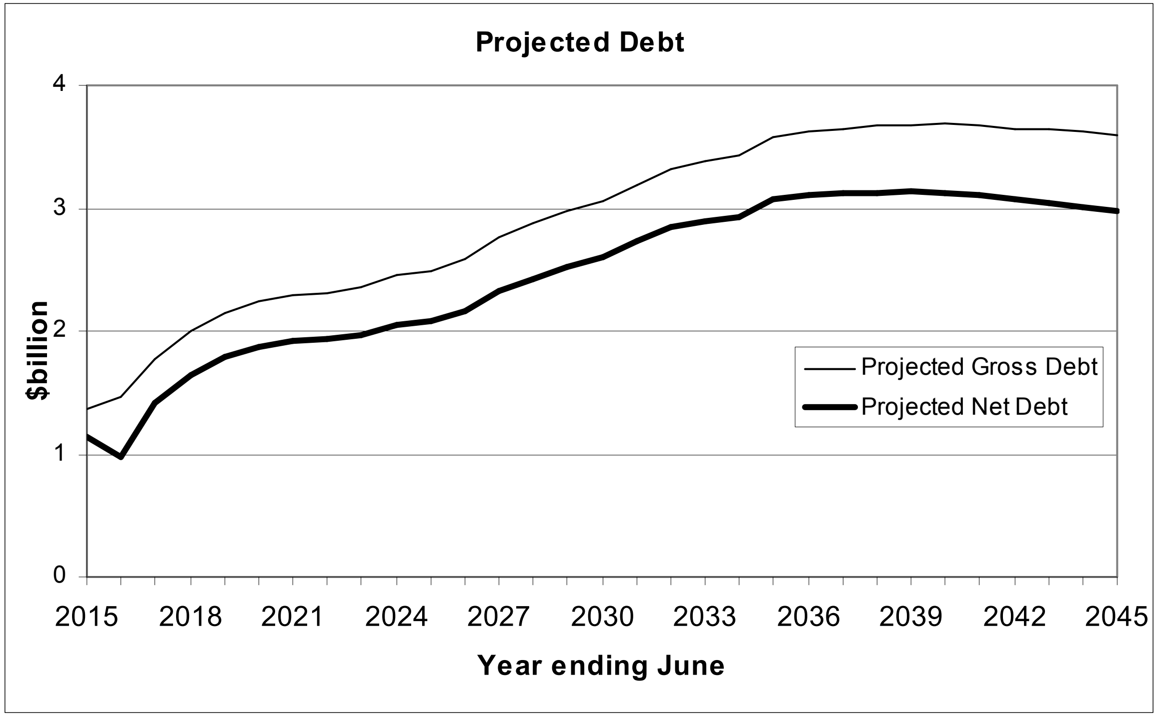



Note that rates' increases in 2023-25 are lower than they would otherwise be due to an expected increase in dividend from CCHL relating to Enable. Rates' increase from 2025 due to an extended peak of renewals over the following decade requiring further ratepayer-funded borrowing.

## Borrowing

Debt is capped at 250 per cent of the net debt to revenue ratio, a key measure of financial resilience, with the maximum expected to be 238 per cent in 2020, thereby providing headroom for further borrowing in the event of an emergency.

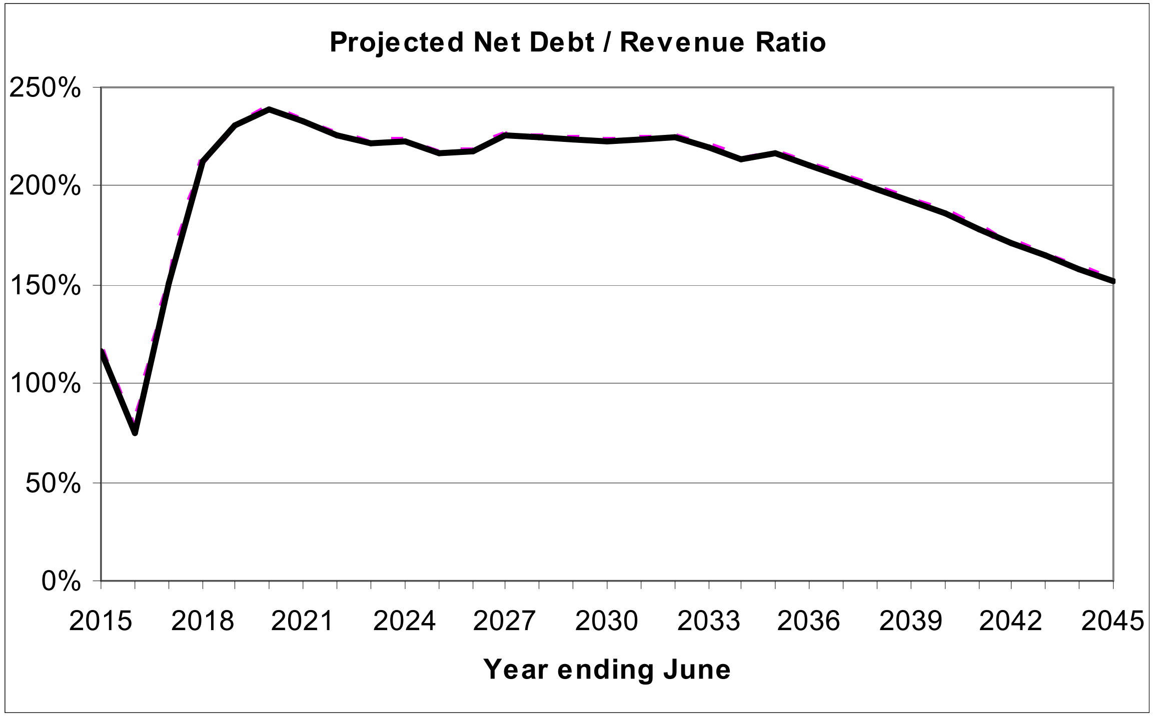
The magnitude of the costs faced by the Council means that if we are to keep rates' increases to an affordable level and deliver the rebuild within an acceptable period of time, we must increase our debt levels. The black line on the graph below shows Council's total debt projection as a result of the infrastructure rebuild and facilities rebuild borrowing required.



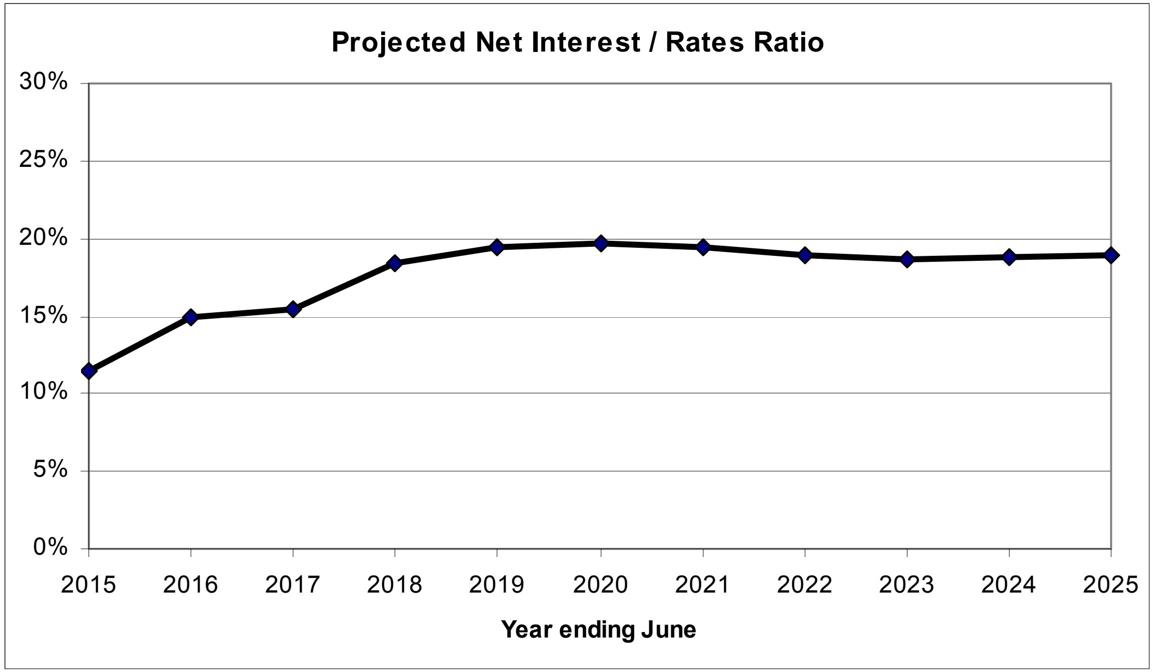

The graph shows that to fund our share of the rebuild and to continue investing in growth, we need to increase our borrowing out until 2040. We are conscious both of the amount of debt we need to take on, and the affordability of that debt. In its foundation policies, the Local Government Funding Agency (LGFA) established debt covenants that govern the total amount of debt a local authority may borrow from the Agency. Council has ensured that it remains within both the affordability (net interest as a proportion of rates) and quantum ratios (net debt as a proportion of total revenue). The Council's Liability Management Policy limits align with the Local Government Funding Authority foundation policy limits.

The LGFA limit is 250 per cent for net debt to total revenue and 30 per cent for net interest to rates' income. The Council's debt is forecast to increase with the ratio peaking in 2020 at 238 per cent. The net interest ratio stabilises at around 19 per cent in the same year. We consider the net debt/ revenue ratio ceiling of 250 per cent is appropriate as most of the City's assets do not generate any return, and our debt repayment is largely funded through rates and CCHL dividends. As for any other borrower, it is important to consider the affordability of our debt. As mentioned above, our net interest ratio stabilises at 19 per cent but this is in an environment of extremely low interest rates. While we have much of our exposure hedged, our hedging contracts do not extend for the full 30 years and it is prudent to leave some headroom to meet our obligations when rates increase.

**Graph of net debt to revenue for the next 30 years**



**Graph of net interest to rates income for the next 10 years**




The charts above demonstrate that although the Council's total debt levels climb as a result of the rebuild and growth, the strategy for repaying this debt ensures the city's total debt stabilises over time. In addition, because the city continues to grow, so do its rates and total revenues. By controlling the increase of debt following the rebuild process, Council's key debt covenants return to conservative levels later in the 30-year period.

### Local Government Funding Agency Policy Limit

The increase in debt in the short to medium term may lead to a further decrease in the Council's credit rating. In its review before the Three Year Plan, Standard & Poor's commented that while they consider the Council's financial strategy to be prudent, Council's credit rating would likely be reviewed if its net debt exceeded 180 per cent of revenue or net interest 9 per cent of revenue. (Standard and Poor's use different ratios and inputs for their purposes compared with those set by LGFA). Council debt ratio peaks in 2020 as a result of the rebuild borrowing. If the capital programme proceeds as forecast, Council will exceed these two ratios, but not the LGFA covenants. As a result it will come under close scrutiny by Standard & Poor's. However, it does not automatically follow that the Council will be downgraded. Standard & Poor's consider the group results which have improved ratios due to CCHL's strong operating revenues. Their assessment also includes the economy, the entity's financial management, liquidity, and budgetary performance, and flexibility. They also consider the stability of the governance and executive management and its willingness to make hard decisions.

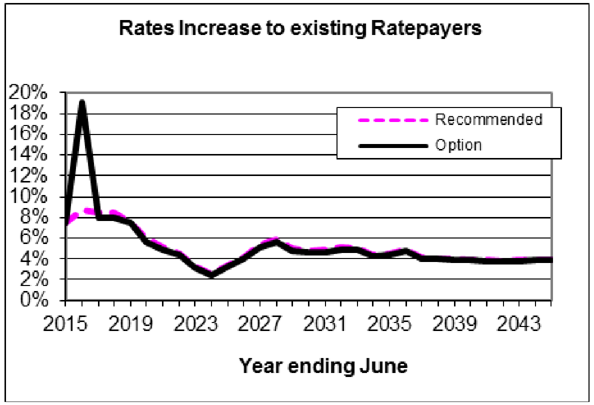
The Significant Assumptions include an indication of the increased cost of borrowing should a downgrade occur.

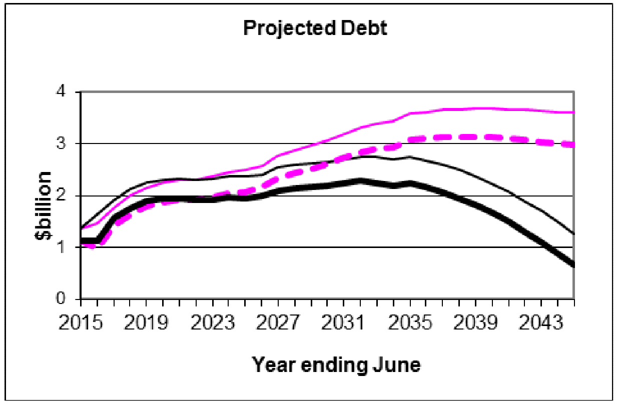
Any downgrade would have only a marginal impact on interest rates within the term of this Plan. This has not been incorporated into the financials. Notwithstanding this, even if a downgrade occurred, it is expected the Council's credit rating would be restored over time as the funding uncertainty decreases and the net debt/ revenue ratio returns to more conservative levels.

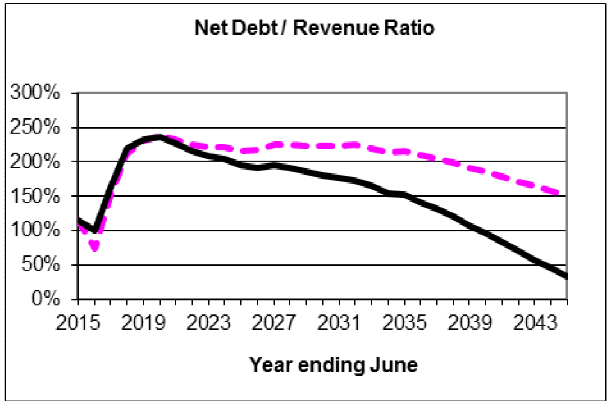
## 5 Alternative Options

There are alternative options to fund the currently proposed expenditure and maintain or improve the Council's key ratio limit of net debt / revenue. In particular:

**Option A**: If instead of a capital release from CCHL of $750 million Council was to release the $551 million resolved in December 2014, rates' increases over the next three years would need to be around 19per cent, 8 per cent and 8 per cent to maintain net debt/ revenue at the same level as the draft financial strategy.[6] The graphs below show the impact of Option A.

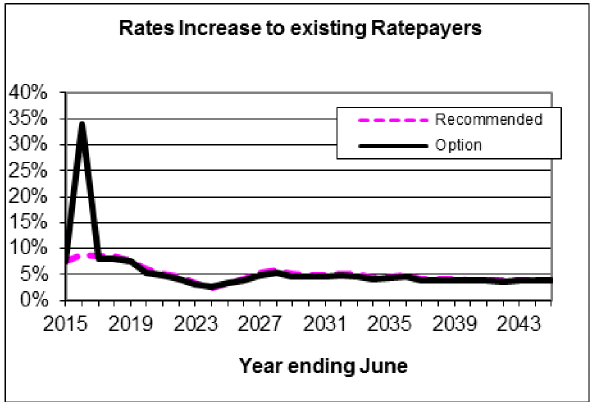


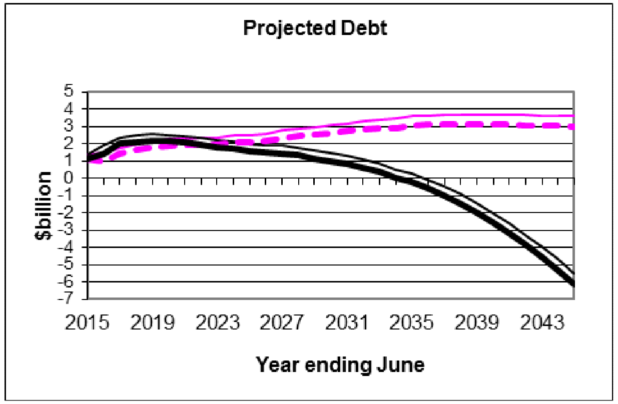



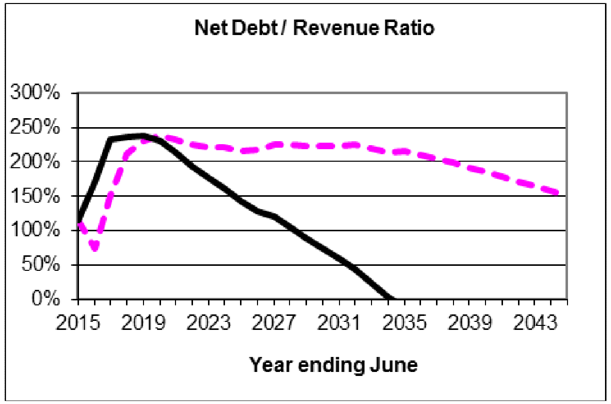




[6] Please note the draft Financial Strategy's parameters are rates for the first three years of 8.75%, 8.5% and 8.5%, which when combined with a capital release of $750 million, all else being equal, results in the net debt/ revenue ratio peaking at 238% in 2020.

**Option B:** If the City wishes to maintain its current portfolio of CCHL assets, meaning no capital release, rate increases in the order of 34 per cent, 8 per cent, and 8 per cent would be required over the next three years to keep debt and ratios at an acceptable level. If we cannot reduce our debt, we need to increase our revenue. The graphs below show the impact of Option B.



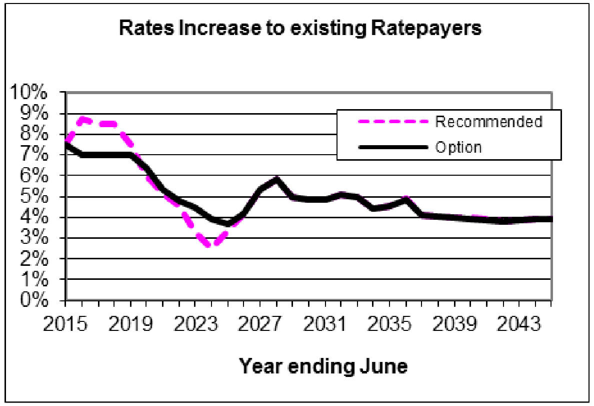



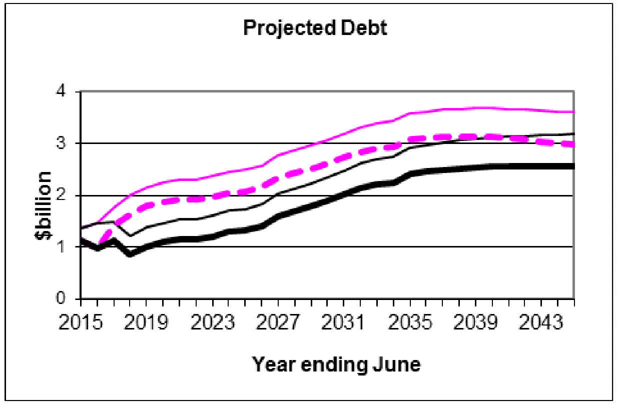



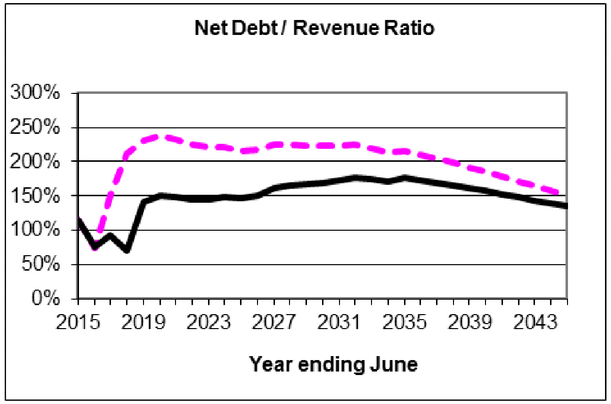

It is envisaged that rates will be reduced below the levels shown in the graphs in both of Options A and B in order to rebalance the intergenerational equity issues. This reduction could occur from 2021 onwards, once the peak ratio has passed, and after considering the level of renewals funding against depreciation. As mentioned above it is our intention to increase the level of renewals expenditure to bring it to around 68per cent of depreciation by 2025. If we did not adjust the rates then current ratepayers would be paying off debt related to long-life assets faster than necessary . Future ratepayers would not be paying a fair share for their use of those assets.

**Option C:** To create headroom in 2020 of $150 million allowing for additional financial resilience would require either a further release of $60 million of capital from CCHL or an increase in rates of 1.9 per cent over the next three years.

**Option D**: To create maximum debt headroom we could release all $1.552 billion of the capital currently in CCHL. If rates are retained at 8.75 per cent, 8.5 per cent, 8.5 per cent the peak net debt/ revenue ratio is 132 per cent in 2020. However, if this was combined with rates of 7 per cent for the next four years, the ratio stays at around 150 per cent for the period of the Long Term Plan , climbing to 177 per cent around 2035 with the next infrastructure renewal peak. The graphs below show the impact of Option D.




The Draft Financial Strategy is recommended, rather than any of the four options above, as a balance between rates, net debt/ revenue, and capital release. We are seeking your feedback on the Draft Financial Strategy and the above or other options.

# 6 Quantified Limits on Rates and Rates' Increases, and Borrowing: Debt Headroom

The quantified limits on rates and rates' increases relate to total rates' income, which includes penalties and rates collected during the year under the Order in Council. Please note these are particular definitions required to be disclosed under legislation. They are different to those used to produce the previous rate percentage information. For existing ratepayers the actual increase is always lower than the absolute increase as long as the number of ratepayers continues to grow. For this reason existing ratepayers should focus on the previous graph rather than the table below. The quantified limit on rates is set at 1 per cent above the rates' income contained in the Plan's financial statements. This allows Council some limited flexibility to cope with difficult to forecast changes in the pace of the rebuild.

The quantified limit on rates' increases is similarly set at 1 per cent above the nominal year-on-year increase in rates' income.

The quantified limit on borrowing is set at the sum of 250 per cent of annual revenue, liquid assets, and on-lending to Council Controlled Organizations.

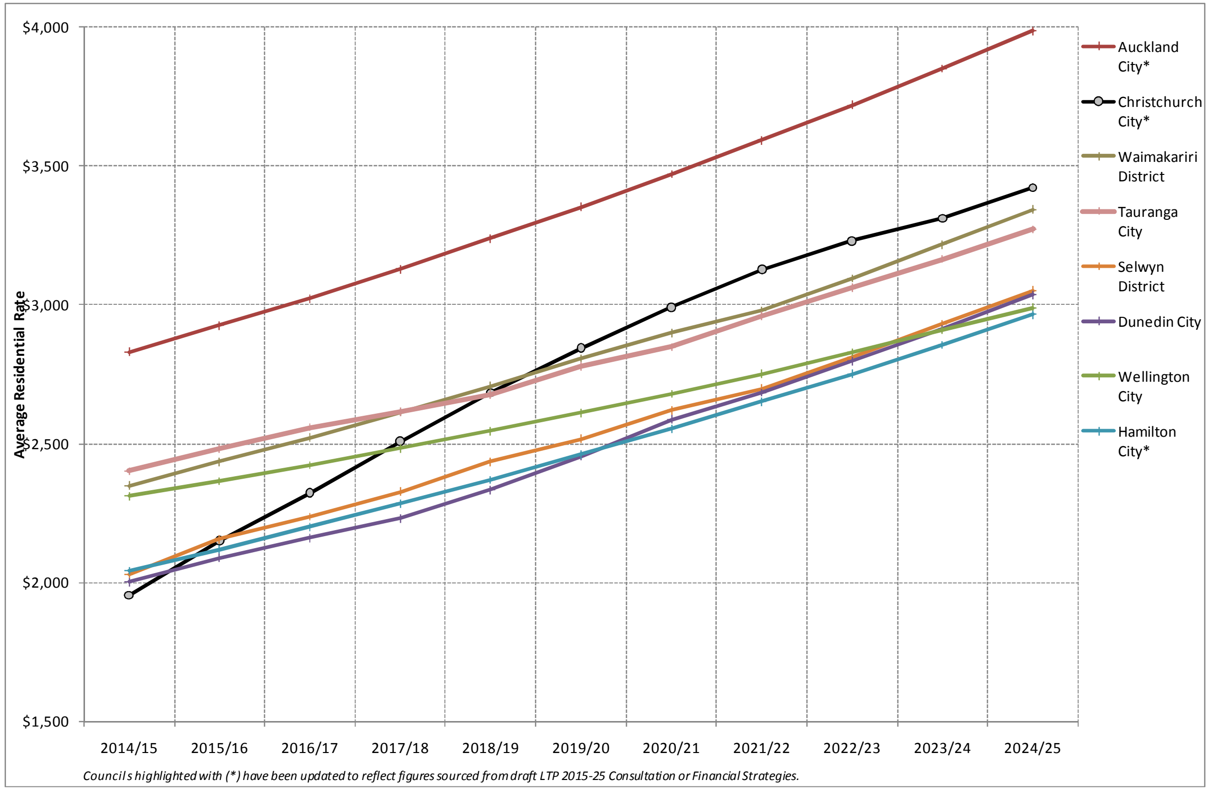
The quantified limits and debt headroom are as follows:

| **Year** | **2016** | **2017** | **2018** | **2019** | **2020** | **2021** | **2022** | **2023** | **2024** | **2025** |
|---|---|---|---|---|---|---|---|---|---|---|
| Rates ($m) | 401 | 439 | 485 | 523 | 557 | 589 | 619 | 643 | 663 | 689 |
| Rates Increase | 11.8% | 10.6% | 11.3% | 9.0% | 7.5% | 6.7% | 6.0% | 4.9% | 4.2% | 4.9% |
| Borrowing | 3,744 | 2,700 | 2,279 | 2,303 | 2,335 | 2,436 | 2,522 | 2,619 | 2,716 | 2,815 |
| Debt headroom ($m) | 2,277 | 928 | 285 | 149 | 91 | 140 | 208 | 253 | 257 | 322 |

The large amount of debt headroom in 2016 and 2017 is due to the Council receiving the proceeds of sale of CCHL investments in those years. It also caters for significant rebuild borrowing in 2017 - 2019.

The following graph shows the estimated average residential rates for the period of the Long Term Plan 2015-25 by relevant metro and district council. Historically rates in Christchurch have been lower or broadly comparable to the other metro councils and neighbouring district councils. Our proposed rates increases mean Christchurch rates charges will overtake Hamilton, Dunedin and Selwyn this year; Wellington, Tauranga and Waimakariri by 2019-20; leaving only Auckland with higher rates by the end of the LTP.[7]

**Estimated Average Residential Rates 2014/15 to 2024/25 by Metropolitan and District Council**




[7] The average residential rate calculated by each individual council and includes all revenue from charges made to residential ratepayers (including water where charged separately) and is divided by the number of residential properties liable for the charges. The 2013 base data has also been presented within the Ratepayers' Report as published by Fairfax Media in June 2014.
The base average rates' bill figures have been inflated by the indicated percentage increase as included in the LTP 2012-22 (and updated by the actual average increase as included in subsequent Annual Plans). Where a council has already released a draft Consultation Document or Financial Strategy for the LTP 2015-25, these rates increases have replaced the LTP 2012-22 figures. Other Council's forecasts will be updated as their Long Term Plans s are released.

# Appendix 1

## Table 1: Major Community Facilities /Anchor Projects

The Council remains committed to the rebuild or repair of the major community facilities listed below, either as part of the Cost Share Agreement with the Crown or on its own. Facilities which are part of the Cost Share are marked with an asterisk.

| | Council contribution | Insurance | Land | Improvement allowance | Borrowing |
|---|---|---|---|---|---|
| Christchurch Art Gallery | 56.7 | 24.0 | - | 32.4 | 0.3 |
| Central library* | 75.0 | 8.2 | 27.2 | 15.5 | 24.1 |
| Athletic track | 6.7 | 4.4 | | 2.1 | 0.2 |
| Eastern aquatic facility | 30.5 | 7.0 | | | 23.5 |
| Christchurch Town Hall | 127.5 | 68.9 | | 51.3 | 7.3 |
| Performing arts* | 30.0 | | | | 30.0 |
| South-west library and aquatic centre | 16.4 | | | | 16.4 |
| Convention centre* | - | 30.6 | 10.8 | | -41.4 |
| Carparking * | 70.0 | 41.7 | 15.0 | 12.9 | 0.4 |
| Former AMI stadium* | 253.0 | 143.0 | | | 110.0 |

| | **Council contribution** | **Insurance** | **Land** | **Improvement allowance** | **Borrowing** |
|---|---|---|---|---|---|
| Central city multi-sport facility* | 147.0 | 77.6 | | | 69.4 |
| Avon river park* | 6.4 | | | | 6.4 |
| Transport Interchange* | 39.9 | | 39.9 | | - |
| Transport Plan –phase 1* | 27.0 | | | | 27.0 |
| The Square | 4.6 | | | | 4.6 |

## Insurance

Over the last four years we have sought to increase our level of insurance cover over the city's assets as the insurers and reinsurers re-enter the Christchurch market. This extends to full cover including earthquake cover for 751 above and below ground buildings, valued at $1,436 million. We are currently seeking to place cover for fire and other perils, excluding earthquake, over a further 307 above-ground buildings valued at $495 million. The remaining 537 buildings totalling $157 million, with individual values of less than $2 million, remain self-insured.

We do not yet have insurance cover on below-ground water and waste water pipes but anticipate being able to obtain at least limited cover over the next few years. In the meantime we are relying on having sufficient borrowing capacity to fund 40 per cent of any damage incurred through a disaster, thereby entitling the Council to the remaining 60 per cent under the Government's Civil Defence and Emergency Management Plan.

## Policy on Securities

Council secures its borrowing by way of a charge over the Council's rates revenue. This process is used when we borrow from the Local Government Funding Agency, and under the Debenture Trust Deed for our general borrowing programme.

From time to time, with the prior approval of Council and the Debenture Trustee, security may be offered by providing a charge over one or more of the Council's assets. This is only done where there is a direct relationship between the debt and the purchase or construction of the asset being funded, such as an operating lease or project finance, and the Council considers a charge over the asset to be appropriate.

## Investments

The Council's investments are in CCHL, other companies, and loans and securities.

### Investment in Companies

The Council's main investment is in CCHL which holds investments on behalf of the City. The Council's objective for owning CCHL is that the company monitors the Council's existing investments. CCHL's dividends provide a key source of revenue for funding Council's activities and services. The return on our CCHL investment from cash dividends has averaged 3 per cent in the last three years and 4 per cent in the last 10 years. When the appreciation in the capital value of its investments is taken into account, CCHL has achieved an internal rate of return over the past five years of 8.0per cent a year, or 25.9 per cent a year since its inception in 1996. This significant return is due to asset growth. The sale by CCHL of some of its investments allows it to realise this increase in asset value and return it to Council as a cash dividend. Further information on CCHL's subsidiary companies is provided in the Long Term Plan and in the companies' Statements of Intent.

In addition the Council has shareholdings in a further eight companies. These are held principally to achieve efficiency and community outcomes and not to receive a financial return on investment.

We believe the risk to Council of investing in all of the above is low.

## Council Investments

| *Company* | *Shareholding* | *Principal reason for investment* | *Budgeted Return* |
|---|---|---|---|
| **Council Controlled Trading Organisations** | | | |
| Christchurch City Holding Investments | 100% | Return on capital<br>Holding company for the Council's trading investments. | $23.6 - $46.0 million per annum as detailed in the forecast dividend table below.<br>Plus special dividends of $549.3 in 2015-16, and $200.9 in 2016-17 |
| Vbase Limited | 100% | Economic Development<br>Achieved through the provision of venue management and event hosting services at its own venues (Horncastle Arena and the earthquake damaged Town Hall and Lancaster Park) and those it manages | None in Long Term Plan period. |
| Civic Building Limited | 100% | Property Investment<br>The company holds the Council's 50% investment in the joint venture that owns the Civic Building offices. This is a long term investment. | None in Long Term Plan period. Returns expected from 2020 onwards. |
| Tuam Limited | 100% | Property Investment<br>Property has been sold. Awaiting insurance settlement before the Company's future is determined. | $20 million return of capital funded by asset sale and insurance proceeds in 2016. |
| Canterbury Development Corporation Holdings Limited | 100% | Economic Development<br>Provides the Council and community with economic monitoring data. Certain Council levels of service are delivered by CDC. | None |

| Share Investments | | | |
|---|---|---|---|
| Transwaste Limited | 38.9% | Regional landfill | $4.2 - $4.7 million per annum |
| New Zealand Local Government Funding Agency | 8.3% | Borrowing | $120,000 per annum |
| New Zealand Local Government Insurance Corporation | 12.9% | Risk Management | None |
| Endeavour Icap | 12.8% | Economic Development | None |

The Council provides loan funding to its 100 per cent subsidiaries as and when required. Interest is charged on this lending at a market rate.

The forecast dividend income is outlined below:

| | 2015/16 | 2016/17 | 2017/18 | 2018/19 | 2019/20 | 2020/21 | 2021/22 | 2022/23 | 2023/24 | 2024/25 |
|---|---|---|---|---|---|---|---|---|---|---|
| **CCHL** | $595.3 million[1] | $226 million[2] | $23.6 million | $27.2 million | $27.8 million | $27.4 million | $28 million | $34.2 million | $42.9 million | $45.1 million |
| **LGFA** | $120,000 per annum | | | | | | | | | |
| **Transwaste** | $4.2 million | $4.3 million | $4.2 million | $4.4 million | $4.7 million | $4.8 million | $4.7 million | $4.7 million | $4.7 million | $4.7 million |

1 includes $549.3 million from the sale of investments.
2 includes $200.9 million from the sale of investments.

The Council is reviewing the following investments:

**CCHL**

As discussed in the consultation document the Council is reviewing the investments held by CCHL with a view to releasing funds to assist with its funding needs over the period of the strategy.

**Tuam**

The future need for Tuam is to be reviewed once its insurance claim is resolved.

**Christchurch City Holdings Limited Investments**

The key purpose of CCHL is to invest in and promote the establishment of key infrastructure assets in a commercially viable manner to assist proactively in the development and recovery of Christchurch. This involves the identification of infrastructural needs and then playing a role in helping to meet those needs. CCHL encourages appropriate investment by its trading companies when significant updates are required is existing infrastructural assets.

The dividends paid by each CCHL subsidiary in the last five years is shown below. Past information is used as we do not yet have the Statements of Intent covering the three years 2016, 2017 and 2018.

These are due to be received by Council later in March. There is a level of uncertainty regarding future dividend payments as these are dependent on the financial performance of the companies.

| **Company** | **Shareholding** | **Principal reasons for investment** | **Value of investment**[8] | **Total Dividends paid last 5 years**[9] |
|---|---|---|---|---|
| *Infrastructure* | | | | |
| Orion New Zealand Limited | 89.3% | Regional Economic Development | $753 million | 2014 $34 million<br>2013 $32 million<br>2012 $34 million<br>2011 $38 million<br>2010 $37 million |
| Christchurch International Airport Limited | 75% | Regional Economic Development | $534.2 million | 2014 $6.6 million<br>2013 $8.8 million<br>2012 $17.2 million<br>2011 $8.5 million<br>2010 $10.5 million |
| Lyttelton Port Company Limited | 100%<br>(Until 24 October 2014 CCHL had a 79.7% shareholding) | Regional Economic Development | $260.8 million (for its 79.7% shareholding) | 2014 $2 million<br>2013 nil<br>2012 nil<br>2011 $3 million<br>2010 $5 million |
| Enable Services Limited | 100% | Economic Development & Long Term Investment Returns | $40.9 million | No dividends have been paid |
| *Contracting* | | | | |

[8] As recorded in the financial statements of CCHL at 30 June 2014.
[9] Total dividend paid by the companies to all shareholders.

| Company | Shareholding | Principal reasons for investment | Value of investment[8] | Total Dividends paid last 5 years[9] |
|---|---|---|---|---|
| City Care Limited | 100% | Investment and Certainty of supply of service | $136.3 million | 2014 $5.7 million<br>2013 $6.3 million<br>2012 $7.9 million<br>2011 $6.4 million<br>2010 $1.9 million |
| Red Bus Limited | 100% | Public Transport Investment | $23 million | 2010 $0.7 million |
| EcoCentral Limited | 100% | Certainty of supply of service | $11.8 million | 2014 $0.2 million |

## Considerations of Ongoing Council Ownership of its Trading Companies

| Advantages of Council Ownership | Counter-arguments to Council Ownership |
|---|---|
| **Synergies.** Provides opportunities for broader Council / Community objectives to be reflected in the companies' objectives. Allows companies to proactively respond to community aspirations such as climate change, energy use, sustainability, and social equity in a more direct and binding manner. | **Synergies.** Community values should be reflected in regulation, policy and incentives that are transparent and contestable. The use of Statements of Intent to influence commercial behavior can lead to sub-optimal business performance. |
| **Local control.** While operating on a commercial basis, wider economic benefits to the region are taken into account – largely through the Statement of Intent process (eg. recognition of Council strategies etc). The CCHL model ensures that intervention is by way of guidance rather than direct lobbying or interference with recognised best practice board governance processes. The model reflects similar principles adopted for Crown commercial enterprises. | **Local Control.** This can lead to mixed messages for the companies and reduce efficiency or returns if companies are required to compromise their potential rate of return. Companies associated or linked to Council may also perceive an inability to act as commercially as competitors. |
| **Asset reliability.** A public owner of key infrastructure is more likely to accept a lower return in the short term to ensure there is sufficient investment into these assets for the long term (e.g. investment in increased network resilience, or proactive asset maintenance). | **Asset reliability.** The private sector has strong incentives to invest in asset reliability and maintain the performance of its assets to ensure it maximizes profits. Further it will not over-invest or gold-plate its assets. Council-controlled companies may be less inclined to reduce services, reduce quality of assets and infrastructure due to community expectation. |

| **Advantages of Council Ownership** | **Counter-arguments to Council Ownership** |
|---|---|
| **Investment returns.** . CCHL has generated a return to shareholders (cash dividends and capital growth) of 25.9 per cent since 1996. The current cash dividend forecasts ($46 million in 15-16) excluding dividends from the sale of investments have the effect of lowering Council rates required by approximately 13 per cent. The total shareholder returns exceeds the Council's cost of capital in investing in these companies. Independent professional directors appointed to CCTOs can be as effective at ensuring efficiency in Council-owned companies as those with private sector ownership. | **Investment returns.** Notwithstanding that total returns (including capital growth) to Council are higher than the cost of capital, cash dividends paid to Council have averaged a 4% return in the last five years decreasing to 3% in the last three year. Cash dividends currently are less than interest forgone on potential sales proceeds. An alternative shareholder may bring additional value to these companies and private sector ownership ensures better efficiency. |
| **Pricing.** Where there is no effective competition in a market, the existence of a Council-owned company can stimulate pricing and help to ensure that pricing for Council tenders is competitive or control pricing where there is a monopoly provider. | **Pricing.** This is only true where markets are not mature and in most instances of monopoly, pricing is regulated. |
| **Future potential.** Also known as "option value", this enables future flexibility with these assets. Eg. Port redevelopment, and Enable investment. If they are sold this value is gone. | **Future potential.** Council should not be exposed to unnecessary commercial risks – for example, Council's ownership may be questioned where it owns assets that are speculative, high risk or for purposes not connected to the well-being of the community. |
| **Long-term investment horizon.** Because they have an owner who is focused on long-term outcomes, the companies have a greater ability to invest in the long-term, where profitability may take some time but creates gain where aligned to the strategies (Community outcomes) of the city. | **Long-term investment horizon.** This investment exposes ratepayers to risk that the private sector is not prepared to accept. If the investment is made by the Council, it should be sold once it becomes commercially viable to reduce the commercial risk. |
| **Stability of ownership.** Strong stable ownership can create a competitive advantage for the operating companies. Private sector owners are more likely to seek profit in a shorter timeframe & not be as prepared to invest in the long-term. | **Stability of ownership.** Stability of ownership can also be achieved through a strong private-sector parent. A private sector parent may also bring other skills and experience that add value to the companies. |
| **Availability of capital.** Council decision-making to make further capital available will be moderated by how the investment contributes to commercial and non-commercial outcomes for the city. The Council could choose to allow its companies to access normal capital markets (CCTOs already raise debt capital through the normal market). | **Availability of capital.** A wider range of capital raising options is available to privately-held companies. Exposure to capital markets places stronger commercial disciplines on businesses. |

## Cash Investments

The Council typically holds a limited amount of surplus cash, to cover short-term working capital requirements or pre-fund the maturity of term borrowings. Cash may be invested for short periods to enhance returns, provided that this does not undermine the Council's liquidity position. Overall cash returns are expected to exceed the Reserve Bank's Official Cash Rate.

## Capital Endowment Fund

The Capital Endowment Fund was formed in 2001 using the proceeds received from the sale of Orion's gas subsidiary. The Fund provides an ongoing income stream which is applied by Council to economic development, and community events and projects. The Fund is invested according to the Council's Investment Policy, including internal lending to the Council to minimise Council's external borrowing. The Council pays the Fund interest on such internal loans at a market rate, although no more than it would pay for a similar loan from an external lender. Fund investments are consolidated with those of the Council for reporting purposes.

The Fund is projected to make returns over the 10 years of the Long Term Plan of:

| | 2015/16 | 2016/17 | 2017/18 | 2018/19 | 2019/20 | 2020/21 | 2021/22 | 2022/23 | 2023/24 | 2024/25 |
|---|---|---|---|---|---|---|---|---|---|---|
| Return | 5.00% | 5.45% | 5.45% | 5.40% | 5.40% | 5.40% | 5.40% | 5.40% | 5.40% | 5.40% |

## Community Loans

From time to time the Council makes loans to community groups to enable them to pursue their stated objectives. The return on these loans ranges from interest free through to 4.4 per cent depending on when they were granted and the conditions imposed on them at the time. The total face value of these loans at 1 July 2015 is estimated at $4.9 million.

## Other Investments

Under the terms of its shareholding in the Local Government Funding Agency (LGFA), each time Council borrows from LGFA it must invest a portion of that borrowing back into LGFA in the form of Borrower Notes. Council earns interest on Borrower Notes at an interest rate equal to the base interest rate charged on the associated borrowing, (ie. excluding any margins).

## Appendix 2: Cameron Partners' Report

In its report of August 2014 Cameron Partners concludes that the Council will need to look at what its strategic objectives are for its assets in terms of quality, availability and price of services, and impact on regional economic development.

### Key questions:

- what are the Council's strategic objectives for its assets?
- does it need to retain ownership to ensure those objectives are met?
- can its objectives be met through regulation or policy?
- can it contract for or enter into partnerships to ensure its objectives are met?

Some assets may not require Council involvement because third parties can provide the same services, with regulation ensuring Council's required outcomes are met.

The Council may need to own / fund assets which provide public benefits that would be uneconomic or too risky for the private sector to provide, e.g. public open space, civic facilities, roads. Some assets may be able to be provided by the private sector with the Council contracting for the services it requires.

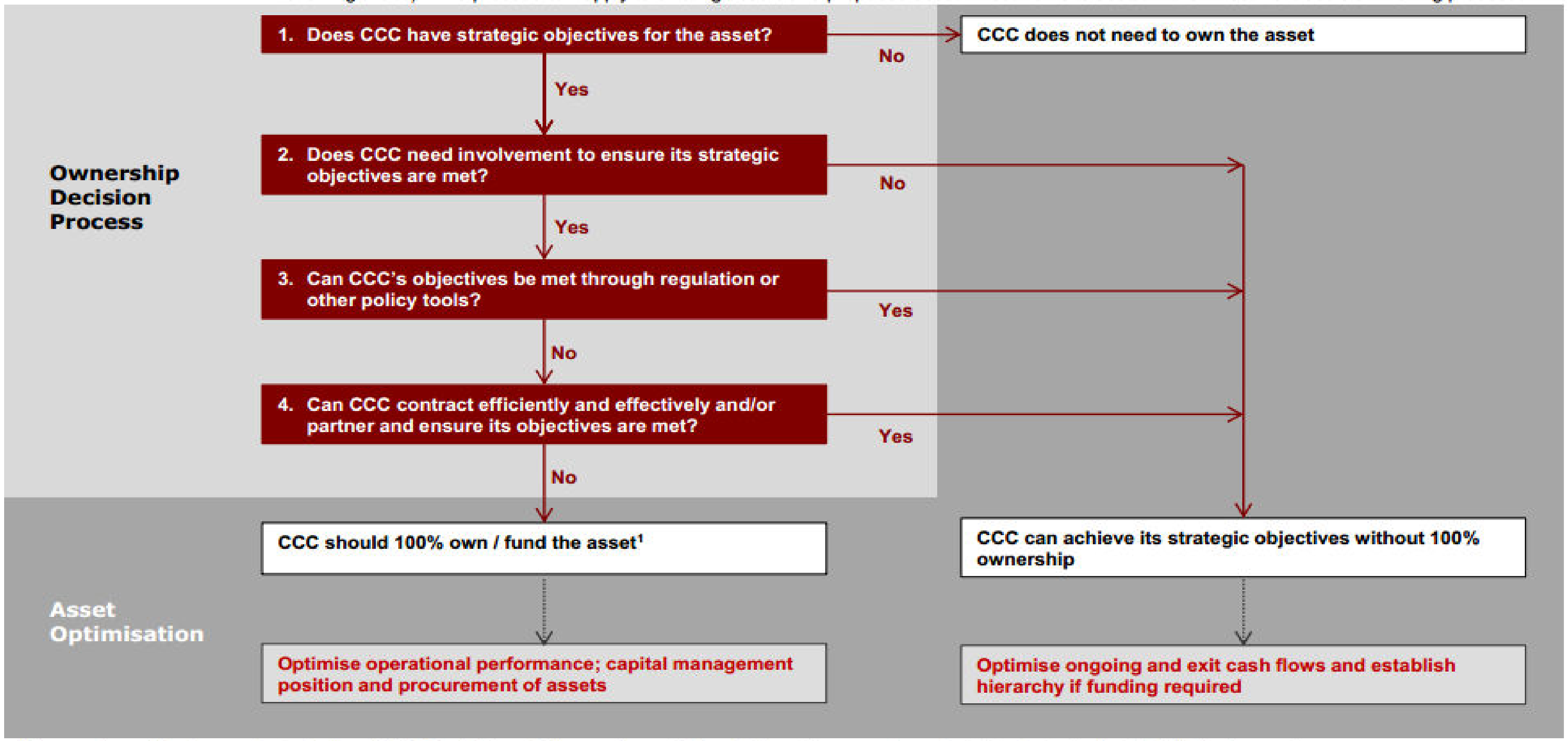
### Options for changing asset ownership while meeting the Council's strategic objectives:

- set a sale price that reflects the need to meet Council objectives and ensure contracts with new owners of the business asset are suitably aligned
- partial sell-down with shareholders' agreement / changes to constitution to ensure the strategic objectives are met
- achieve Council's strategic aims through contractual arrangements
- partnering with other like-minded investors / long-term strategic partners (Crown, local authorities, iwi
- this is shown diagrammatically on the next page and the full report is available at http://resources.ccc.govt.nz/files/TheCouncil/policiesreportsstrategies/reports/CameronPartnersReviewAugust2014.pdf

# 7. Asset Optimisation

## Assets Requiring CCC Involvement – Decision Framework

- The process for assessing whether CCC involvement is required or not is broadly as outlined in the following flow chart (with commentary on the following slides) . The process can apply to existing assets and proposed asset investments to assist in the investment decision making process




[1] *An exception could be where an investor is aligned with CCC and is happy for its non-value maximising objectives to be pursued – e.g. Govt; other local authorities; iwi; philanthropic sources)*