4 Financial strategy contained in the Three Year Plan ('TYP')

4.1 Overview

CCC produced the TYP in June 2013. CCC was working to prepare a Long Term Plan ('LTP') that covered nine years but the Government passed legislation requiring it to produce the TYP instead.

CCC faced a very significant challenge to prepare the TYP. To estimate the Rebuild Costs, CCC had to:

- identify the damage that had to be repaired;
- assess what work would be needed to repair the damage, which was complicated not only by the scale of the repairs but also by the uncertainty around exactly how some damage could be fixed;
- estimate what it would cost to do the work that CCC expected would be needed; and
- work out how the cost would be funded;

Many parts of CCC have produced information to feed in to the TYP.

We understand however that the Financial Strategy at an 'all-of-Council' level was mainly put together by CCC's CEO and GM Corporate Services.

To conduct this review, we had to spend a lot of time speaking to different people within CCC to obtain information to support the estimates contained in the TYP. No one person within CCC was able to readily provide all that information. This leads us to believe that no one person at CCC had a detailed understanding of the basis for the various Rebuild Cost estimates contained in the TYP and the accuracy of many of those assumption at the time of our review.

This lack of understanding was no doubt not assisted by the CEO and GM Corporate Services no longer being with CCC. The lack of understanding represented a big financial risk for CCC.

By the conclusion of our review, CCC staff appeared to have been able to obtain a much more thorough understanding of the various components of the Financial Strategy.

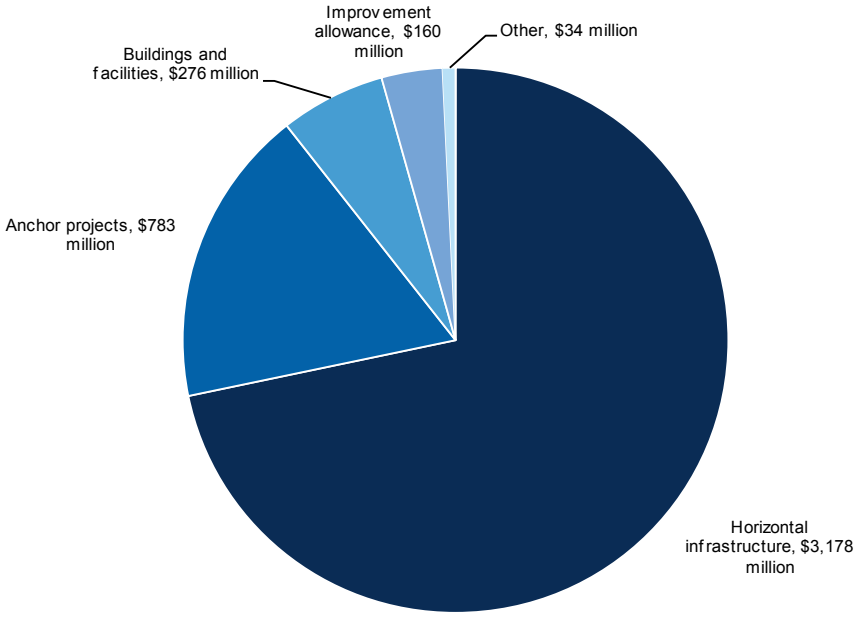
A lot of work has also been put in to reassessing the key components of the Rebuild Costs to ensure that CCC has a good understanding of them. CCC is about to start on its LTP planning process. We understand that the Rebuild Costs will continue to be reassessed through that LTP process.

The scale of this task should not be underestimated. As is explained in this report, there are thousands of individual things CCC has to fix to repair the damage from the earthquakes. There are also some very large issues that have to be considered, such as land drainage across the entire city. All of this work has had to be done by existing CCC staff, on top of the normal day-to-day functions of a council.

CCC did not establish a centralised control point for dealing with the rebuild work. Doing so may have assisted because one person (or group of people) would then have had an overall perspective of the rebuild programme. We understand that the organisational restructuring CCC is currently undertaking is, in part, aimed at achieving this. Without this overall perspective, there would have remained a very real risk CCC would not have always had an accurate understanding of the status of all the rebuild work and its financial implications.

4.2 TYP Rebuild Cost estimates

The TYP estimated total Rebuild Costs of $4.431 billion.[2] The cost of repairing Christchurch's Horizontal Infrastructure ('HI') is the single largest component of the Rebuild Costs.



Approx. $2 billion of this budget has already been spent, or is committed to be spent. By committed, we mean a project is already underway so the cost is already being incurred. Mostly all of this money has been spent on HI, through the Stronger Christchurch Infrastructure Rebuild Team ('SCIRT') (refer section 5).

The net cost to CCC was estimated at $1.618 billion after allowing for central government's contribution of $1.8 billion and $1.004 billion of insurance payouts:

	TYP $ million
Total cost	4,431
Less Government subsidy	(1,800)
Less Insurance	(1,004)
Less Other contributions	(9)
Net cost to council	**1,618**

The TYP included some funds that were not specifically allocated to the work programme but which CCC thought would be required. This may therefore provide a contingency. The amount was originally about 5% of the estimated net cost to council.

The purpose of our review has essentially been to identify whether:

- $4.431 billion remains an appropriate estimate of the Rebuild Costs, and, if not, what CCC currently estimates the revised cost to be; and
- $1.618 billion remains an appropriate estimate of the amount of the Rebuild Cost that CCC will itself have to pay.

[2] Refer page 49 of the TYP.

The TYP split the Rebuild Costs into 21 line items. All those line items can be split into three master categories:

	TYP $ million
Horizontal infrastructure	3,178
Buildings and facilities	1,219
Other	34
Total	**4,431**

This report does not cover the 1,000+ individual components of the rebuild programme. Instead, we discuss the Rebuild Costs for the Horizontal infrastructure and the buildings and facilities categories. This is the way in which CCC manages the overall budget. We do not discuss the other category in this report as it remains unchanged.

4.3 TYP assumptions about how the Rebuild Costs would be funded

CCC did not have $1.618 billion to pay for the Rebuild Costs so the Financial Strategy also explains how CCC will raise enough money to pay them.

At the time CCC essentially had three key options to raise this money:

1. Increase rates

   CCC decided to charge a one off levy of 1.84% for the Metro Sports facility and a special earthquake levy of 1.93% from 2011/2012. Rates have increased and will continue to increase by 1.93% per annum until the fifth year, following which rates will remain at that higher level. Even after charging the special earthquake levy, Christchurch City ratepayers pay much less than most other major centres.[3]

2. Optimise the performance of its investments

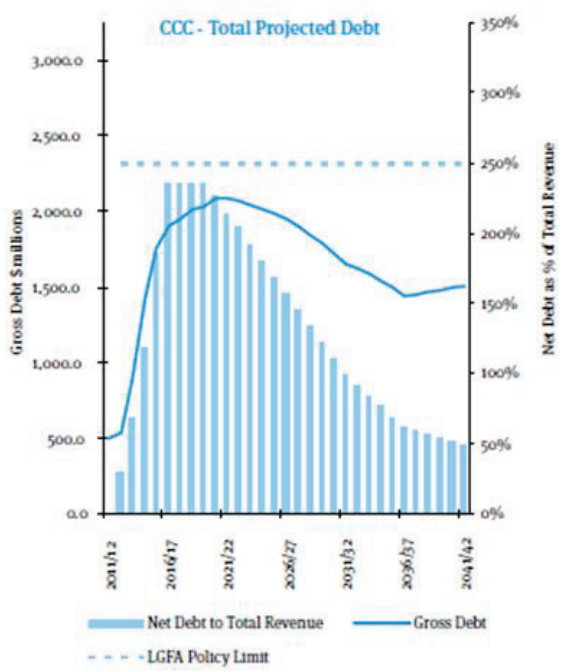
   The net assets of CCC's investment holding company, Christchurch City Holdings Ltd ('CCHL'), were valued at $1.450 billion in CCHL's 30 June 2013 financial accounts. CCC could have worked to maximise the return CCHL generated from its assets or, perhaps, sell some. It did neither.

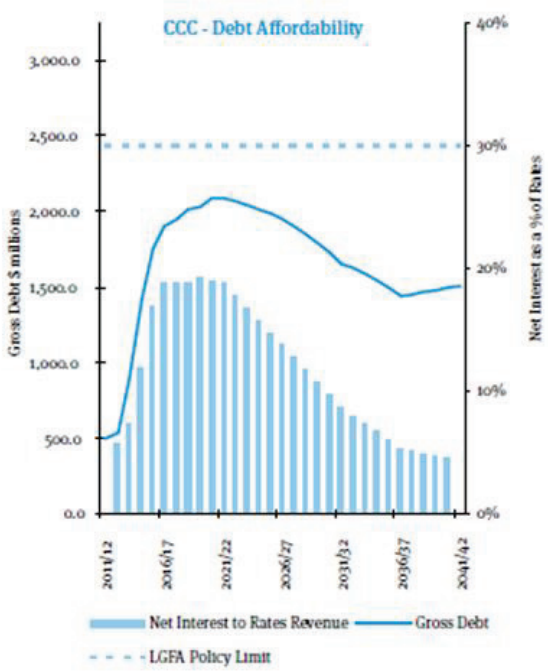
3. Borrowing

   The Financial Strategy explained that CCC would borrow around $1 billion to fund the Rebuild Costs it could not otherwise meet.[4]

CCC borrows money via the New Zealand Local Government Funding Agency ('LGFA'). There are rules (covenants) that limit how much CCC can borrow from LGFA. The TYP showed that the amount CCC was planning to borrow was within the two key covenants but very close to the upper limit of the net debt:total revenue ratio:

[3] Refer page 57 of the TYP.
[4] This borrowing is in addition to CCC's normal borrowing for its capital programme.





The amount CCC can borrow is also affected by the amount of revenue and rates revenue it receives. If revenue is less than CCC expects, it will be able to borrow less, and it can borrow more if revenue is higher.

CCC does not have an updated long-term revenue forecast against which we could measure how much it can borrow. We are aware that rates revenue is currently lower than expected but we do not know what the long term trend is expected to be. CCC will produce a forecast as part of its upcoming LTP planning exercise.

We estimated that, all other things being equal (especially CCC's revenue), based on the TYP CCC could borrow another $100 to $150 million before it breached the net debt:total revenue covenant. Put another way, if the Rebuild Costs were to increase by more than $100 to $150 million, CCC would have to raise or save money some other way.

It would be risky for CCC to borrow the maximum amount it could at any point in time because that would leave no flexibility in the future to manage variances against its forecasts. For this reason, even if the TYP assumptions are still correct, we do not believe it would be sensible for CCC to borrow the additional $100 to $150 million it could technically borrow. We consider it has no practical ability to borrow more (based on the TYP assumptions).

It is important to bear this in mind when reading the rest of this report.