Financial Strategy

Purpose

This strategy sets out how the Otago Regional Council will manage its finances over the next 10 years. It outlines the financial direction Council wishes to take on matters such as levels of future rating, borrowings and investments and discusses factors that influence those areas. These matters have a significant influence on Council's ability to deliver against the six focus areas defined in our 'Strategic Direction 2024-2034' including: the community outcome aspirational statements and associated goals. The 10-year work program that delivers progress against our strategic intent must be implemented in consideration of what is affordable to the community. This financial strategy sets out a path for the prudent and sustainable funding of this Long-Term Plan.

Executive Summary

Over the previous Long-Term Plan period (2021-2024) Council increased its work program to reflect increased Central Government requirements and community expectations. This resulted in significant rates increases over the last three years. This Long-Term Plan (2024-34) reflects that increased work program and also has identified areas that still require further investment especially in public transport and infrastructure activities.

Council has undertaken a review of its funding and rates to ensure funding of the future work program is sustainable and affordable over the long term while also meeting immediate funding requirements. This has resulted in a change to the period over which capital expenditure is funded and a corresponding increase in external borrowing. Changes to rates are outlined in this strategy and in the Revenue and Financing Policy which has been reviewed resulting in a number of rates changes that are proposed in this Long-Term Plan.

Additionally, over previous years Council has relied on reserves to fund increases in operating expenditure especially in public transport. Going forward Council aims to 'balance the budget' and have operating expenditure funded as it occurs. The changes proposed for public transport rates achieves this going forward but there are also existing deficits in transport reserves that need to be addressed. This financial strategy and the Revenue and Financing Policy address this issue and assumes those deficits will be paid off under the existing rating policy over the first 3 years of this 10-year plan.

Over the next 10 years the key financial challenges and how Council is proposing to address them in this financial strategy are:

- There is a significant increase in planned expenditure occurring in the Infrastructure Strategy 2024-2054 and in public transport. That requires a corresponding increase in expenditure and funding in the Long-Term Plan.
- There will be an increased use of debt and reserves over the life of this plan. This reflects a change to extend repayment of capital expenditure to better reflect the life of those assets. Capital repayment is now assumed to occur over a 30-year period. External debt is forecast to increase from $25M to $105M to fund the resulting reserve deficits.
- Existing public transport deficits are proposed to be repaid over the first 3 years of the plan. This will be done on the existing rating basis and a new rating basis is proposed going forward and ensures public transport operating costs are fully funded in the year they occur.
- An extensive review of Council's Revenue and Financing Policy (RFP) has been undertaken. This included establishing a set of funding principles and completing funding needs analysis for all of Council's activities. As a result, a number of new and amended rates are proposed. This reflects changes in those activities over time and the need to ensure funding is sustainable, consistent and transparent. The key rates changes (outlined in the Revenue and Financing Policy) are:
    - A new catchment management rate has been introduced. This will fund biosecurity and catchment activity including integrated catchment management and liaison group activity across the region. These activities were previously funded by a mix of general rates, general reserves, river and waterway management targeted rates and the rural water quality rate (which has been disestablished).

    - Flood and drainage general rate allocations have been amended to apply a consistent targeted / general allocation across all schemes. Flood schemes now assume an 80% targeted / 20% general split and drainage schemes assume 90% targeted / 10% general.
    - Differentials within the flood and drainage targeted rate allocation have been simplified and reduced to one or two differentials.
    - Lower Waitaki River Control has been amended and is now funded by the River and Waterway Management Rate – Waitaki moving funding to be district wide as opposed to a smaller defined area.
    - A 20% general rate allocation has been introduced for public transport. The targeted rate has also been amended to be funded over the entire district (Dunedin or Queenstown Lakes) and is now charged on a uniform basis.
    - The existing transport rate zones for Dunedin and Whakatipu are retained, and historic deficits will be repaid by those ratepayers on a CV basis over the first 3 years of the Long-Term Plan.
    - A new rate is proposed for Oamaru transport to fund the on-demand trial requested by that district. Consistent with other public transport rates, this rate will fund 80% of the rate requirement with 20% being general rate funded. The targeted rate will be funded over the entire Waitaki district on a uniform basis.
    - A new navigational safety rate has been introduced. This is charged on a uniform basis in the districts where Council provides Harbourmaster services (Central Otago, Clutha, Dunedin and Waitaki). Previously this was funded through sub-regional general rates.
    - A new farm plan rate is proposed for year 2 at which time the existing dairy monitoring rate will cease.
    - General rates are now only allocated on a region wide basis. The use of sub-regional (district based) general rates has been removed and those activities are now funded by new targeted rates i.e. catchment management, navigational safety. If the activity doesn't justify establishing a new targeted rate other targeted rates have been used where possible i.e. river and waterway management or general rates if no alternative exists or the amount being rated doesn't justify establishing a separate rate.
- To reduce the rates increases, Port Otago dividends are forecast to increase from current levels ($15 million in 2023-24 and provide $18 million in year 1 (2024-25) rising to $20 million in year 2 (2025-26) and remain at that level for the remainder of the Long-Term Plan.

Background

For the 10-year period of this plan, work programs and initiatives have been developed that will contribute to achieving Council's 'Strategic Directions 2024-2034'.

Our process to develop our work program was comprised of the following steps:

- Understanding of the 'status quo' regarding service delivery. As a group the elected regional Councillors received presentations from managers across all Council activity. Output from these presentations remained accessible and served as a benchmark for Long-Term Plan decision-making.
- Future work programme possibilities. Both Councillors and executive leadership identified and prioritised where current Council activity could change. The preceding consideration of Council 'Strategic Directions 2024-2034' provided critical context for where and why this change might occur. Importantly council staff also provided feedback, via the executive, on their perspective about service direction.
- Councillors directed staff to focus on 12 priority initiatives – reporting back on the delivery, financial and any other relevant considerations.
- Infrastructure Strategy – council staff reported the key issues that would underpin the draft strategy. This provided Councillors an opportunity to 'cross check' against the 12 priorities and direct staff on the scope of the strategy.
- Activity build and service proposals – council staff drafted business plans and detailed financial budgets based on the preceding direction. Three key proposals for community consultation were identified and drafted for Council consideration along with the draft Infrastructure Strategy.
- Consolidation of Councils draft activity build – Councillors were presented with the draft work programs, budget estimates and the funding impact.

- Final direction and decisions to the Long-Term Plan proposal for community consultation.
- Importantly, the reviews of both this Financial Strategy and the Revenue and Financial Policy occurred in parallel to the steps above. The content of the Financial Strategy had a direct relationship with the financial implications of proposed service delivery. The Revenue and Financing Policy review was focused on the political and community acceptance of how rating would be used to fund future services.

The programs and initiatives that resulted from the above process come at a cost. Affordability and sustainability for ratepayers is a key aspect of this strategy and Council is mindful of the potential burden on ratepayers to fund the proposed work program. Council's Revenue and Financing Policy details how each of its activities are funded, whether through rating, fees and charges, or some other form of funding. In doing so, Council has given consideration to community outcomes, benefits, what causes the need for the activity, whether separate funding is justified and the overall impact on community wellbeing.

Council holds a number of investments and the income derived from those investments is used to contribute to the cost of our work. All ratepayers benefit from this income, as the contribution is used to reduce the general rate requirement each year. Council's Treasury Management Policy (TMP) provides a framework for how Council manages its borrowing and investments. A Statement of Investment Policy and Objectives (SIPO) has been adopted to provide further parameters around the management of Council's long-term investment portfolio.

Council has a strong balance sheet and uses its financial position strategically to preserve the financial stability it currently enjoys. Historically, Council had preferred to use internal borrowing, that is, to lend from its surplus reserves to fund certain activities, as the cost of internal borrowing had been lower to the ratepayers than if Council were to borrow externally. In the last Long-Term Plan Council introduced external borrowing as continued internal borrowing was no longer sustainable. Further increases in levels of expenditure, especially capital expenditure, means external debt will increase further over the 10 years of this Long-Term Plan.

Principles

This financial strategy is based on the following financial principles:

- **Prudence**
  Council will not take undue financial risks and aims to ensure spending and funding requirements are affordable and sustainable.
- **Fairness**
  Council will ensure spending reflects the needs of the community and that those who enjoy the benefit of that spending or are responsible for that spending occurring pay a fair share to fund that spending. That includes providing for intergenerational and community equity in both expenditure and funding decisions.
- **Value for money**
  Council will ensure that all expenditure provides the best possible value for money in terms of impact and effectiveness. That includes considering the lifetime cost and most efficient form of funding for that expenditure.
- **Transparency**
  Council aims to provide clear information to the community on its financial direction and decision-making framework Council is undertaking around that financial direction.

Key issues that have a significant financial impact

There are key issues associated with the Long-Term Plan 2024-34 that have significant financial impacts. They include:

- Effects of the changing climate on our region's indigenous biodiversity, our ability to grow food, and the impacts of storm and flood events on ORC flood protection and drainage infrastructure.
- Political aspirations and policy direction for the provision of future public transport services.
- Political aspirations and policy direction for the provision of future flood protection and drainage services.
- Increasing environmental degradation, decreasing access to freshwater and other pressures on natural resources.
- The tension between land use intensification, both rural and urban, and national direction to maintain and improve our freshwater resource.

- Inflation driven by geopolitical instability, overseas conflicts, rising energy prices, a tight labour market and the ongoing effects of Covid-19.

Council is addressing these issues in the following ways:

- Taking a collaborative and inclusive approach for achieving acceptable environmental, economic and social outcomes in particular for land and water, and climate adaptation issues.
- Council has the expectation that national direction on climate change will continue to strengthen, and that community resilience and transport will remain a significant part of achieving desired outcomes. Over this LTP cycle the Council will begin acting on its Climate Change Strategy in partnership with others. This LTP is also investing to grow patronage over time via improving public passenger transport services.
- Our Infrastructure Strategy is an important component of deciding how Otago communities adapt to change and it signals a commitment to ensure our existing flood protection infrastructure can perform to the agreed and communicated standards.
- This LTP continues to ensure our operational response to maintaining and improving Otago's natural environment is appropriate.
- The Councils regional planning framework and programme remains a critical component for managing the regions approach to natural resources, particularly land and freshwater.
- In conjunction with regional planning the Council is continuing to support integrated catchment planning – working with communities to achieve desired environmental results.
- The LTP currently does not include provision for any substantive Air implementation programme. There is an expectation that a 'Regional Plan: Air' will be completed in this LTP plan cycle.

Other assumptions that have a financial impact

Population growth

In the 10 years from 2023, the region's population is projected to increase by 6% (16,100 people) each year to reach 264,700 (Source: Statistics New Zealand subnational population estimates). Population within the Queenstown Lakes and Central Otago districts is forecast to grow significantly over the next 10 years, with much smaller increases in Clutha, Waitaki and Dunedin. Otago's median age is forecast to increase, with fewer in the under 15 age group and more in the over 65 age group than the New Zealand average.

Currently there are approximately 124,000 ratepayers in Otago. The forecasted growth outlined above will translate into an increase in the ratepayer base. Over the 10-year period the population growth could translate to growth of the ratepayer base of approximately 20,000 (i.e. approx. 16%). This level of growth will impact on the level of activity undertaken by Council over the 10-year period, including in the areas of public passenger transport and urban development, and management of natural resources such as fresh water and land. This Long-Term Plan makes provision for a program of work that builds into the requirements of growth alongside other non-growth-related issues.

Economic growth, employment, and technology

In 2022, Otago's regional Gross Domestic Product (GDP) was valued at $15,901 million. This reflects an annual increase of 6.3%, which was higher than the national average of 5.3%. The top three industries in terms of GDP were construction; professional, scientific and technical services; and agriculture, forestry and fishing. Available economic modelling suggests that Otago's GDP growth in the 10 years from 2020-2030 will be around 14% in total, which is lower than in the prior 10 years (30%). This may constrain resources and funding.

Otago districts have different economic structures. Clutha and Waitaki's economies are focused heavily on the primary sector and have a bigger manufacturing sector than other districts. Dunedin's economy is relatively concentrated on tertiary sectors i.e. food and accommodation, retail and health and social services. Central Otago's economy relies more on both the primary and the tertiary sector. Queenstown Lake's economy has the highest tourist concentration in the region.

The region's employment growth in the 10 years to 2030 is estimated to be 13% (or 1,700 people per year on average), which is lower than the previous 10 years (22%). The construction, health care and social assistance, and accommodation and food services sectors are estimated to be the top three sectors in the region by employment by 2030. The prominence of these sectors varies significantly across the region.

Technology advances will have a profound impact on environmental management (for both Council and primary producers), consumer expectations, and transport systems. Technological innovation will continue to transform the economy and the way people live and work in Otago.

Role of Council

Changes in Government policy will directly impact the roles and responsibilities of Council. This plan assumes that there will be changes in the legislation that will impact on Council's work programs over the next 10 years. Implementing new legislative requirements has been considered in the development of our work program. It is assumed that any further legislative changes will include a transition period to understand and implement these changes.

Council is anticipating reform and policy change in the areas of: resource management (at system level), water services, freshwater and land management (including the National Planning Framework), climate change and public transport.

Natural hazards and climate change

Otago is exposed to a large range of natural hazards including floods, landslides, debris flows, droughts, earthquakes and tsunamis. These pose a risk to the wellbeing of people in Otago through impacts on public safety, housing, infrastructure and the economy. Most of the region's population lives within five kilometres of this coastline and several communities along the coast have a level of exposure to hazards from elevated sea level and coastal erosion.

Climate change projections for the Otago region include warmer temperatures, with more hot days and fewer frosts. Winter and spring are expected to be wetter, but with significant decreases in seasonal snow likely. More severe extreme rainfall events are anticipated, as is the severity and frequency of windy days. Even with intervention, sea level rise is expected for the next 100 years and more. Hazards associated with these changes in climate are likely to include increased flooding and landslides, drought, coastal inundation and erosion, and increased instances of wildfire.

Climate change will increase the severity and frequency of the natural hazards that we experience in New Zealand, including flooding, heatwaves, drought and wildfire.

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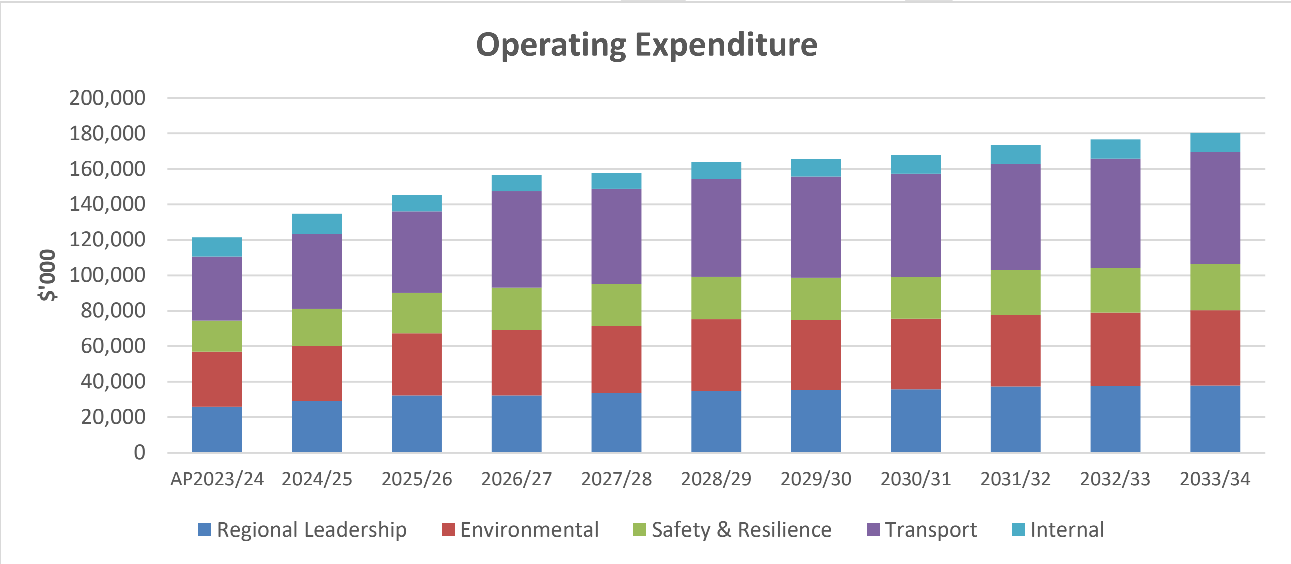
Expenditure

Operating expenditure

Council's strategy is that operating expenditure is fully funded from operating revenue, being rates, fees and charges, grants, investment and other income. Council's strategy is also that it will not use reserves to fund day to day, business as usual type operating costs, as this is not considered a prudent use of reserves. There are, however, special cases where Council's revenue policy does allow for operating expenditure to be funded from general reserves, for example, specific one-off activities or projects and activities have benefits that continue over the following years.

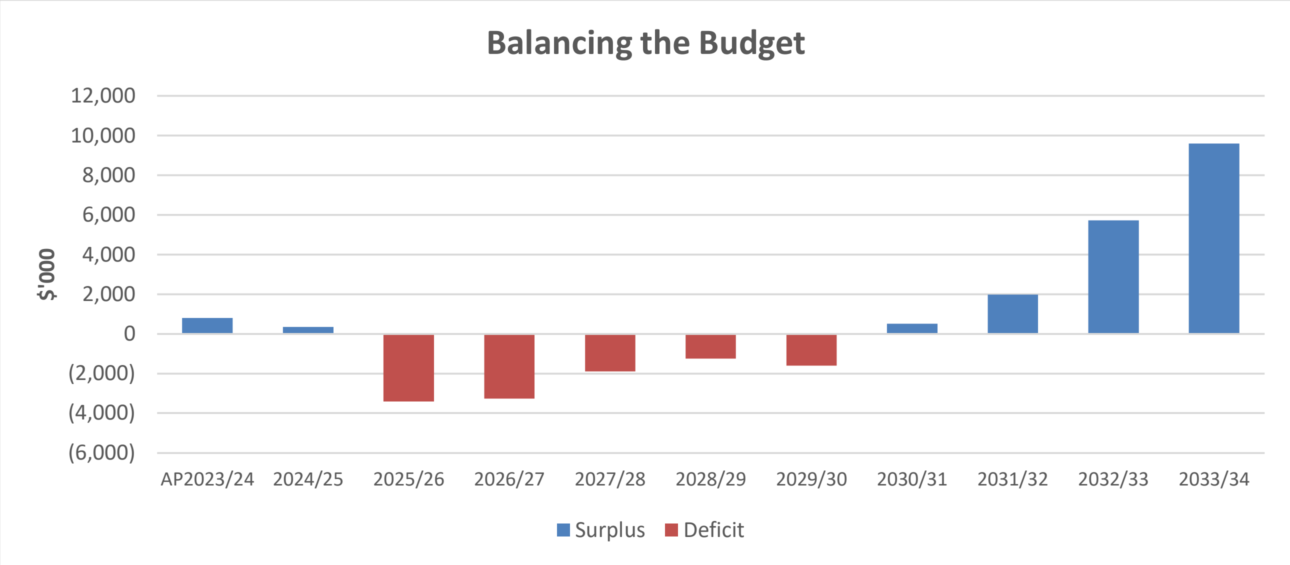
Council has a number of activities which are funded by targeted rates, such as public passenger transport, flood and drainage schemes, and river and water management. Reserves are maintained for activities funded by targeted rates. There are times when these reserves may be used to fund scheme operating costs, to allow certainty around the level of rates that are required from year to year. Expenditure in these activities can be volatile in nature, with some years spend being very high, and other years very low. Targeted rate reserves are used to help smooth the impacts of these variations in expenditure. Targeted rate reserve deficits may be internally or externally debt funded.

The graph below shows estimated operating expenditure over the 10-year period of the Long-Term Plan, by significant activity.



Operating surplus and balancing the budget

Council is required to ensure that for each year, estimated revenue is sufficient to cover its estimated operating costs. Council is however allowed to set its revenue at a different level if it resolves that it is financially prudent to do so. It is estimated that in years 2 to 6 of this plan, the estimated revenue will not cover estimated operating costs.



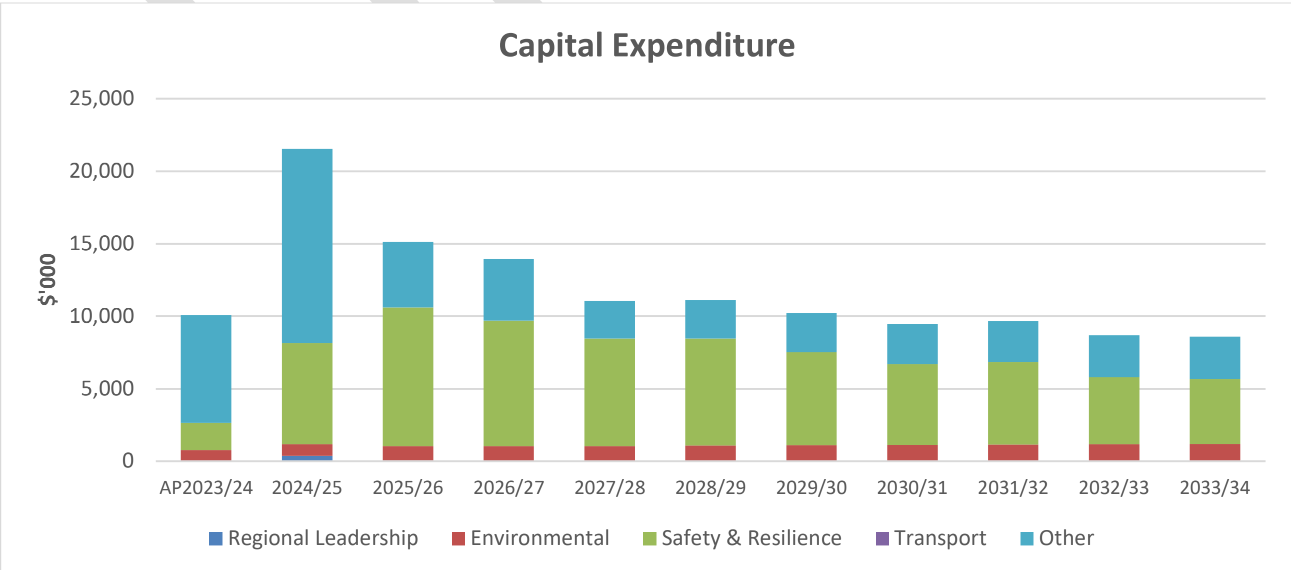
The primary reason for the shortfall in revenue is that Council plans to use reserves to smooth rates increases required to fund infrastructure operating expenditure. Infrastructure expenditure in flood, drainage and river management activities is estimated to exceed revenue by $4.5 to $5 million per year over the first 3 years of the Long-Term Plan. This deficit reduces to $3 million in year 4 and $1.5 million in year 5 as rates revenues increase.

In years 1 to 3 the infrastructure deficit is offset by $3 to $3.5 million per year of surplus generated from the repayment of public transport reserve deficits. A one-off property sale disposal in year 1 results in an overall surplus in that year.

Capital expenditure

Most infrastructural assets, such as floodbanks, pump stations and drains, belong to flood and drainage schemes. Ratepayers within these schemes fund the depreciation on these assets through targeted rates. Each scheme has its own reserves made up of funded depreciation, unspent targeted rates and interest earned on reserve balances. These reserves are used to fund capital expenditure. If there are insufficient reserves available to fund the capital expenditure, then either internal or external borrowing will be used.

The graph below shows estimated capital expenditure over the 10-year period of the Long-Term Plan, by significant activity.



Scheme Infrastructure Asset Investment

A significant increase in expenditure is required during the life of this plan on flood, drainage and river management scheme infrastructure. Generally, capital works in established schemes are funded by the depreciation reserve built up for each of the schemes, and maintenance work is funded by targeted scheme rates. However, depreciation reserves are not always sufficient to cover capital investment so increases in targeted rating have been planned where appropriate, along with the utilisation of internal and external borrowings.

The planned capital expenditure for each scheme over the 10-years is as follows:

	LTP 2021-31			LTP 2024-34			Change
	Inc in Level of Service $'000s	Renew / Replace $'000s	Total 10-Years $'000s	Inc in Level of Service $'000s	Renew / Replace $'000s	Total 10-Years $'000s	Total 10-Years $'000s
Alexandra Flood	-	41	41	-	-	-	(41)
Leith Flood Protection	-	1,823	1,823	-	4,669	4,669	2,846
Lower Clutha Flood & Drainage	307	2,251	2,558	788	15,848	16,636	14,078
Lower Taieri Flood Protection	-	7,915	7,915	-	23,598	23,598	15,684
West Taieri Drainage	3,405	4,581	7,986	-	5,907	5,907	(2,079)
East Taieri Drainage	1,729	2,327	4,056	-	5,295	5,295	1,239
Tokomairiro Drainage	-	233	233	-	1,991	1,991	1,758
Total	**5,441**	**19,170**	**24,611**	**788**	**57,308**	**58,096**	**33,485**

Each scheme has its designed level of service (or protection). Climate change risk assessment work for the Taieri Plain, Clutha Delta and South Dunedin continues within this Long-Term Plan. This work will influence future decisions on infrastructure and associated levels of service for existing flood and drainage schemes and non-scheme areas.

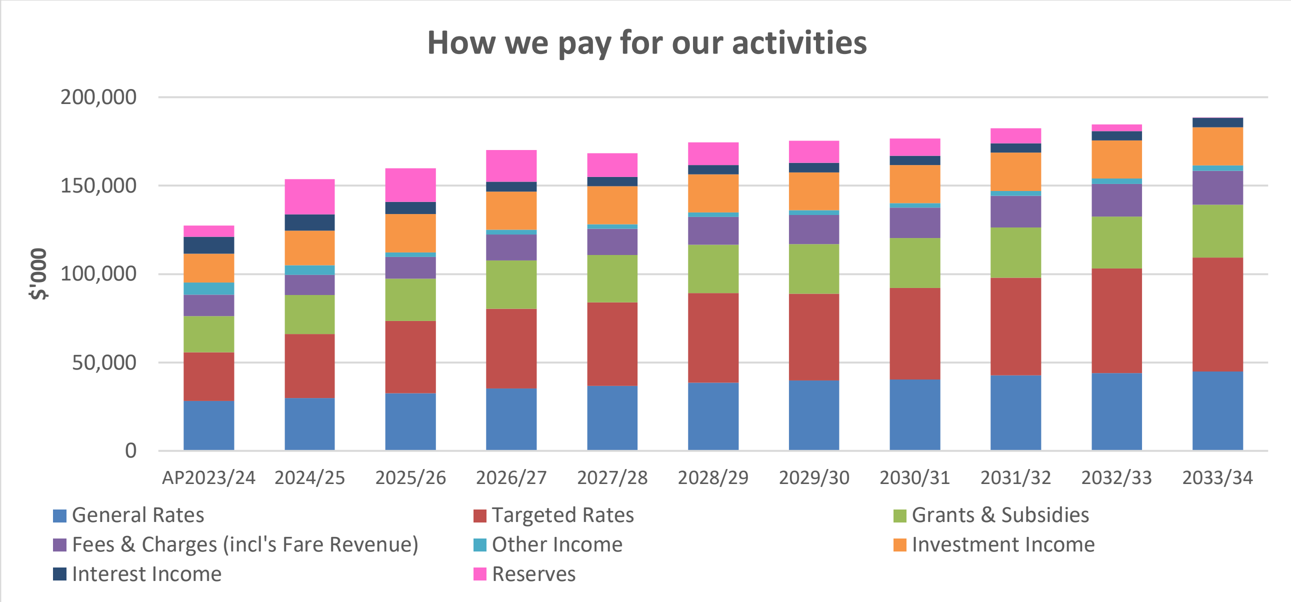
Scheme works involves implementing an on-going and planned renewal and asset replacement to maintain the current levels of services. This work is outlined in the Infrastructure Strategy 2024-2054.

Other Asset Investment

Other (non-scheme infrastructure) capital expenditure relates mainly to operational property and information technology activities. Year one (2024-25) includes expenditure on Council's head office relocation project and a replacement of Council's regulatory software system. Investment in other property sites outside Dunedin is included in years two and three of the plan.

Revenue

Council pays for its services through a variety of revenue sources. The graph below shows the mix of funding sources used to fund operating and capital expenditure for each year of this 10-year plan.



General Rates

General rates are charged where there is a wider community benefit or where a defined benefit area or group cannot be determined, or it is uneconomic to separately rate or charge that area or group.

Each year general rates are subsidised by dividends received from Port Otago Limited, and by investment income earned on council's managed fund and investment properties. Historically, investment income has reduced the general rate requirement by around half of the gross rate requirement. In the previous Long-Term Plan (2021-31) this reduced to an average of 41% and in this Long-Term Plan (2024-34) it reduces further to an average of 33%.

Dividends are estimated to increase from $15 million in the current year (Annual Plan 2023-24) to $18 million in year 1 of the LTP and $20 million in year 2 and remain at that level for the remaining 8 years. The previous Long-Term Plan assumed dividends reached $20 million in year-10 (2030-31). This Long-Term Plan assumes dividends of $20 million will occur five years earlier in the 2025-26 year.

The amount of general rates Council collects remains low, currently funding around 22% of Council's total expenditure. This level remains consistent over this 10-year plan at an average of 21% of total expenditure. This low general rate means that any general rate increases, whilst small in monetary terms, are generally high in percentage terms. A 1% increase in general rates equates to approximately $325,000 (including GST). This, spread across 124,000 ratepayers, averages out to an increase of $2.61 per annum, per ratepayer.

The average amount of general rates payable across the region is also low at $261. The proposed increase in general rates will increase this by $277 to $16 on average.

Over the previous two Long-Term Plan periods, general rate increases have been higher than were historically experienced in pervious years. Those increases recognised additional demands from central government and a growing work program to meet community expectations resulting in a need to increase our general rates to a sustainable level. Over this Long-Term Plan general rate increases are lower than previous years as activity expenditure increases are more focused in targeted rate funded areas i.e. flood and drainage, and public transport. Additionally new targeted rates have been created to fund some activities that were previously general rate funded i.e. catchment management and navigational safety. Offsetting this, general rate allocations from flood and drainage have increased and a new general rate allocation has been established for public transport.

Over years 1 to 3, general rates will increase 5.9%, 11.2% and 9.4% respectively and result in general rates being $35 million (excluding GST) at the end of year three. Increases from year 4 (2027-28) in general rates decreases to an average increase of 3.5% for the remaining seven years of the plan.

This Long-Term Plan provides for inflation each year of between 1.9% and 2.7% over the 10-year life of the plan.

Of the total general rate to be collected each year, 25% is from a uniform annual general charge (UAGC).

Targeted Rates

Targeted rates are used where there is a defined area of benefit, or a defined group benefiting from an activity.

Council has targeted rates established for flood and drainage schemes, river and waterway management, emergency management, public transport and biosecurity. In this Long-Term Plan new targeted rates are being established for catchment management, navigational safety and farm plans (from year 2). Some existing targeted rates will be disestablished i.e. wilding pines, rural water quality and dairy monitoring (from year 2 which is aligned with the introduction of the farm plan rate).

Each targeted rate has its own reserve. Any unspent rates are allocated to the appropriate reserve and used to fund expenditure applicable to that targeted rate in future years.

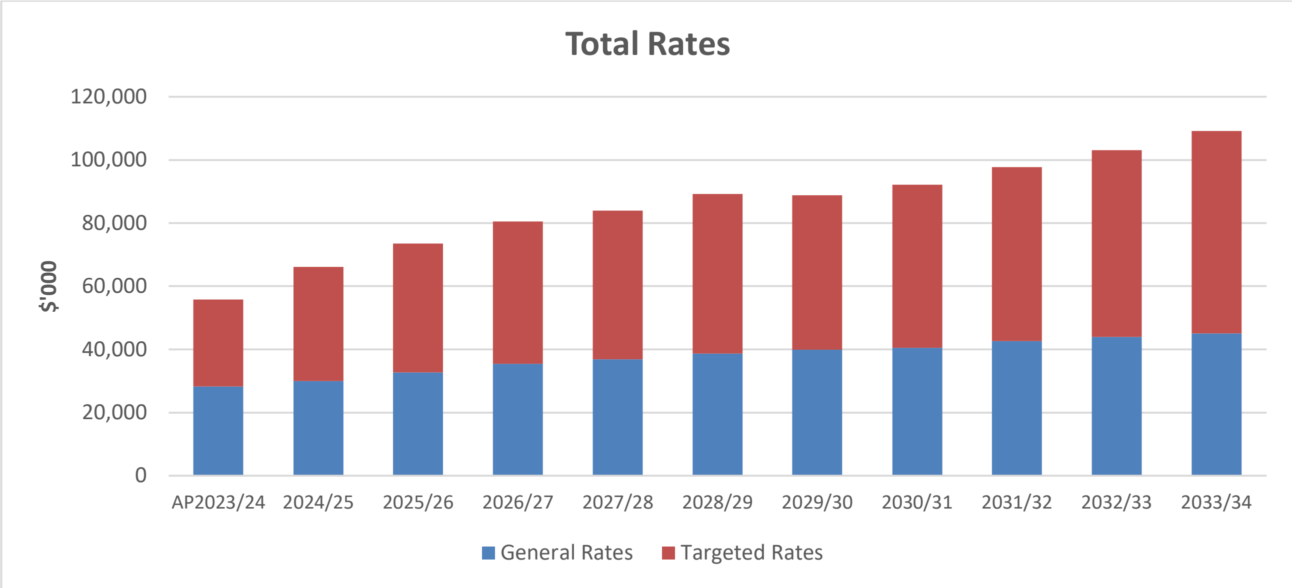
Where significant capital expenditure is required on flood, drainage and river management schemes, Council debt funds the initial investment through the applicable reserve and assumes repayment over a period of 30 years. The 30-year term recognises the spread in benefits to future generations. This is a change from previous Long-Term Plan's and financial strategies where capital expenditure was significantly lower and repayment was assumed to be achieved over each 10-year plan period. With capital expenditure increasing in this plan period it is more appropriate to align repayment of that expenditure to the life of the underlying asset.

For river and waterway management, Council has historically aimed to have reserves in funds equating to approximately one year's worth of average operating costs. While this approach has been feasible in the past, the level of river management expenditure (both operating and capital) is increasing significantly in this Long-Term Plan meaning river management reserves will remain in deficit until the later years of this Long-Term Plan period.

Increases in targeted rates vary depending on the individual rate and level of expenditure in the underlying activity or activities the rate is used to fund. Rate increases in flood, drainage and river management are all smoothed over the 10-years of the plan. Due to the significant increase in planned expenditure in these activities the smoothed rate increase has been phased in over the first 3 years and then remains the same for years 4 to 10. From year 4 river management rates are increasing an average of 24% year on year and flood and drainage rates an average of 11%.

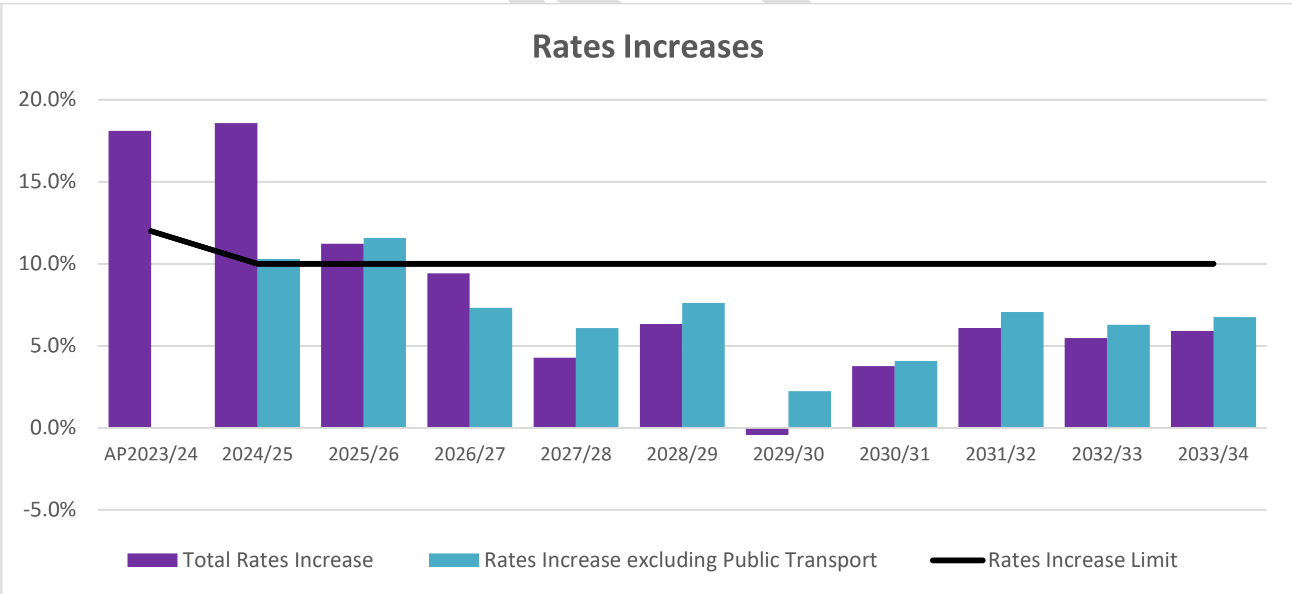
Total Rates

Total rates over the 10-year period are as follows:



Rate Limits

Rates increases over the 10-year period are as follows:



Council is aiming to limit total rates increases to 10% in any year of the Long-Term Plan. This target is not being achieved in years 1 to 3 due to the public transport rates. This includes increase rates to fully fund operating expenditure every year and the repayment of historical deficits. Total rate increases will be 18.6% in year 1, 11.2% in year 2, and 9.4% in year 3.

Excluding public transport, rate increases over years 1 to 3 will be 10.3%, 11.6% and 7.3% respectively.

Borrowing

External Borrowing

Council currently has external borrowing through the Local Government Funding Agency. This borrowing includes on-lending to Port Otago Limited.

Council may borrow for the following primary purposes:

- To fund special one-off type projects.
- To fund expenditure for items of an intergenerational nature.
- Short-term borrowing to manage timing differences between cash inflows and outflows.
- On-lending to Port Otago Limited.

Borrowing limits are set as follows:

- Net debt will not exceed 175% of total revenue.
- Net interest will not exceed 20% of total revenue.
- Net interest will not exceed 25% of annual rates revenue.
- Liquidity will not be less than 110%.
  (On-lending to Port Otago Limited may be offset in the above calculations if permitted under LFGA covenant calculation rules).

It is Council policy to offer security for any borrowing by way of a charge over its rates. In the normal course of business, Council policy is not to offer security over any of the other assets of the Council. However, in special circumstances and if it is considered appropriate, Council may resolve to offer such security on a case-by-case basis.

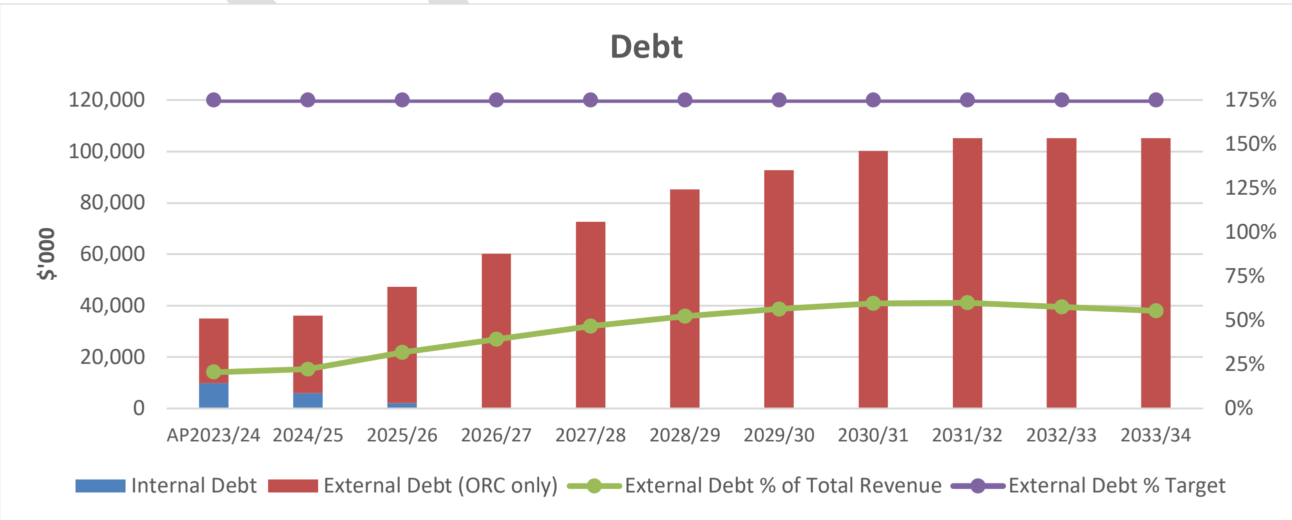
Internal Borrowing

When considered appropriate, Council uses accumulated reserves as a borrowing mechanism, thereby reducing the level of external borrowings required. The following operational guidelines apply to the use of reserves for funding rather than external borrowings:

- Interest is charged on the month end loan balances.
- The interest rate charged will be set in advance in Council's Long-Term Plan and Annual Plan's.
- Reserves available for internal borrowing are limited to 50% of total reserves (total equity) excluding revaluation reserves.

Total Borrowing

The graph below shows proposed debt over the 10-year period of the Long-term Plan:



Investments

Council's primary objective when investing is to earn a return whilst protecting its initial investment. Accordingly, the risk profile of all investment portfolios is conservative. Within approved credit limits, Council seeks to maximise investment returns, and manage potential capital losses due to interest rate movements, currency movements and price movements. Council's investments are discussed below.

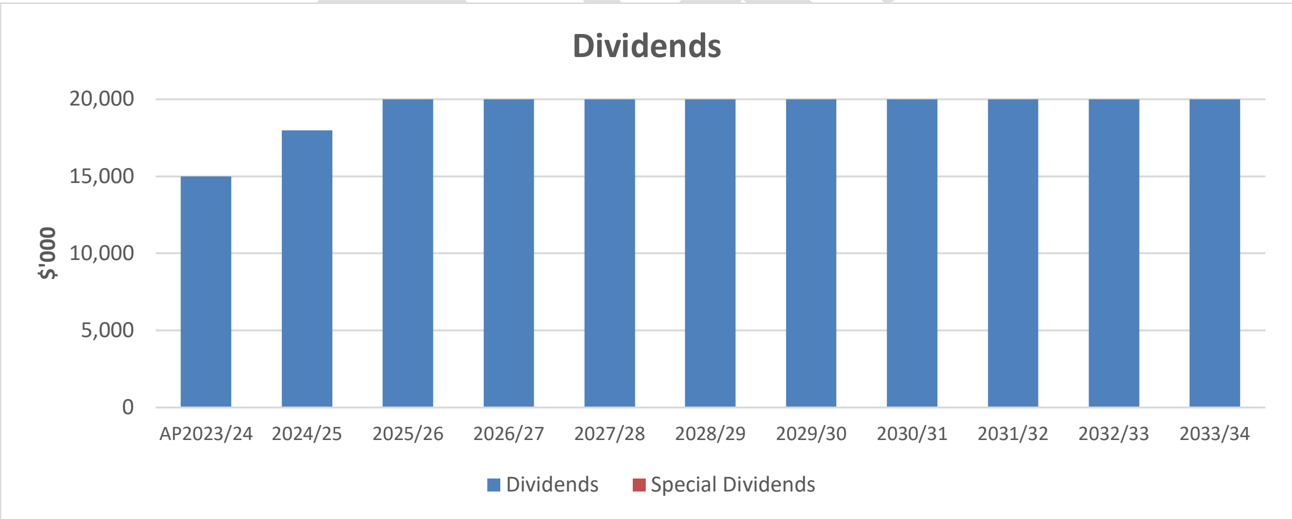
Port Otago Limited

Council holds 100% ownership of Port Otago Limited. Each year, dividends are received from Port Otago Limited that significantly reduce the general rate requirement. Council is of the view the this is a strategic asset held on behalf of the Otago community and through subsidising general rates, every ratepayer enjoys the benefit of that ownership. Port Otago's dividend policy aims to provide a dividend of between 50-70% of normalised operating profit after tax. This allows Council to receive an acceptable and sustainable return while still allowing the Port to retain capital for reinvestment in the long-term future of the business.

Dividends are forecast to increase over the next 10 years. This increases Council's funding reliance on the Port which comes with additional risk should the Port be unable to maintain this level of dividend. Over the 10-years of this plan Council aims to mitigate this risk by holding sufficient financial reserves to cover an unexpected dividend shortfall. While this may reduce the rates impact of reduced dividends in the short term, it will impact other investment income and significant rates increases are likely to be required if dividend levels reduce.

From time to time, special dividends may be received from Port Otago Limited for specific purposes. Before requesting special dividends, Council will discuss with Port Otago its ability to pay such dividends, taking account of factors such as the company's own programme of capital expenditure. No special dividends are proposed in the 10 years of this Long-term Plan.

Over the next 10-years, dividends are estimated to be as follows:



Investment Property

Council doesn't generally invest in property but does own investment property within Dunedin City that was vested to it when Council was established. Some of this is land leased by the University of Otago and the Otago Polytechnic. Council also owns property on the Dunedin harbour basin, being the Custom House building and the Monarch building.

The return by way of rentals on all these properties is at commercial rates and is used to subsidise general rate funding each year.

Managed Funds

Council holds a long-term managed investment fund incorporating classes of cash, fixed interest bonds and equities (New Zealand and international). Council's primary investment objectives when investing is the managed fund are:

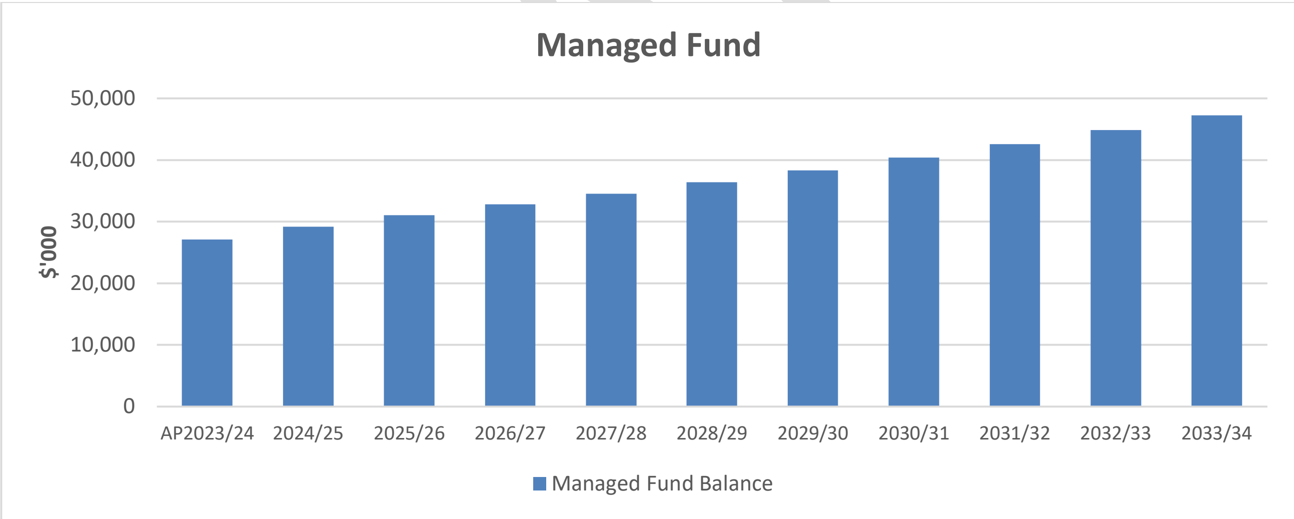
- To protect and maintain the purchasing power of the current investment assets and all future additions to the investment assets.
- To maximise investment returns within reasonable and prudent levels of risk.
- To maintain an appropriate asset allocation in order to make distributions as required while preserving the real value of the Council's capital from the effects of inflation.

Investment in the managed fund is based on an investment horizon of greater than seven years. Council is risk adverse in its investments and has a low willingness to accept risk but seeks to achieve return equivalent to inflation plus 2.3% to 3.1% (net of fees).

Based on Council's required return and risk appetite the managed fund incorporates an asset allocation that allows for 40% to 60% of the portfolio to be invested in growth assets. Accordingly, the aim is to achieve a 50% income assets, 50% growth assets split.

Our assumption in this plan is that the managed fund will achieve an overall return between 5.35% and 7.65% per annum. This return includes capital movements, dividends and interest income and is partially retained in the fund and partially used to subsidise general rates.

Over the next 10-years, managed fund balances are estimated to be as follows:



Reserves

Restricted and Council Created Reserves

Restricted reserves are a component of public equity generally representing a particular use to which various parts of equity have been assigned. Reserves may be legally restricted or created by the Council.

Restricted reserves are those subject to specific conditions accepted as binding by the Council and which may not be revised by the Council without reference to the Courts or a third party. Transfers from these reserves may be made only for certain specified purposes or when certain specified conditions are met.

Also included in restricted reserves are reserves restricted by Council decision. These Council created reserves may altered by Council without references to any third party or the Courts. Transfers to and from these reserves are at the discretion of the Council.

The majority of Council's reserves relate to the revaluation of assets and therefore do not represent cash reserves available for Council's use. Reserves included in this Long-Term Plan are:

- **Available-for-Sale Revaluation Reserve**
  The available-for-sale revaluation reserve arises on the revaluation of the shares in Council's subsidiary company, Port Otago Limited. This is an unrealised non-cash reserve.

- **Asset Revaluation Reserve**
  This reserve arises on the revaluation of investment property. This is an unrealised non-cash reserve.

- **Kuriwao Endowment Reserve – Restricted**
  This reserve represents the accumulation of sale proceeds and net income from Kuriwao Endowment land less any distribution of that income. The reserve is available to fund works for the benefit of the Lower Clutha District.

- **Asset Replacement Reserve**
  This reserve represents funds held for the replacement of Council operational assets (excludes targeted rate scheme assets). It is funded by rating for depreciation on those operational assets.

- **Emergency Response Reserve**
  This is a contingency reserve to enable Council to respond appropriately to emergency situations. It was initially established to provide funds for assets that Council is self-insuring its terms of use have been expanded to cover any emergency event.

  The reserve was created from transfers from general reserves and accumulated interest income. If the reserve is used for any non-general rate activity it is expected that scheme will repay this reserve. If it is used for general rate funded activity, then it may be replenished through general rates or a transfer from general reserves.

- **Building Reserve**
  The purpose of this reserve is to set aside funding for the development of a new head office for the Council.

  Council is planning to move to a new Head Office premise in the 2025-26 year. This reserve will be used to fund Councils contribution to the construction of this project. Any remaining funds in the reserve will be transferred back to general reserves.

- **General Reserve**
  The balance of Council public equity after accounting for restricted reserves is the general reserve. This reserve can be used for the planned funding one-off activities. It also provides contingency funding for emergency events and a source of funding for essential unbudgeted expenditure.

Targeted Rate Reserves

Reserves are maintained for each targeted rate. This allows any unspent rating expenditure to be allocated to the appropriate reserve and used to fund expenditure applicable to that targeted rate in future years. Expenditure in these activities can be volatile in nature, with some years spend being very high, and other years very low. Targeted rate reserves are used to help smooth the impacts of these variations in expenditure.

Targeted rate reserves may go into deficit to allow significant expenditure to occur immediately and rate funding to repay that expenditure over time. Where significant capital expenditure is required on flood and drainage schemes, Council will not support the repayment of scheme works over a period longer than 20 years.

- **River and Waterway Management Reserves**
  Targeted rating has been used to fund river management works across the city and districts within Otago.

  Council aims to maintain these reserves in surplus equating to approximately one year's worth of operating costs. This provides some financial security, should a flood event occur, so that additional work can be undertaken as necessary without the need for a significant rate increase in any one year.

- **Flood and Drainage Scheme Reserves**
  Targeted rating is used to fund the costs associated with maintaining the level of flood protection and drainage provided by these schemes. This includes funding both operating and capital expenditure.

- **Transport Reserves**
  Targeted rating is used in Dunedin and Queenstown to fund the Council's costs associated with the provision of public transport services including buses, ferries and the associated infrastructure.

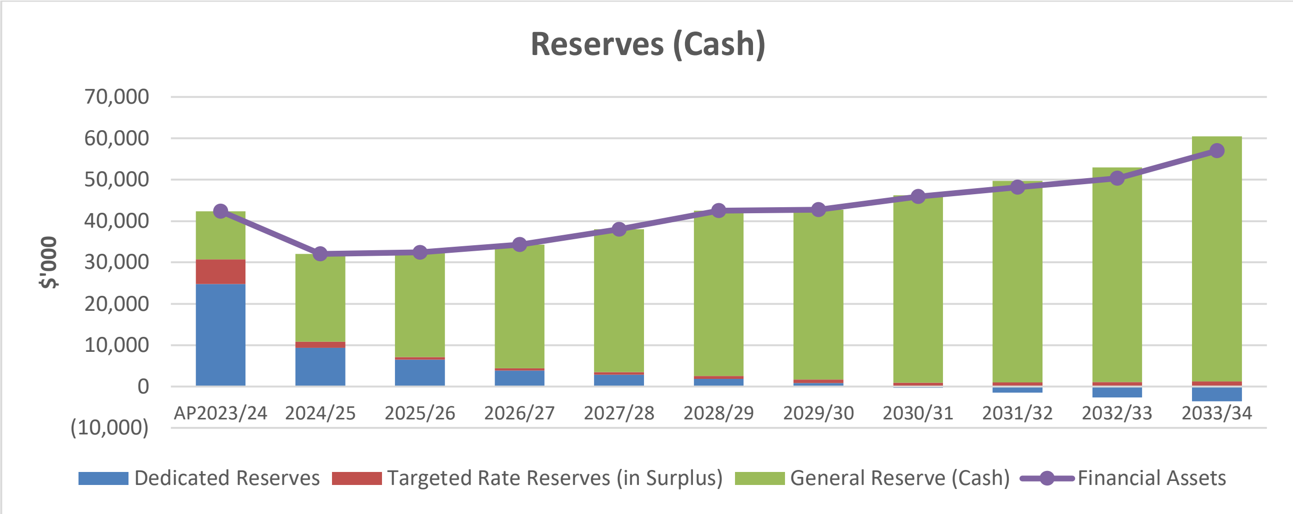
- **Biosecurity Reserve**
  This reserve is primarily used to smooth rates increases and reallocate any under or over spent funding to future years. It covers biosecurity activity including wilding pines.

- **Catchment Management Reserve**
  This reserve is primarily used to smooth rates increases and reallocate any under or over spent funding to future years. It covers a range of environmental activity including biodiversity, integrated catchments, liaison groups, remediation projects and Ecofund.

- **Dairy Monitoring Reserve / Farm Plan Reserve**
  This reserve is primarily used to smooth rates increases and reallocate any under or over spent funding to future years. Dairy monitoring is proposed to be discontinued in year 2 and a new farm plan activity / rate established.

- **Emergency Management Reserve**
  This reserve is primarily used to smooth rates increases and reallocate any under or over spent funding to future years.

The graph below shows Councils reserves of the 10-years of the Long-term Plan. The General Reserve has been balanced to reflect the underlying reserve amount available in cash on hand an in the managed fund.



Insurance

Council holds comprehensive insurance through a range of policies to manage the financial risk of loss due to unforeseen events. Operational assets such as buildings, vehicles and plant are fully insured.

Infrastructure assets are not fully insured due to the nature of the assets and the low probability that all assets would be affected by a single event. These assets are either fully or partially self-insured. Included in self-insured assets are flood protection and drainage infrastructural assets including floodbanks, protection works and drains and culverts. Assets of this nature are constructions or excavations of natural materials on the land and have substantially the same characteristics as land.

Council does not maintain separate self-insurance funds and considers that the level of reserve funds held is sufficient for the purpose of self-insuring assets that are not covered by insurance contracts. Operational budgets also provide for repairs of a smaller scale and amount.