

**TO: COUNCIL**

**FROM: DIRECTOR OF FINANCE AND CORPORATE SERVICES**

**MEETING DATE: TUESDAY 30 JANUARY 2018**

<b>UNBALANCED BUDGET</b>
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**Report Prepared by:** Melissa Short – Strategy and Policy Manager  
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**SUMMARY**

<p>Under the Local Government Act 2002, Council is required to set a balanced budget where operating revenue is equal to expenditure. Council may only operate an unbalanced budget where this can be shown to be financially prudent. Council intends to operate an unbalanced budget during the term of the Long-term Plan.</p>
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**RECOMMENDATIONS**

**That the unbalanced budget proposed in the Draft Long-term Plan is considered by Council to be prudent in the circumstances of Council’s current financial situation;**

**AND**

**That the Director of Finance and Corporate Services be authorised to include a statement within the Financial Strategy disclosing that there is an unbalanced budget and the reasons for it;**

**AND**

**That the Consultation Document include the statement contained within the body of this report to disclose the unbalanced budget and reasons for it.**

**IMPLICATIONS**

1.	<p><i>Has this been provided for in the Long Term Plan/Annual Plan?</i></p> <p>This forms part of the development of the Long-term plan.</p>
2.	<p><i>Is a budget amendment required?</i></p> <p>No</p>
3.	<p><i>Is this matter significant in terms of Council’s Policy on Significance?</i></p> <p>No</p>
4.	<p><i>Implications in terms of other Council Strategic Documents or Council Policy?</i></p> <p>No</p>
5.	<p><i>Have the views of affected or interested persons been obtained and is any further public consultation required?</i></p> <p>The unbalanced budget is highlighted in the Financial Strategy that will be available as supporting information to the Consultation Document; it is also referenced in the Consultation Document, and open for submission during the Long-term Plan consultation process.</p>

6.	<i>Has the Child, Youth and Family Friendly Policy been considered?</i> N/A
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## **FINANCIAL IMPLICATIONS**

No financial implications arise from this report.

## **BALANCED BUDGET REQUIREMENT**

Under the Local Government Act 2002, local authorities are required to set balanced budgets, where operating revenue is equal to expenditure. Council's may operate an unbalanced budget only where this can be shown to be financially prudent.

## **ASSESSMENT OF SECTION 100(2) OF THE LOCAL GOVERNMENT ACT**

Section 100(2) of the Local Government Act 2002 (LGA) sets out the matters that Council must have regard to when determining that it is prudent to operate an unbalanced budget.

These matters are:

- (a) the estimated expense of achieving and maintaining the predicted levels of service provision set out in the Long-term Plan, including estimated expenses associated with maintaining the service capacity and integrity of assets throughout their useful life; and
- (b) the projected revenue available to fund the estimated expense associated with maintaining the service capacity and integrity of assets throughout their useful life; and
- (c) the equitable allocation of responsibility for funding the provision and maintenance of assets and facilities throughout their useful life; and
- (d) the funding and financial policies adopted under section 102.

The following paragraphs are the staff assessment of the matters included in section 100(2) as they relate to the unbalanced budget proposed.

The proposed Long-term Plan has set projected operating revenues for some years at levels less than would be required to meet projected operating costs (**Appendix 1**). This occurs in all years with the exception of 2021/22 and 2026/27 where operating surpluses are recorded. The key reason for the unbalanced budget deficits in these years is that the full cost of depreciation within the infrastructure areas of Council is not being fully met. Over the course of the ten year plan the gaps between depreciation and funding decreases. The Council moves towards 100% funding by the end of the Long-term Plan period. Council has decided that it is prudent to take this approach as it allows Council to achieve its long-term goal but in a way and pace that is affordable to our ratepayers.

In certain years the depreciation gap deficit is somewhat offset by the receiving of subsidies and grants for capital projects. This occurs in the 2019/20 and 2020/21 years with a grant being received for the Living Dinosaurs Experience project and for the new pool at Splash Palace. Both grants will be used for capital development rather than for operating expenditure, resulting in reduced deficits in those years. The 2021/22 year proposes a large grant (\$9.7 million) being received for the proposed new Art Centre, this results in a surplus being recorded in that year.

The 2022/23 and 2023/24 years again see deficits being recorded due to underfunding of depreciation, although the deficit is steadily decreasing. The 2024/25 year sees a large deficit due to Council paying a significant grant for the Regional Storage Facility. 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 \$8.5 million in one year.

The 2025/26 year sees a smaller deficit as the depreciation funding gap is now reducing. The 2027/28 year has a large deficit; this is due to the payment of a grant to the Southland Museum and Art Gallery Trust Board for the redevelopment of the Museum facility. The grant will be funded by a loan. As above, 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 \$10.8 million in one year.

## **ASSESSMENT OF SECTION 101 OF THE LOCAL GOVERNMENT ACT**

Section 101 of the Local Government Act requires that Council manage its revenues, expenses, assets, liabilities, investments, and general financial dealings prudently and in a manner that promotes the current and future interests of the community.

In all years the reason for not balancing the operating budget has been to keep projected rate increases within what Council considers to be reasonable levels to ensure that the increases are affordable for our Community.

Given Council's healthy financial position, and the detailed assessments and programming that have been made for expected infrastructure renewals, there is confidence that a high degree of financial sustainability will be retained on an ongoing basis. The Council is running a deficit in eight of the ten years, but as this mainly relates to non-cash depreciation, Council will still be in a position to meet all of its operating requirements.

The unbalanced budget is prudent financial management in Council's current financial state and best promotes the current and future interests of the community.

## **LONG TERM PLAN AND CONSULTATION DOCUMENT**

Council must disclose the fact that the budget is not balanced and the reasons for the budget not being balanced within its Long-term Plan and also in the Consultation Document. Staff recommend using the text, included under "Assessment of Section 100(2) Local Government Act 2002" as part of the Financial Strategy as the means of including it within the Long-term Plan.

Staff further recommend that the following statement be included within the Consultation Document, under the Financial Strategy Summary:

*The Council is required to develop budgets where income equals expenditure. Over the next ten years there will be eight years where we will not be achieving this.*

*We are doing this for three reasons:*

- 1. To manage the level of rates increases over the ten years by avoiding significant fluctuations.*
- 2. To reflect the underfunding of infrastructure asset depreciation, particularly within the early years of the plan, with the goal being 100% funding of depreciation by 2028.*
- 3.. To enable us to provide the \$8.5 million grant towards the capital development of a Regional Storage Facility in 2021/22 and the \$10.8 million grant to the Southland Museum and Art Gallery Trust for the redevelopment of the Southland Museum in 2027/28, both being funded by loans rather than rates.*

*The Council is taking this approach because we are in a healthy financial position and we are confident that we are managing operating and capital expenditure to provide our community with the most cost effective solution.*

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