financial strategy

OVERVIEW

The focus of Council's Financial Strategy is to maintain our assets to the level desired by the community while keeping our debt low and our rates revenue stable. Due to the large number of infrastructure renewals that Council has planned, getting the balance right is going to be a challenge.

Council's overall debt levels will increase over the life of this Strategy as Council focuses on intergenerational equity, ensuring that both current and future ratepayers meet the cost of providing the asset that they will use. Although increasing, debt levels will remain comparatively low to ensure that Council is not creating an affordability issue for future communities.

Key Strategies include:

- The use of loan funding (intergenerational equity principle) to ensure that both current and future communities pay for the asset they are using.
- Economic growth through the promotion of the Awarua Industrial Estate to enable job creation.
- Continuation of the conservative approach in managing the finances of Council.
- The establishment of an innovation project to investigate new and more effective ways of delivering services.
- More use of targeted rates to ensure that ratepayers who benefit from the service, pay for it.
- Continue increasing dividends from Invercargill City Holdings Limited group over the course of the Long-Term Plan to reduce reliance on rates revenue.
- Ensuring that affordability is the key focus of all expenditure and investment discussions.

Invercargill CITY COUNCIL

BACKGROUND

As a part of Council's planning for the future, we have considered the importance of good financial management and have prepared what we consider a robust financial strategy for going forward. This strategy is more than just about setting limits on rates and debt and other financial measures, it is a tool that Council will use to ensure sustainability of service and to prioritise projects.

Council is required by law to manage its revenues, expenses and general financial dealings in a manner that promotes the current and future interests of the Community. This requires careful balancing in delivering services the Community wants at a price it can afford while, also ensuring that those using the services, both now and in the future, pay their fair share of the cost of supplying it.

Council's overall philosophy is to take a considered, conservative and sustainable approach to financial management, and by doing so, ensures that Council meets the Community's expectations without burdening future generations. The development of this strategy ensures that Council takes this approach in a transparent manner.

It is important when looking at the Council's Financial Strategy to understand where the Council is currently. As at 30 June 2014, the financial situation of the Council is one of good health. The Council's Statement of Financial Position shows the Council's debt ratio at 5.8%, being Total Liabilities over Total Assets, which is rated as excellent for a New Zealand council and this is supported by Council's AA credit rating from Fitch. Recent changes to the Financial Reporting and Prudence Regulations 2014 have required Council to measure themselves against financial benchmarks. For the year ended 30 June 2014, the Invercargill City Council were meeting all eight of the prescribed financial benchmarks. The goal of the Council during the next ten years is to maintain the financial health of the Council to a similar state as it currently is. Council believes that by continuing to meet the required Financial Reporting and Prudence benchmarks, keeping its debt ratios low and maintaining the limits on rates revenue, rates increases and borrowings (further detail on Pages 46 to 50 on these limits) the Council will be able to maintain its current position of strong financial health.

Throughout the ten year period covered by the Long-Term Plan, Council intends to keep costs as low as possible. By following this Financial Strategy, by the 2024/25 year, Council will have continued to maintain assets to the standard desired by the Community, while keeping debt levels and rates revenue relatively stable. Council debt is anticipated to grow over the next eight years to peak at $58 million before falling back to a similar level as it is currently.

This financial strategy has informed all subsequent decisions made during the 2015-25 planning process.

INVERCARGILL AND ITS ENVIRONMENT

Invercargill's location within New Zealand and its role in the Southland Region bring not only benefits to Council but also challenges to manage.

Some key challenges that Council will be managing over the next ten years are:

- Some of our population earn much less than others and as a Community we earn less than the New Zealand average.
- Members of our communities have different needs and wants.

- We have a population ageing faster than the New Zealand average which means the proportion of our population over 65 years continues to increase.
- The cost of providing local government services (the Local Government Cost Index) continues to increase at a higher rate than inflation.
- The devolution of responsibilities from Central Government (such as alcohol and gambling regulations) and increased standard requirements (such as building regulation) places more mandatory requirements onto the Council.
- Continued pressure for new projects and increased services.
- Continued pressure for financial support for community facilities / projects.

These challenges mean that:

- Our population is unlikely to be able to continue to afford escalating costs.
- The costs of providing services are not going to reduce without significant intervention.
- Council will need to continue to make difficult trade-off decisions, compromise on delivering 'nice to haves' to ensure essential services are provided and costs are kept down.
- Council will have to balance the affordability and prudence of increasing debt levels. Too much debt now could compromise future development projects.

This strategy considers these challenges and outlines how they affect Council's decision making.

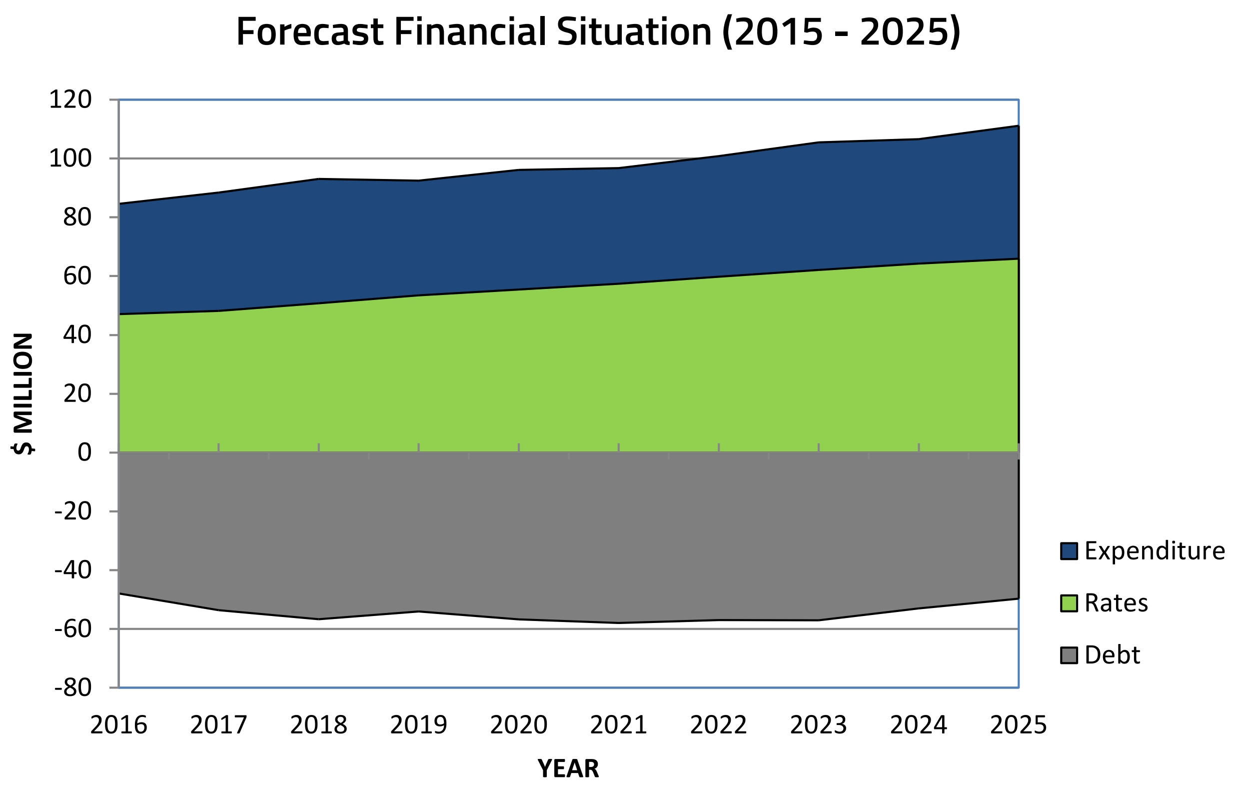
WHAT DRIVES COST?

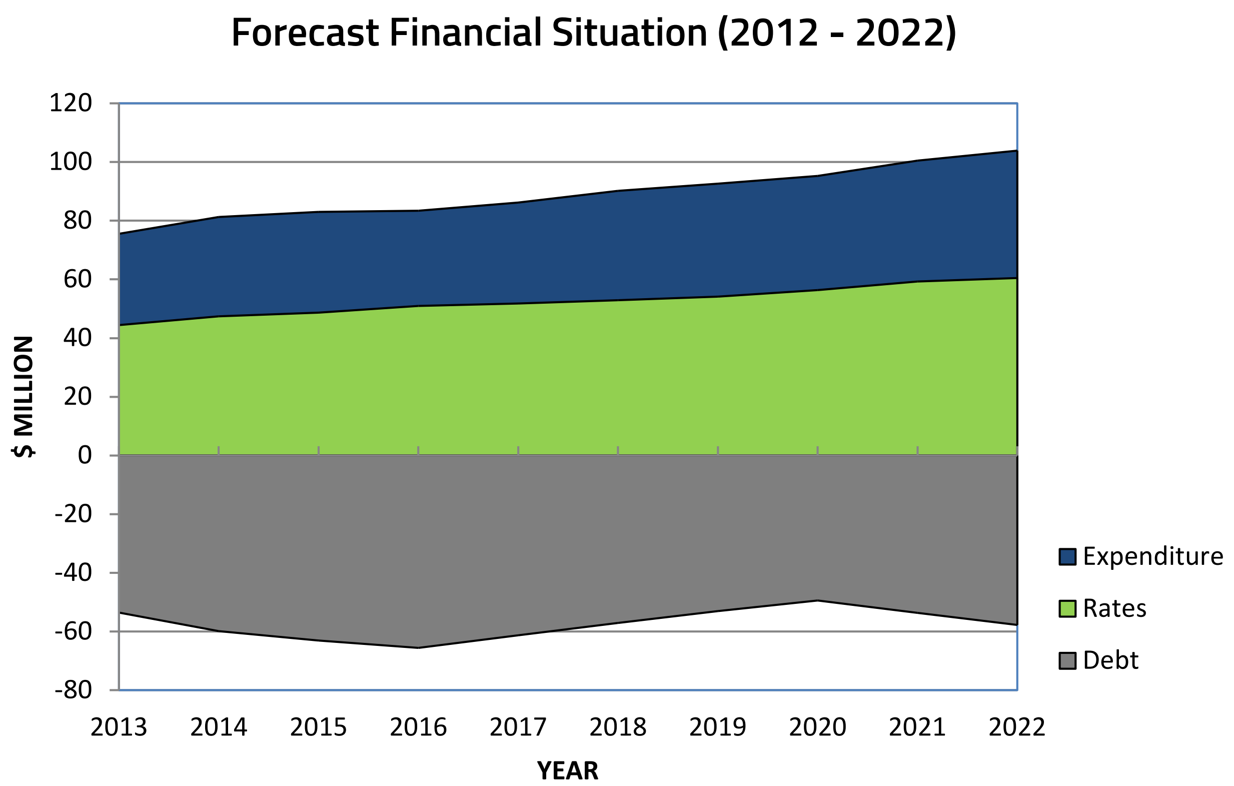
The graphs on the following pages following show the financial situation, including expenditures and revenues over the Long-Term Plan period. The previous 2012-22 Long-Term Plan comparatives are also shown.

The difference in debt levels from the 2012-22 forecasts to the 2015-25 forecasts (forecasted Financial Situation graphs on page 36) are predominately due to certain infrastructure projects costing less than was budgeted and other projects being deferred, such as the City Centre Revitalisation project.

Forecasted Expenditure by type shows both operating expenditure and interest tracking similarly to the 2012-22 Plan. Interest costs are slightly greater than the 2012-22 Plan, mainly due to increased capital expenditure being loan funded in the 2015-25 Plan. Capital expenditure has increased in the 2015-25 Plan, particularly in the 2016/17 years. This is predominately due to some infrastructural renewal and upgrade being required sooner than expected, particularly within the Water Supply area. The remaining capital expenditure profile for the years 2018-25 remains similar to the 2012-22 Plan.

Forecast Revenue by source has remained consistent to what was anticipated in the 2012-22 Plan, although Council is anticipating increasing fees and charges during the later years of the 2015-25 Plan.


Forecast Financial Situation (2015 - 2025)
$ MILLION
120
100
80
60
40
20
0
-20
-40
-60
-80
2016
2017
2018
2019
2020
2021
2022
2023
2024
2025
YEAR
Expenditure
Rates
Debt


Forecast Financial Situation (2012 - 2022)
$ MILLION
120
100
80
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0
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2013
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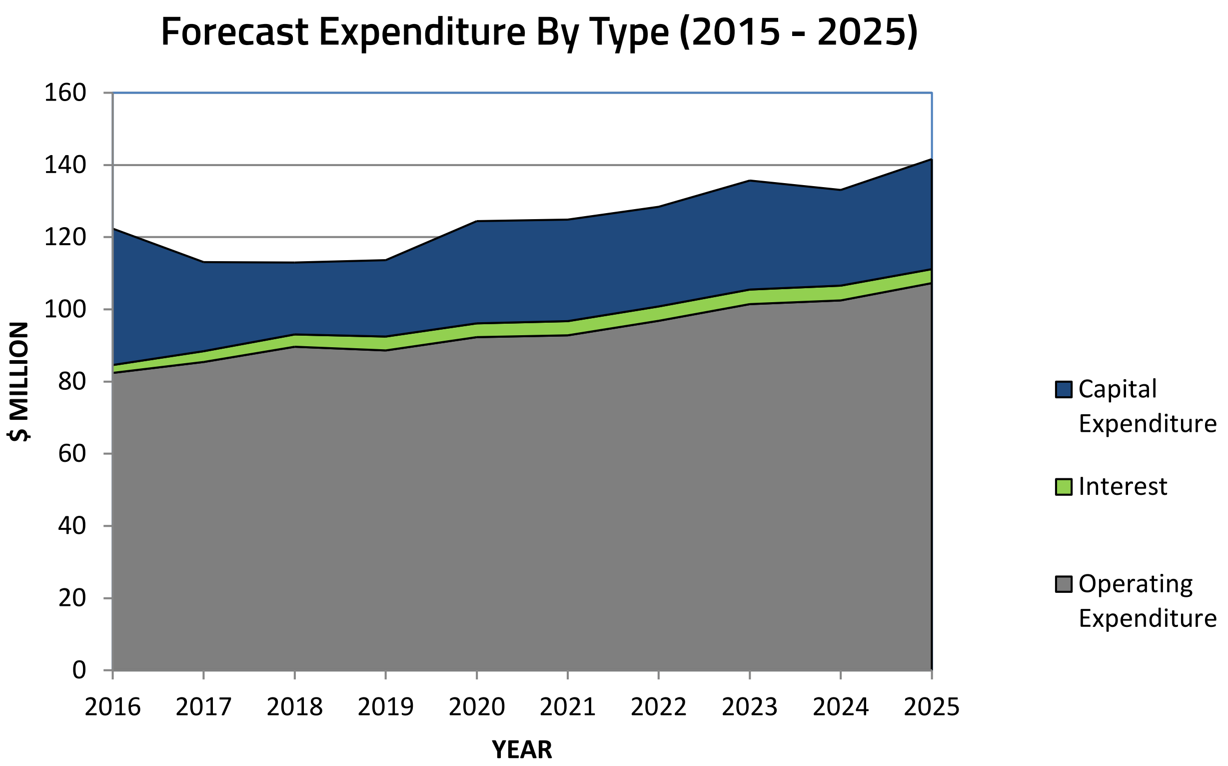
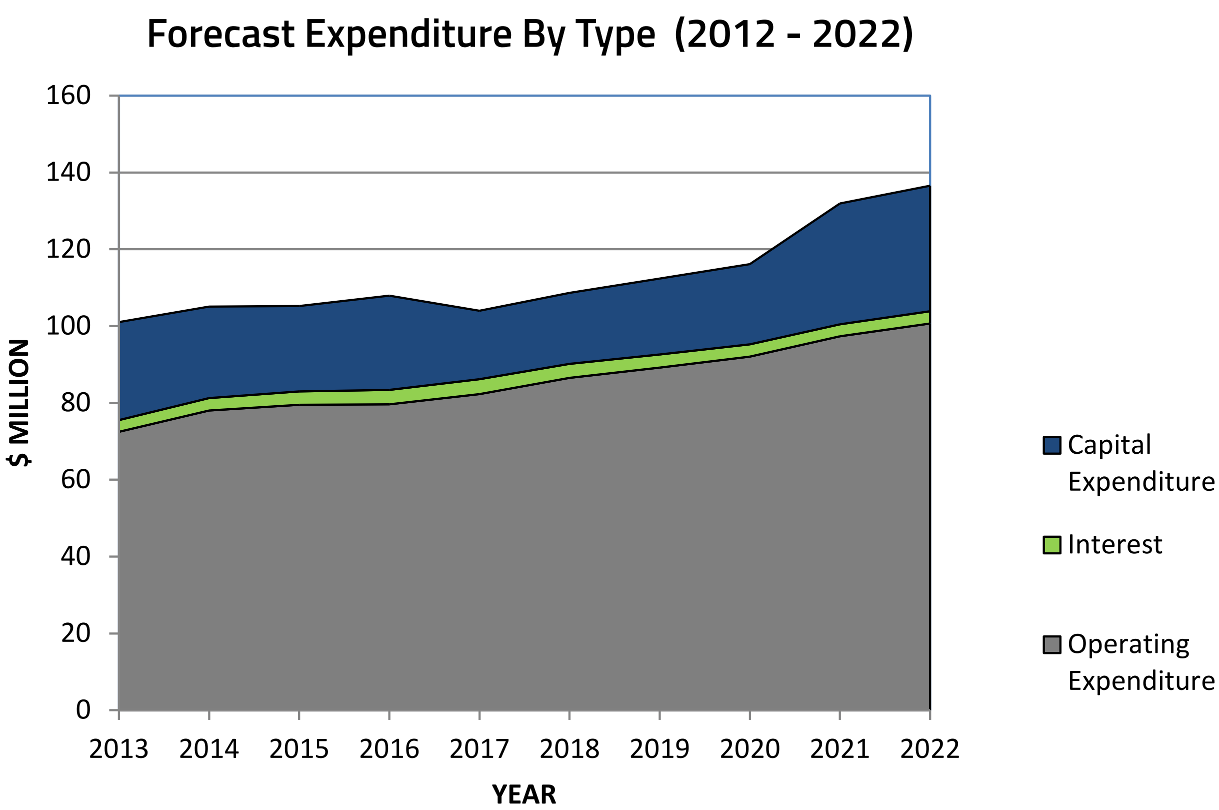
Expenditure
Rates
Debt


Forecast Expenditure By Type (2015 - 2025)
$ MILLION
160
140
120
100
80
60
40
20
0
2016
2017
2018
2019
2020
2021
2022
2023
2024
2025
YEAR
Capital Expenditure
Interest
Operating Expenditure


Forecast Expenditure By Type (2012 - 2022)
$ MILLION
160
140
120
100
80
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2013
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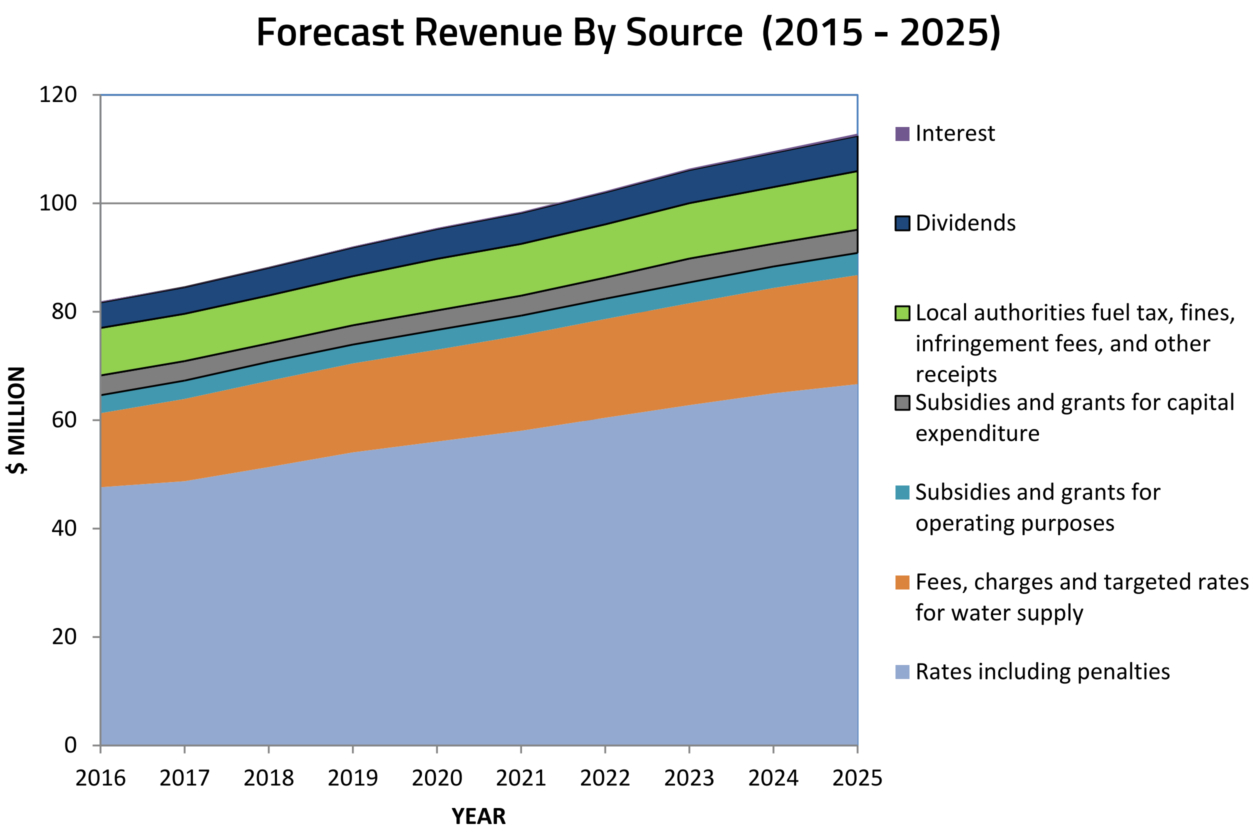
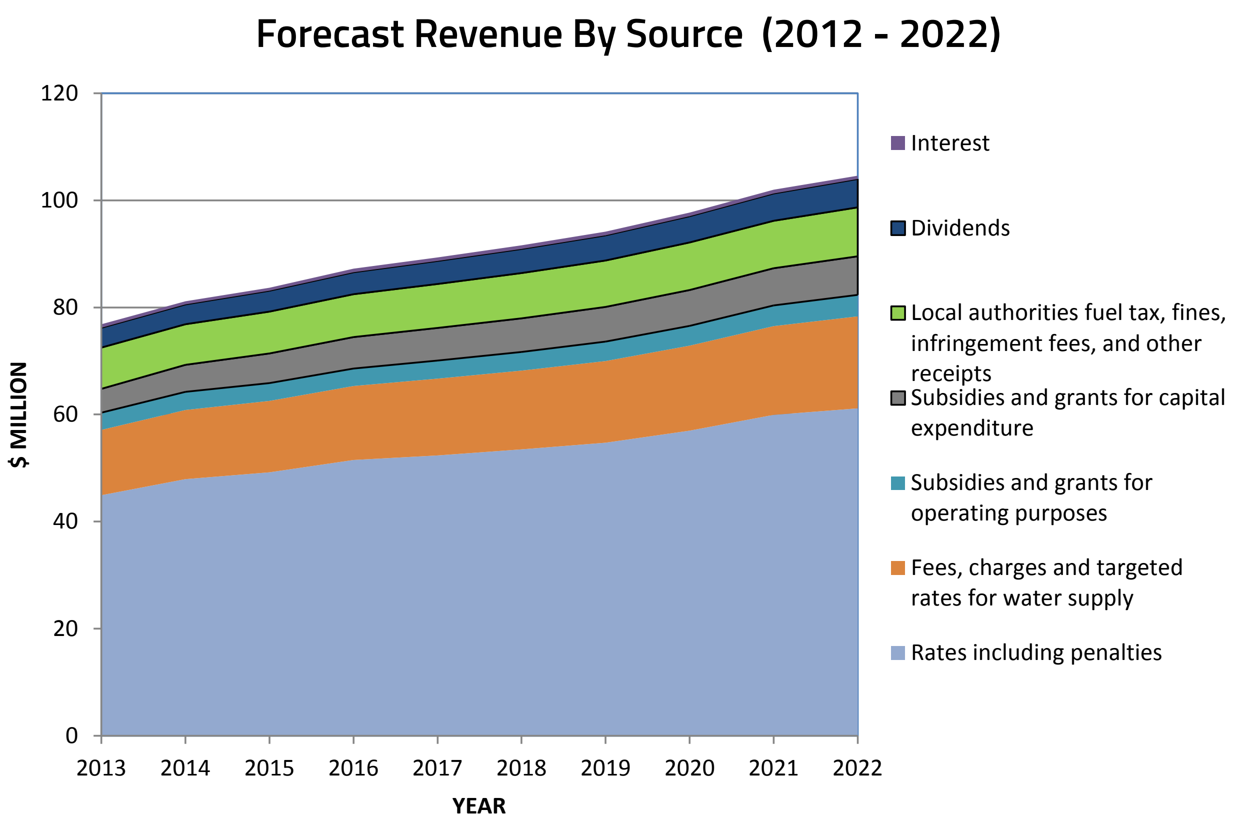
YEAR
Capital Expenditure
Interest
Operating Expenditure


Forecast Revenue By Source (2015 - 2025)
120
100
80
60
40
20
0
$ MILLION
2016
2017
2018
2019
2020
2021
2022
2023
2024
2025
YEAR
Interest
Dividends
Local authorities fuel tax, fines, infringement fees, and other receipts
Subsidies and grants for capital expenditure
Subsidies and grants for operating purposes
Fees, charges and targeted rates for water supply
Rates including penalties


Forecast Revenue By Source (2012 - 2022)
120
100
80
60
40
20
0
$ MILLION
2013
2014
2015
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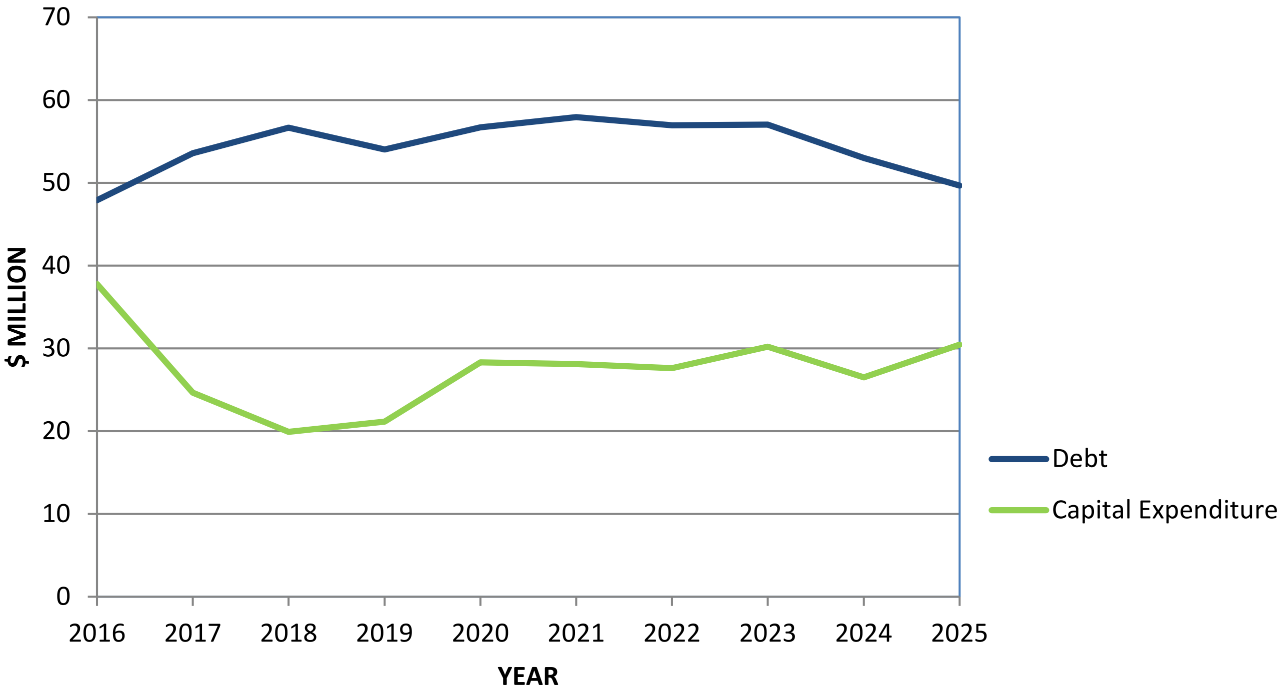
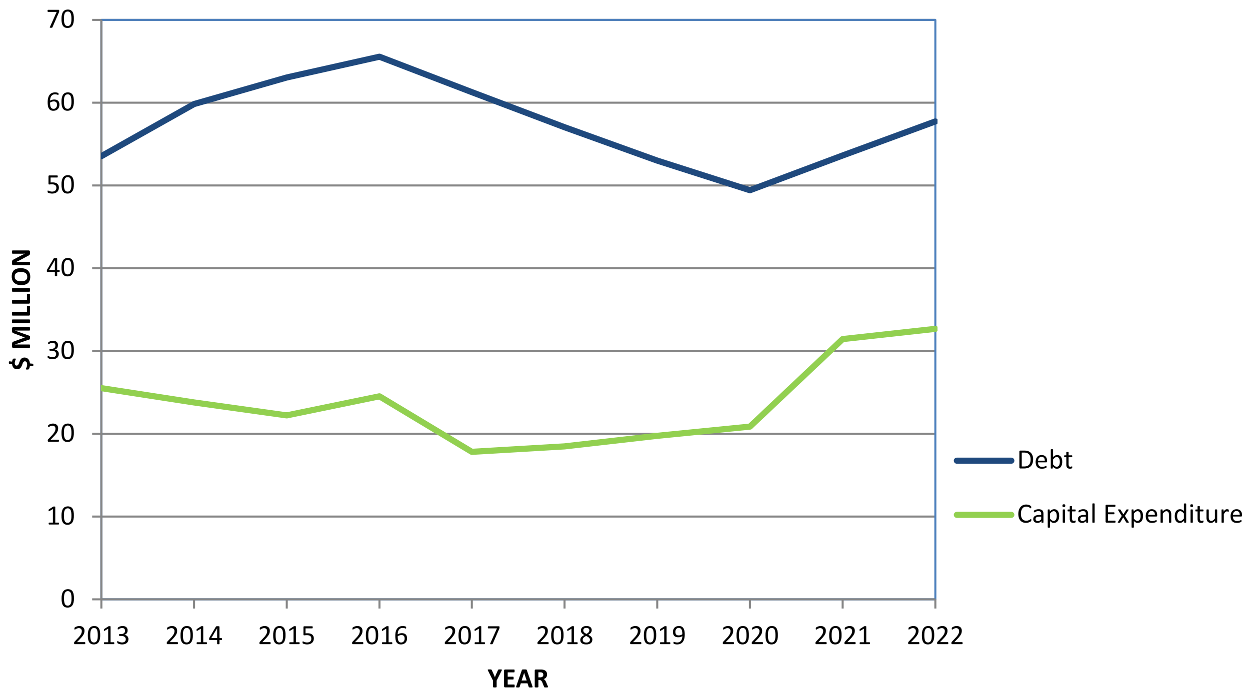
2020
2021
2022
YEAR
Interest
Dividends
Local authorities fuel tax, fines, infringement fees, and other receipts
Subsidies and grants for capital expenditure
Subsidies and grants for operating purposes
Fees, charges and targeted rates for water supply
Rates including penalties

Forecast Capital Expenditure & Debt Profile (2015 - 2025)



Forecast Capital Expenditure & Debt Profile (2012 - 2022)



FINANCIAL CHALLENGES

There are a number of factors which are expected to impact on Council's management of its finances and running of its business over the next ten years. These are outlined below.

1. Economic Climate and Growth

Over previous years, New Zealand and Invercargill have been affected first by a global economic recession, and secondly by a period of slower and lower than expected economic growth. During recent times there has been a stronger growth in the economic outlook and Economic commentators are projecting 3% growth for the 2015 year, although predictions do differ between commentators. After 2015 it is predicted the growth will level off at around the 2.5% per annum mark. While this points to the better economic picture for Southland, this needs to be tempered with the recent drop in milk prices within the dairy sector, which has a bearing on the local economic climate. Council is actively encouraging employment opportunities within the District through Venture Southland, and the development of the Awarua Industrial Estate. Council, in partnership with Invercargill City Property Limited, continues to explore potential users of land for large industrial development on the Awarua Estate. It remains Council's strong intention to encourage and develop this land for industrial use and in doing so, create more jobs. Given that Invercargill has high labour force participation rates, it is assumed that additional people will move into the District when employment opportunities become available.

Council assumes that our population will continue to age faster than the New Zealand average, which means that the proportion of our population over 65 years will increase. As the District's population ages and people retire from full time employment, employment opportunities will be created which cannot be filled from within the community. The Invercargill District will continue to have low unemployment levels. These vacancies create the opportunity to attract people and their families into the District. This migration will lessen the proportion in the 65 years plus age group, but the trend will remain dominant. You can read more about Council's assumptions on what the future of Invercargill will look like in the Significant Assumptions section within this plan.

Given the assumption that Invercargill's population will increase slightly over the next ten years, there will be demand for additional housing, and therefore services. There will be pressure to extend infrastructural services beyond the existing urban areas. Low density connections to Council infrastructure do not lead to efficiencies in the supply of services or long-term maintenance. Council does not anticipate any significant expansion to the infrastructure network.

2. Intergenerational Equity

Many of the services provided to the community rely on the use of costly assets which have a long-term life, sometimes in excess of 50 years. It would be unfair to burden existing ratepayers with the full current costs of these assets when the benefits will extend well into the future.

Setting appropriate rates levels involves balancing how much of the expenditure required should be funded by today's ratepayers and how much by future ratepayers. The concept of achieving a fair division of cost over time (and therefore ratepayers) is called intergenerational equity and commonly, raising loans (debt) repayable say over a 10-20 year period is a tool to achieve this.

Council has during this Long-Term Plan been required to prepare a 30 year Infrastructure Strategy. The Infrastructure Strategy reflects the above principle of intergenerational equity. For example, the City Centre Revitalisation estimated to cost $12.0 million will be funded from loans with repayments ending in the 2039/40 financial year.

The 2015-25 Long-Term Plan anticipates a budget deficit in its first three years as Council has deliberately set projected operating revenues for these years at levels less than what would be required to meet projected operating costs. When determining to run an unbalanced budget (budget deficit), Council looks at the potential it has to adversely affect intergenerational equity. In this instance Council has determined that running an unbalanced budget is prudent and fair to both the current and future communities. The proposed operating deficits occur in 2015/16, 2016/17 and 2017/18. The key reason for the unbalanced budget in these years is that meeting the full cost of depreciation in some roading areas is not necessary and budgets have therefore decreased expenditure in this area. Footpaths are an example of this with a decrease of approximately $1.24 million each year against forecast depreciation. Council has decided to underfund the footpath asset as the potential risks faced are low compared to other infrastructural assets. A footpath failure is likely to be relatively localised, easily identified and remedied very quickly allowing a higher risk to be taken. The risk of this strategy is mitigated as the materials utilised, more concrete than asphalt, and the thicker construction, 100 mm not 75 mm, that are currently being installed, will have a longer life that those installed in the 1980's under the government works scheme. This extended life will mean less annual calculation of depreciation in the future.

In 2017/18 a $4 million grant is to be released for the Southland Museum and Art Gallery Development. This will cause a loss in this year as the Grant will be funded by a loan. Although a grant is considered operating expenditure, the nature of the work proposed is capital in nature. It is therefore considered prudent to loan fund the work to ensure intergenerational equity, rather than have current ratepayers fund the entire $4 million.

In the period 2020/21 to 2024/25 operating revenue is projected to exceed operating expenditure giving a profit in each of these years. The key reason for the unbalanced budget in these years is that the water pipe network is not lasting as long as expected. The asbestos cement water distribution network will need to be replaced over a number of years, but earlier than what is identified through the financial tool of depreciation. As a consequence, capital expenditure will exceed the cost of depreciation by $2 – $6 million in each year, and this work will be funded by rates. It is noted that the Revenue and Financing Policy indicates that major renewals such as this are often loan funded, but it is considered that due to the overall economic cost of loan funding this work, funding through rates revenue is more cost effective for both the current and future communities.

3. Affordability

Council is concerned about the level of rates increases that have been needed to fund the services it delivers and has been actively seeking efficiencies where possible and looking at new and innovative way to provide value for money to our ratepayers. To assist Council with finding these efficiencies and innovations, Council has been launching an innovation project called "Our Ideas". Utilising money from an innovation fund established for this purpose, the innovation project sets out to tap into the vast resource of knowledge held by the staff members of the Invercargill City Council. The 'Our Ideas' project seeks to capture, assess and implement better ways of performing Council functions from the people who know best, the people at the coal face. By implementing and continuing this project, Council believes it will unearth efficiencies within the way Council delivers its services. This will allow Council to either deliver the current service for less cost or deliver better services for similar cost. In addition to the innovation project, Council has been actively engaging with other New Zealand councils to identify best practice methods for delivering services within Invercargill.

Council recognises that our Community's income levels are, on average, lower than the rest of New Zealand and that those ratepayers on low / fixed incomes are reaching the limit of what they are able to pay. Council is actively encouraging economic activity in Invercargill and this requires Council to consider and balance the affordability of rates to all ratepayers. It is anticipated that by encouraging economic growth, Council will increase its ratepayer base and therefore reduce the rates burden on individuals.

The cost of providing Council services across New Zealand (Local Government Cost Index) continues to increase at a slightly faster rate than household costs. An explanation of the Local Government Cost Index is provided in the Overview section of the Long-Term Plan. The cost of providing Council's infrastructure services (roading, stormwater, sewerage, water supply and solid waste services) accounts for around 57% of all Council's revenue from rates. This is forecasted to increase up to 61% over the life of the ten year plan. The remaining rates revenue funds the Community Services, Development and Regulatory Services and Corporate Services groups of activities.

The increasing cost of providing Council services means in practice, that should Council set its rates at a figure less than the Local Government Cost Index, it would need to either find, or have found, efficiencies, reduce its services, or transfer costs to future generations. There is a continued expectation from the Community that services will be maintained and improved. Council must balance the benefits and costs of doing so for the current and future ratepayers of Invercargill.

4. Minimising Risk

Council has had to make some assumptions about what the future Invercargill will look like. This carries with it a level of risk. Council assumes that there will be a gradual increase in population based on a growing economy. Should growth slow or stagnate, further challenges around the affordability of providing Council's services and activities would arise. Alternatively, should a significant employer choose to locate in Invercargill, the potential demand on services and activities may also require Council to review and change its current activities and levels of service.

OUR STRATEGY FOR MANAGING THE FINANCIAL CHALLENGES

The Council intends to manage these challenges by the following methods:

- Focussing on affordability and keeping income from rates steady, without significant rates increases.
- Taking a conservative but innovative approach.
- Utilising a 'those who benefit pay' approach where possible.
- Utilising a 'just in time' approach to the provision of infrastructure.

Affordability and Rates

Council recognises that some members of its community are reaching the limit of what they are able to pay in rates. As such, Council has made rates affordability a lens through which all decisions are viewed. Increasing costs of providing Council services is likely to intensify the affordability issues into the future. In certain years of the Long-Term Plan, pressure from required infrastructure renewals has led to rates increases that are less affordable than Council would like. This is particularly the case in years 2017/18 and 2018/19, as larger rate funded capital projects are carried out. These include the escalation of the asbestos cement water pipe renewals and the LED street lighting upgrade. It is Council's intention to establish a system where the level of rates required is predictable and the income required from rates is stable.

In order to achieve this, Council will:

- Investigate how we can achieve efficiency gains in service delivery. The "Our Ideas" project is the key way Council intends to achieve this.
- Investigate using other revenue sources, for example user-pays, to reduce reliance on rates as an income source. Council has worked closely with Invercargill City Holdings Limited and the Holding Company will increase the dividend it pays to Council annually during the course of the Long-Term Plan.
- Continue to investigate the possibility of rationalising surplus assets. An example is the disposal of some parks and disestablishment of certain community playgrounds. Council views this method as a "when all other options have been exhausted" approach, but continues to assess the viability of this approach.

Council will carefully plan its activities and the services provided by:

- Focussing on public services rather than the 'nice to haves'.
- Looking to shared services with other Southland Councils where appropriate, to ensure services are delivered in the most cost efficient way.
- Ensuring good asset management principles are applied. Over the past 15 – 20 years, Council has developed its asset management knowledge. This process has given Council an improved understanding of the condition of much of its underground assets, as well as a better working knowledge of its above ground assets. This knowledge has also uncovered infrastructural assets that are nearing the end of their useful life sooner than was anticipated, particularly in Water and Sewerage assets. This knowledge base is reflected within Council's Asset Management Plans.

Council anticipates that this approach will ensure that rates are kept affordable now and in the future, and debt levels will remain conservative, while still providing for Council's assets to be maintained and renewed.

Conservative yet Innovative Approach

To meet the financial challenge posed by an increasing percentage of our Community being on a fixed income, and our Community earning less than the New Zealand average, Council intends to take a conservative approach to managing our finances.

Council realises that we have to spend money to progress, but intends to do things in an innovative way, ensuring we don't spend more money than is necessary. In essence, Council is aiming to deliver more while spending less. The mechanism for achieving this is primarily via the "Our Ideas" project, although Council management and staff are always evaluating and assessing ways to deliver services in a better and more cost effective way.

"Those Who Benefit Pay" Approach

One of the key challenges identified by Council is that members of our communities have different needs and wants and Council is under continuous pressure to provide new projects and increased services. Council will endeavour to ensure that the users generating the demand will fund the service.

Consideration of who benefits is unique for each of Council's activities. Individuals, when they obtain a consent or registration which allows them to undertake an activity, receive a personal benefit. Therefore, applicants pay the full costs associated with processing applications once they are lodged. Other Council services, for example Splash Palace, also have a user pays component. Council's strategy is to charge user fees to those who directly use an activity, but only to the extent that Council considers affordable.

Council's strategy is to retain a mixed rating structure which provides for targeting rates towards those who generate the demand and funding activities through general rates where it is not possible to clearly identify customers or users. Council's strategy is to use targeted rates where an activity benefits an easily identifiable group of ratepayers and where it is appropriate that this group pay for some or all of a particular service, for example Water Supply.

Council has removed most differentials from our rating system. The only differential remaining is that applied to the Rural – Farm rating category. It is Council's intention to also phase this differential out over time. In order to maintain an equitable rating impact and preserve the relationship which exists between residential, rural, commercial, utilities and large industrial rating units, Council's strategy is to apply a mixture of uniform charges (the same charge paid by all ratepayers), targeted rates and general rates. Using different rating mechanisms allows Council to recognise the diversity of our Community and the different ways that the different ratepayer categories utilise Council services.

Council's strategy is to ensure that both current and future ratepayers pay their fair share of the cost of providing services. This intergenerational equity is achieved through loan funding long-term assets and drawing rates to pay for the loan over an extended period of time. This ensures that both current and future users pay for the service.

This approach will mean a move towards more user fees and targeted rates, although general rates will still be utilised to keep these other funding sources affordable. To ensure affordability and continuity of services, ratepayers who do not use some services directly, for example Splash Palace or our libraries, will continue to subsidise the cost of providing these services via rates.

"Just in Time" Approach to Expenditure

Council intends to only provide new infrastructure when it is really needed and where it is planned. Council has, through its Spatial Planning process, begun to plan for what Invercargill's long-term infrastructure needs may be. Council does not anticipate a significant expansion to our infrastructure network. Council will only construct this infrastructure as close to the time as possible to service the need, although revenue collection to fund the project may occur beforehand. The revenue collected prior to undertaking a project would be used to fund the renewal component of the project. Loan funding will still be utilised to ensure that both current and future ratepayers contribute their fair share. Council further undertakes proactive asset management planning to extend replacement timing, reduce the longer term replacement costs and ensure renewals are occurring in the most cost efficient manner.

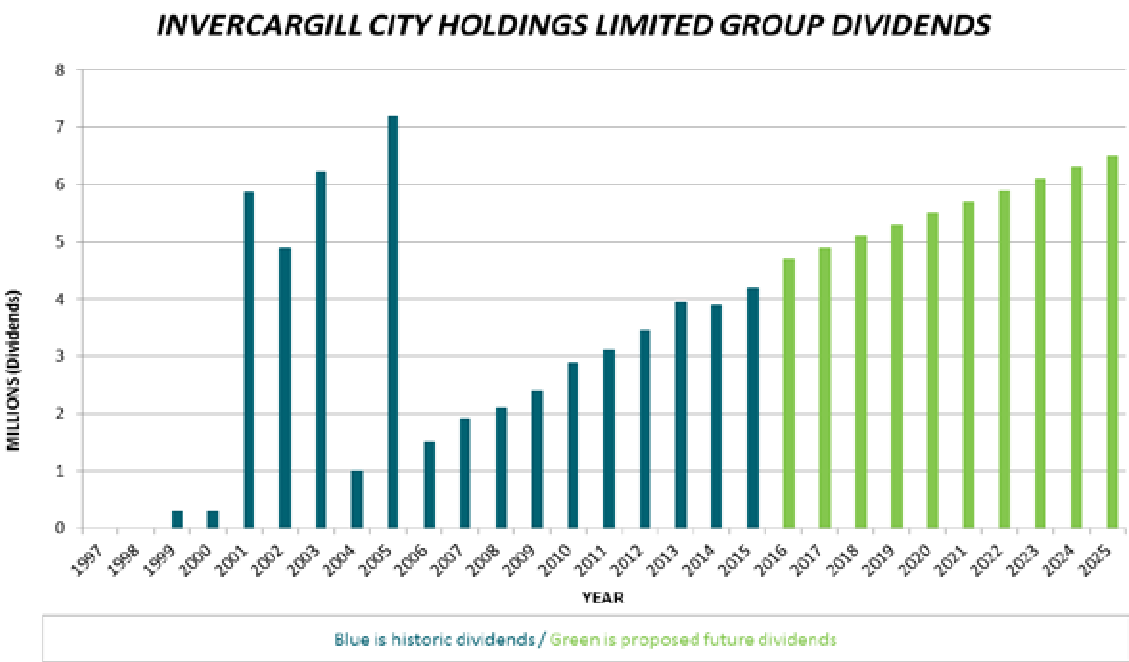
Invercargill City Holdings Limited (ICHL)

Invercargill City Holdings Limited is a 100% owned subsidiary of Invercargill City Council. ICHL was formed to provide a clear differentiation between Council's core ratepayer orientated activities and its commercial trading enterprises and investments. It was established for the purpose of consolidation and management of existing Council companies, with the responsibility of control and oversight of the performance of the Council Owned Companies activities on behalf of the ultimate shareholder, Invercargill City Council.

Companies that sit within the ICHL group include, Invercargill City Forests Limited, Invercargill City Property Limited, Invercargill Airport Limited and Electricity Invercargill Limited (EIL). Within EIL sits a number of utility based entities. One of the main purposes of ICHL is for these individual companies to trade profitably in order for ICHL to return a dividend to Council and help offset the rates demand as a result.

ICHL has historically given a dividend to Council since 1999.

Below is a graph that outlines the history of the ICHL dividend and the proposed dividends over the next 10 years.



As part of the ongoing relationship between ICHL and Council, Council receives regular (six monthly) updates of the financial performance of ICHL. ICHL Statements of Intent further outline this agreement between the parties and the proposed dividend going forward.

FINANCIAL PARAMETERS AND BENCHMARKS

DISCLOSURE STATEMENT

The purpose of this statement is to disclose the Council's planned financial performance in relation to various benchmarks to enable the assessment of whether the Council is prudently managing its revenues, expenses, assets, liabilities and general financial dealings. The Council is required to include this statement in its Long-Term Plan in accordance with the Local Government (Financial Reporting and Prudence) Regulations 2014 (the regulations). Refer to the regulations for more information, including definitions of some of the terms used in this statement.

For the year ended 30 June 2014, the Council was meeting all eight of the prescribed financial benchmarks (further information is available on page 9-16 of the Council's 2013/14 Annual Report). Three of the eight benchmarks are used as Financial Parameters within the Financial Strategy, limit on rates, limit on rates increases and limit on borrowing.

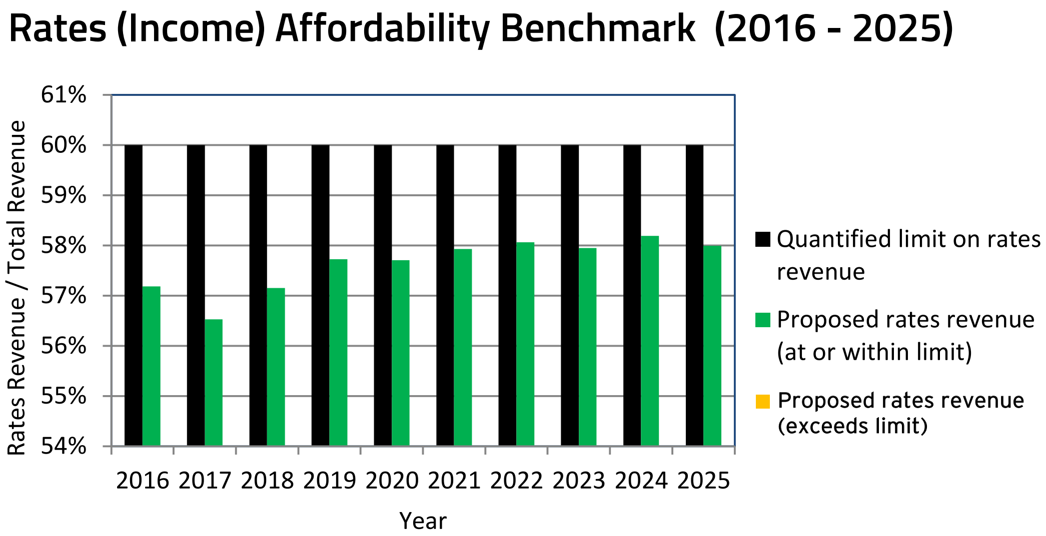
Two of the Financial Benchmarks compare actual performance against planned performance, so therefore cannot be used in the Long-Term Plan document.

While developing this strategy, Council has been acutely aware of the issue of affordability and financial sustainability. To ensure a conservative, prudent approach that considers intergenerational costs and benefits and reflects what the Invercargill Community expects and can afford, the following policy approaches will be taken:

1. Limits on Rates

The Council is required under the Local Government Act to include a statement on quantified limits on rates. The Local Government Rates Inquiry suggests that around 50% of a Council's operating revenue should be taken from rates. Currently Council draws about 57% of its operational revenue from rates and proposes to limit the rates collected each year to a maximum of 60% of total Council revenue.

Council aims to maintain the rates collected to between the range of 50% and 60% of total Council revenue and intends to increase user-pays methods to enable the income required from rates to maintain steady without significant rates increases. Council will



Year	Local Government Cost Index % Adjustment
2015/16	2.24
2016/17	2.45
2017/18	2.53
2018/19	2.61
2019/20	2.75
2020/21	2.90
2021/22	3.04
2022/23	3.19
2023/24	3.36
2024/25	3.53

also seek efficiencies in how services are delivered to assist with maintaining rates revenue at a steady level.

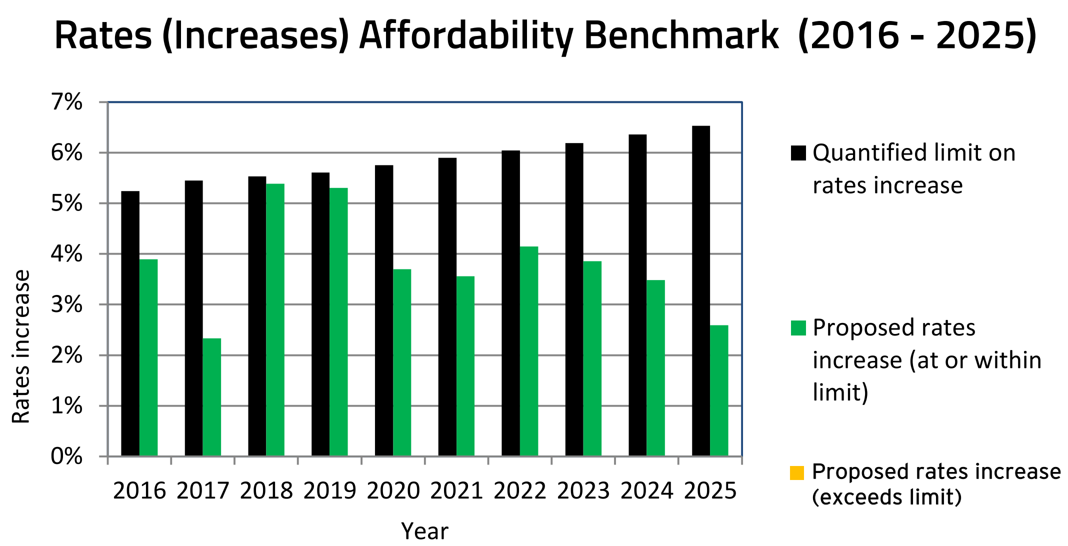
Rates are an important source of funding for Council, but they are not the only source available. You can see more about how Council funds its services in the Financial Management section of this Long-Term Plan. The Council's Revenue and Financing Policy sets out the funding of its operational and capital expenditure and the sources of those funds on an individual activity basis.

Throughout the Plan rates fund approximately 57% of Council's total revenue. This consists of approximately 14% of general rates and 86% of targeted rates. Uniform annual charges (meaning every ratepayer in the district pays the same amount) are also used for services supplied that can be used equally by all members of the community.

The graph on page 46 shows Council's limit on rates over the ten year period of the Long-Term Plan.

2. Limits on Rate Increases

Council recognises that the cost of providing Council's services (LGCI) is rising at a higher rate than the Consumer Price Index (CPI). Council is also mindful of affordability issues amongst our ratepayers. Council continues to investigate cost-cutting methods to ensure that the rates revenue required to run Council is kept relatively steady. The rates increases reflect the money required each year. It is not Council's



practice to rate more than it needs one year (and put that money aside for the following year) to reduce the next year's rates increase.

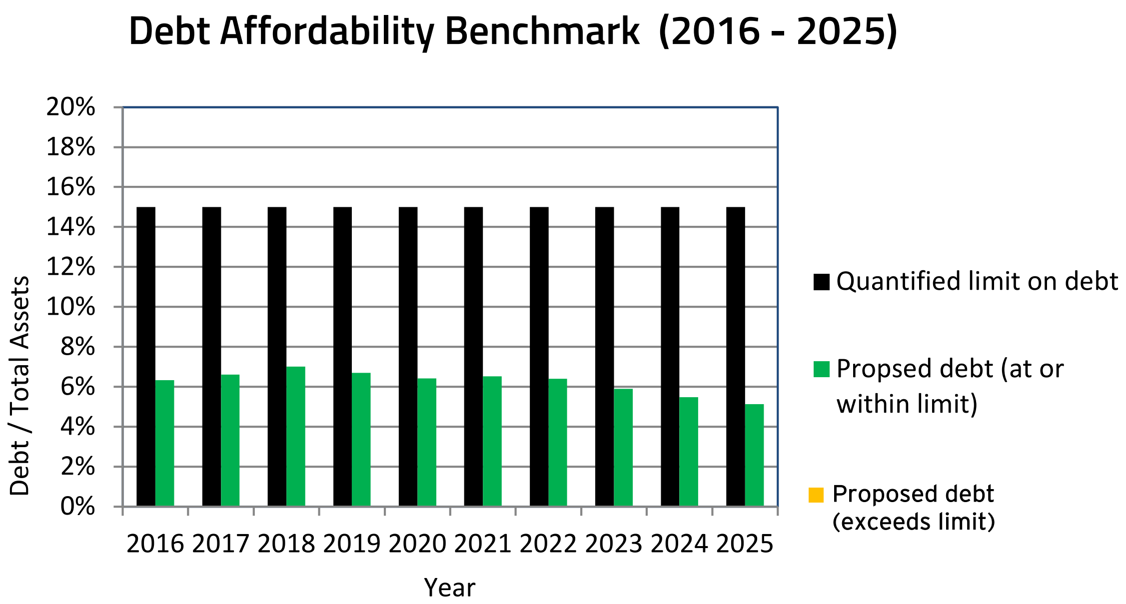
Council is setting a maximum limit on rates increases at the Local Government Cost Index (LGCI) plus 3%. The forecast LGCI increases for the next ten years are shown in the table (page 47), but for example, if the LGCI change was 2.24%, Council's rates increase would be no more than 5.24%. Council recognises that this increase could potentially be higher than household income, so although a maximum limit has been set, Council will endeavour to achieve lower increases when planning projects and services that rely on rates revenue.

The graph on page 47 shows Council's maximum rates increase in line with this policy and also what the projected actual rates increases are for the next ten years.

Changes in the consumer price index (CPI) are used as the basis for measuring the inflation faced by households. It gives a picture of how the prices of the goods and services purchased by the typical New Zealand household are changing over time. It is therefore heavily represented by food, accommodation and transport costs, which collectively make up over 50 percent of the index. The Council however purchases a different mix of goods and services. Council's 'basket' is dominated by changes in the Local Government cost adjustors such as labour costs, land and materials associated with assets. There is therefore a difference between changes in CPI and Council's cost (LGCI). To enable Council to best predict what the future cost of providing Council's services will be, we have based future inflationary costs on the LGCI rather than CPI. The additional 3% is to allow Council to undertake new projects, for example the Branxholme Water Treatment Improvements project, to increase existing levels of service and to meet debt servicing costs.

3. Limits on Borrowing

Council wishes to continue to take a conservative approach to borrowing. Council uses loans to fund new identifiable long-term assets over a period of up to 20 years and does not use loans to fund ongoing annual operating costs. Borrowing is undertaken to ensure that the cost of providing activities or services that have intergenerational benefits are met by both current and future ratepayers.



Borrowing will be kept at a low level, managing exposure to adverse interest rate movements and ensuring rates are kept predictable

The two most common measures of limits on the borrowing of Council are as a percentage of assets or a percentage of income. The current level of borrowing as at 30 June 2014 is 4.01% of total assets or interest expense is 2.66% of total income. During the ten years of the Long-Term Plan, limits on borrowing are anticipated to remain at 7% or below (debt over total assets).

The Council considers that setting a borrowing limit of 15% of assets will assist in prudently managing Council's borrowing activities to ensure the ongoing funding of Council. Council will continue to consider and approve the borrowing requirement for each financial year in the Annual Plan or Long-Term Plan recognising that borrowing capacity does not have to be fully utilised.

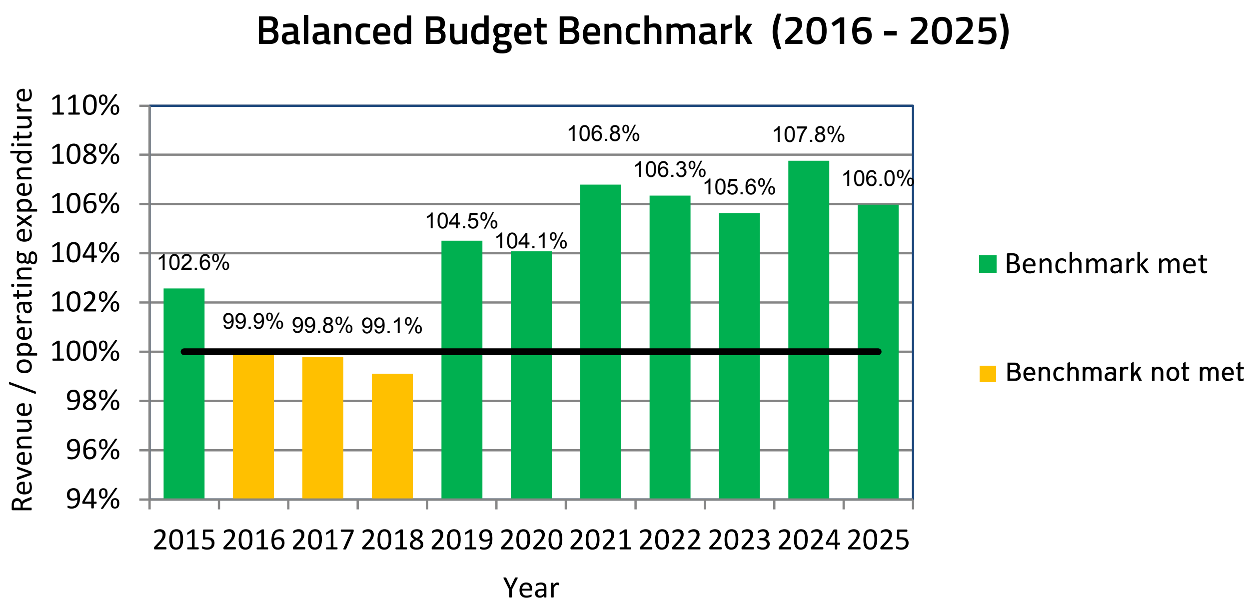
The graph on page 48 shows Council's limits on borrowing over the ten year plan.

4. Balanced Budget Benchmark

The graph below displays the Council's revenue as a proportion of operating expenses. The Council meets this benchmark if its revenue equals or is greater than its operating expenses. In the first three years of this Plan, Council is not meeting the benchmark (is running a deficit). This is due to Council underfunding depreciation for the Roading Activity (in particular footpaths). In years 4 – 10 Council is running operating surpluses, this is due to the increased rate of expenditure on the asbestos cement pipes within the water distribution network.

5. Essential Services Benchmark

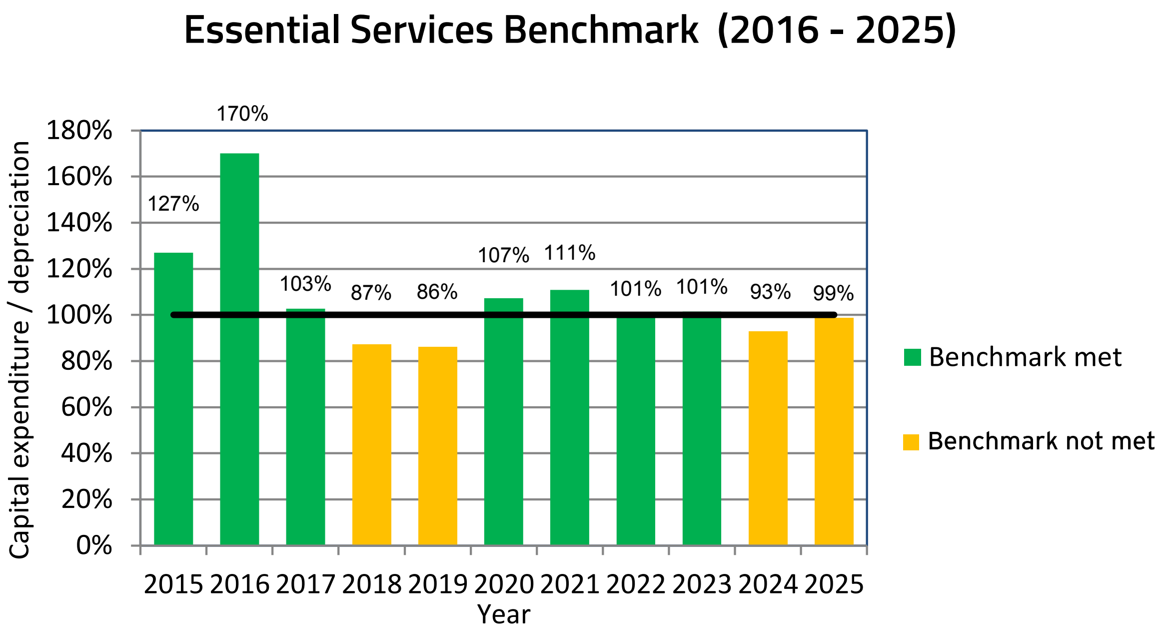
The graph on page 50 displays the Council's capital expenditure on network services as a proportion of depreciation on the network services. The Council meets this benchmark if its capital expenditure on network services equals or is greater than depreciation on network services. Although not

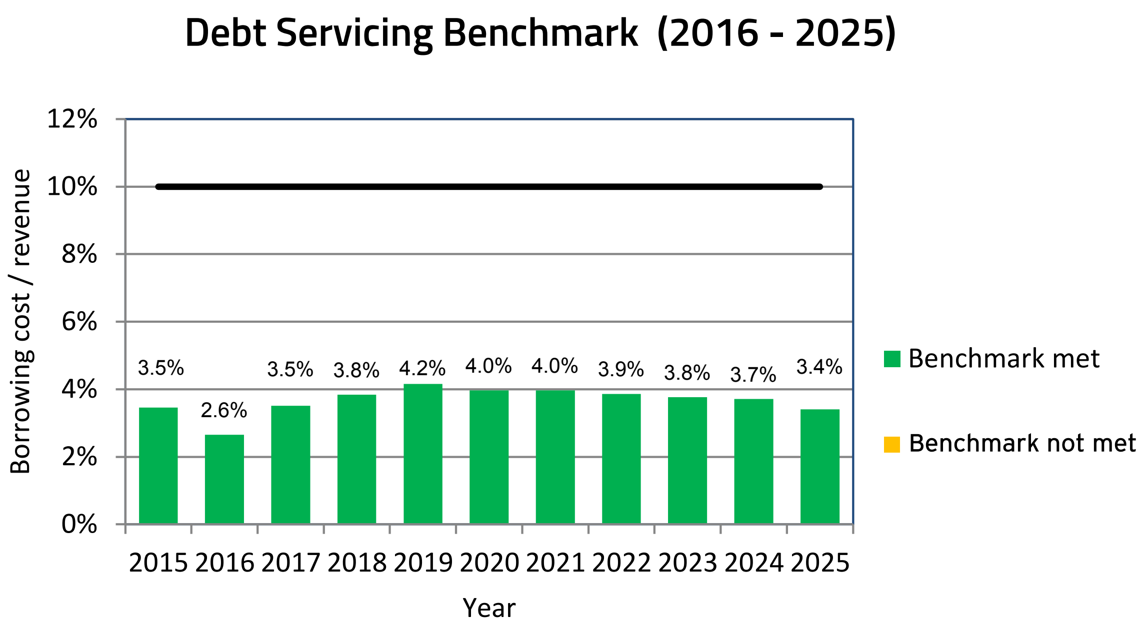


reaching the target in every financial year, over time Council's capital expenditure should equal its depreciation. This will mean Council is replacing its assets as they deteriorate, however due to some projects being large it is hard to assess this on a year by year basis.

6. Debt Servicing Benchmark

The bottom graph displays the Council's borrowing costs as a proportion of revenue. The Council meets the debt servicing benchmark if its borrowing costs equal or are less than 10% of its revenue.





Securities For Borrowing

Council does not currently give securities over borrowings but rather operates under a negative pledge with our funders. A negative pledge prohibits Council from creating any further security interest over the same property, specified in the loan documents, which might compete with the security of the party funding Council.

Council intends to change from this method and to enter into a Debenture Trust Deed in order to achieve greater flexibility in its funding sources. Council anticipates that this may enable the Council to obtain cheaper rates for its borrowing.

A debenture trust deed is a deed entered into between a local authority (Council) and a trustee. Under the deed, the local authority has the ability to issue bonds and other debt instruments to creditors. It is generally used by local authorities to borrow funding from financial institutions.

The local authority is required to grant a security interest in its rates and rates revenue to the 'trustee' under the debenture trust deed. Once security is granted to the trustee, any creditor of the local authority which makes funding available to the local authority under the framework of the debenture trust deed will have the benefit of the security granted to the trustee.

Importantly, the terms of the security will provide that, unless there is an enforcement event (which can only happen if the Council defaults under its debt obligations), the Council is free to set, assess and collect rates and spend the rates revenue as if there was no security in place. However, if there is an enforcement event, the trustee can take control of rates which have been collected and apply them to the repayment of the secured debt, and it can also appoint a receiver that is entitled to assess and collect a rate on behalf of the local authority to recover the secured debt.

Holding and Managing Financial Investments and Equity Securities

An investment is an asset held by Council that provides service potential or future economic benefit to Council. Investments include property, ownership in Council related trading entities and financial assets. A financial asset is any asset that is cash or the contractual right to receive cash including financial investment instruments.

Council holds financial investments sufficient to match reserve accounts created by Council resolution and as a result of short term cash flow surpluses.

The Council recognises that as a responsible public authority, any investments that it does hold should be of a relatively low risk. It further recognises that lower risk generally means lower returns. Council aims to maximise investment income within a prudent level of investment risks. Council currently has money invested with banks in New Zealand. Council aims to achieve market rates for these investments. Council may also consider using investment funds for strategic assets where this could result in lower than market rate returns.

Council's quantified target for returns on financial investments is to achieve a return equivalent to market rates. Council will ensure that all funds are placed in suitable deposit accounts and no excess funds will remain not on deposit for more than 90 days. This is Council's current practice.

Throughout the Long-Term Plan development process, Council has assessed its ability to maintain existing levels of service within the rates and debt limits set in this Financial Strategy. Council has determined that it can maintain current levels of service and meet additional demand for services while remaining within the rates and debt limits.

FUNDING IMPACT STATEMENT - INVERCARGILL CITY COUNCIL

	Annual Plan	Long Term Plan 2015 - 2025		
	2014/15 ($'000)	2015/16 ($'000)	2016/17 ($'000)	2017/18 ($'000)
SOURCES OF OPERATIONAL FUNDING				
General rates, uniform annual general charges, rates penalties	7,054	6,898	6,676	6,781
Targeted rates	38,806	40,737	42,069	44,574
Subsidies and grants for operating purposes	3,476	3,311	3,376	3,500
Fees and charges	12,810	13,661	15,181	15,907
Interest and dividends from investments	4,601	4,915	4,971	5,220
Local authorities fuel tax, fines, infrigements fees, and other receipts	9,196	8,757	8,726	8,833
Total operating funding	**75,943**	**78,279**	**80,999**	**84,815**
APPLICATIONS OF OPERATIONAL FUNDING				
Payment to staff and suppliers	58,426	60,168	61,407	66,777
Finance costs	2,773	2,182	2,990	3,411
Other operating funding applications	0	0	0	0
Total applications of operational funding	**61,199**	**62,350**	**64,397**	**70,188**
Surplus (deficit) of operational funding	**14,744**	**15,929**	**16,602**	**14,627**
SOURCES OF CAPITAL FUNDING				
Subsidies and grants for capital expenditure	3,782	3,651	3,601	3,414
Development and financial contributions	0	0	0	0
Increase (decrease) in debt	3,336	14,854	5,691	3,076
Gross proceeds from sale of assets	152	202	143	146
Lump sum contributions	0	0	0	0
Other dedicated capital funding	0	0	0	0
Total sources of capital funding	**7,270**	**18,707**	**9,435**	**6,636**
APPLICATION OF CAPITAL FUNDING				
Capital expenditure				
- to meet additional demand	271	1,156	41	42
- to improve the level of service	7,806	9,303	1,704	1,457
- to replace exsting assets	16,919	27,330	22,922	18,421
Increase (decrease) in reserves	(2,982)	(4,153)	383	370
Increase (decrease) in investments	0	1,000	987	973
Total application of capital funding	**22,014**	**34,636**	**26,037**	**21,263**
Surplus (deficit) of capital funding	**(14,744)**	**(15,929)**	**(16,602)**	**(14,627)**
FUNDING BALANCE	**0**	**0**	**0**	**0**
Depreciation expense (not included in the above FIS)	19,676	22,229	24,019	22,864

2018/19 ($'000)	2019/20 ($'000)	2020/21 ($'000)	2021/22 ($'000)	2022/23 ($'000)	2023/24 ($'000)	2024/25 ($'000)
7,148	7,117	7,275	7,353	7,361	7,587	7,649
46,916	48,940	50,772	53,096	55,416	57,375	59,001
3,474	3,639	3,634	3,731	3,834	3,954	4,082
16,409	16,947	17,600	18,218	18,799	19,431	20,115
5,480	5,706	5,926	6,149	6,381	6,633	6,921
9,054	9,517	9,552	9,828	10,221	10,450	10,805
88,481	**91,866**	**94,759**	**98,375**	**102,012**	**105,430**	**108,573**
64,111	65,903	67,445	69,395	71,672	73,925	76,389
3,848	3,815	3,930	3,977	4,032	4,095	3,871
0	0	0	0	0	0	0
67,959	**69,718**	**71,375**	**73,372**	**75,704**	**78,020**	**80,260**
20,522	**22,148**	**23,384**	**25,003**	**26,308**	**27,410**	**28,313**
3,561	3,601	3,688	3,899	4,402	4,200	4,287
0	0	0	0	0	0	0
(2,638)	2,688	1,225	(987)	76	(4,041)	(3,313)
170	200	177	177	176	233	211
0	0	0	0	0	0	0
0	0	0	0	0	0	0
1,093	**6,489**	**5,090**	**3,089**	**4,654**	**392**	**1,185**
118	122	46	47	48	50	52
2,716	3,932	2,006	1,785	993	1,174	1,944
18,323	24,265	26,070	25,772	29,158	25,281	28,482
498	360	397	537	815	1,352	(921)
(40)	(42)	(45)	(49)	(52)	(55)	(59)
21,615	**28,637**	**28,474**	**28,092**	**30,962**	**27,802**	**29,498**
(20,522)	**(22,148)**	**(23,384)**	**(25,003)**	**(26,308)**	**(27,410)**	**(28,313)**
0	**0**	**0**	**0**	**0**	**0**	**0**
24,510	26,400	25,360	27,434	29,776	28,547	30,871

Invercargill
CITY COUNCIL