

Financial Strategy



2024 – 2034
DRAFT

Council's Vision

Our City with Heart – He Ngākau Aroha

This financial strategy supports the delivery of Council's vision by ensuring we have a sound financial position from which to continue to provide all the services and activities with which we are involved.

It aligns with our mission – ***Waihōpai – To leave in good order*** – through supporting prudent financial management, providing a guide against which Council can consider proposals for funding and expenditure, to ensure we have a sound financial position over the life of the Long-term Plan and into the future. All significant financial decisions made by Council while this strategy is in place will be made within the framework of and with reference to this Financial Strategy. It should be read in conjunction with Council's Infrastructure Strategy.

Critical in this strategy is ensuring that we as Council:

- Maintain our long-term financial resilience.
- Ensure that we are in a position to meet the challenge of significant inflation to the value of our asset networks with flow through impact on depreciation requirements.
- Provide cost effective infrastructure and services.
- Ensure that our rates remain affordable and sustainable.

Council's financial direction over the next 10-30 years requires a balancing act between ensuring that we can continue to provide our infrastructure networks while also providing the district with the other services and activities needed to support community wellbeing.

A number of trade-offs have had to be made in this strategy to find the optimal way forward balancing the needs of the community now and into the future and to prioritise a number of initiatives.

Prudent Financial Management

Councils are required by law to exercise prudent financial management. Subpart 3 of the Local Government Act 2002 provides for a level of predictability for ratepayers, and highlights the need for decisions to be made in the interests of both current and future residents.

The major components of a good financial strategy tie in three key factors:

1. Capital expenditure as appropriate to continue to deliver sustainable levels of service. This includes:
 - costs to renew existing assets,
 - to provide for increasing levels of service where desired, and
 - to provide for growth if necessary.
2. Borrowing is a rationed resource. Council does not have unlimited borrowing capacity and the ratepayers do not have unlimited resources to pay increasing rates for increased debt servicing.

3. Rates are a limited resource. Council must be mindful of the impact rates have on ratepayers. It runs into two limitations. The first is ability to pay, and the second is willingness to pay. Ability to pay is addressed through the government rates rebate, but willingness to pay is harder to define.

Looking Ahead – Our Strategic Priorities

- Meeting the changing needs of our rangatahi as part of our wider population, which is growing older and more diverse.
- Delivering City Centre vibrancy through appropriate renewals and improvements.
- Enabling the housing, health, security, and social infrastructure our city needs to grow.
- Navigating increasingly complex environmental challenges including climate change, land contamination, and earthquake risks.
- Ensuring Community affordability in a time of economic volatility - with financial prudence and efficiency.
- Ensuring Council leadership and delivery is credible and effective, building community trust and engagement.

In addition, there are a number of strategic priorities relating to infrastructure:

- Allowing infrastructure growth where future land uses change and support other priorities.
- Maintaining our core infrastructure.
- Delivering Strategic Projects.

Key Financial Challenges

Council faces a number of challenges going into the next Long-term Plan. These include:

- Continued uncertainty around Central Government's proposed Affordable Water reforms.
- Ageing buildings needing significant upgrade or replacement (including Rugby Park, and Te Hīnaki Civic Building among others), as well as renewal of in-ground infrastructure which is due for renewal.
- Funding for a significant capital expenditure programme – replacing existing ageing infrastructure and building the new Te Unua Museum of Southland.
- Significant levels of asset inflation which means it will now be much more expensive to replace assets, and determining how best to fund that.
- Increasing regulatory demands – especially in water quality, sewerage disposal, and Resource Management Act reforms with flow through impact to increased funding requirements for infrastructure upgrades.
- Continued impact of movement toward an ageing population, with reduced ability to pay for services.
- Impact of an inflationary environment affecting the ability of all the community to pay for services.

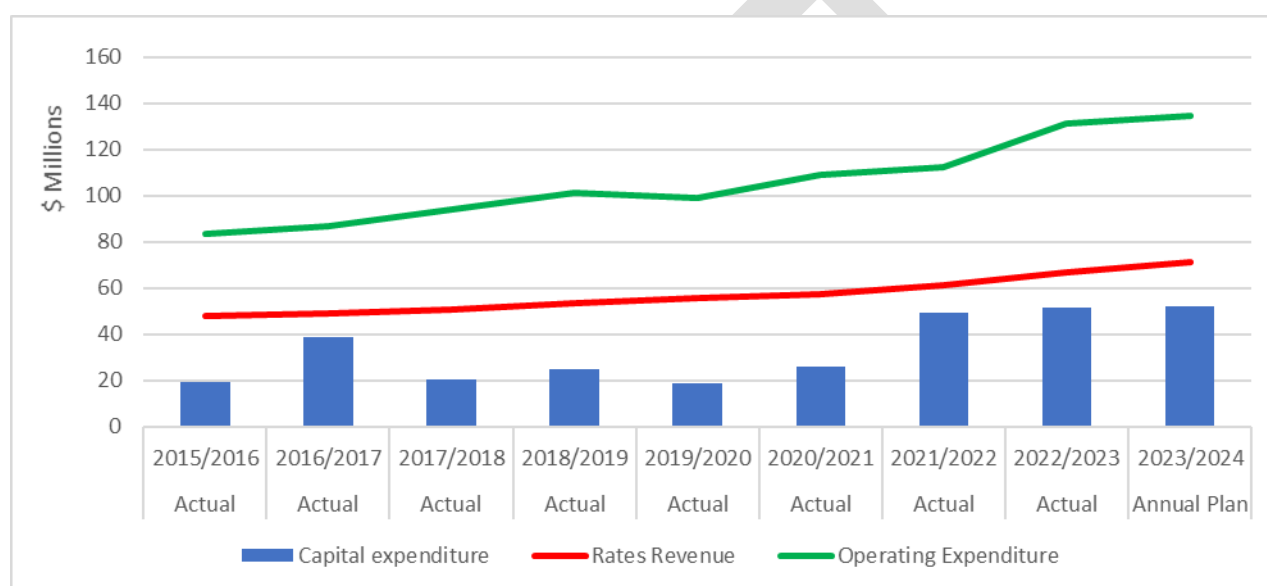
These are the main factors which together with balancing affordability are expected to impact on Council's ability to maintain existing levels of service and to meet additional demands for service.

Commentary on the first three items is included below.

In relation to the potential Affordable Water Reforms, Council has taken an approach of business as usual, until further notice, while also preparing as required for any transition. In practice, this means that Council will continue to deliver three waters services according to our plans, and if new centralised entities are formed in the future, then they will inherit assets and a revenue base that has been maintained. The focus of Council throughout has been on kaitiakitanga and the benefit and wellbeing of the community.

Investment in the inner city and ageing buildings has been addressed through the capital work programme.

Current Position



As at 30 June 2023 Council met all but one of the six prudence benchmarks¹ and the 2023/24 Annual Plan is planning to meet all but two (being the Balanced Budget and Essential Services benchmarks).

Council is forecasting to begin the next Long-term Plan with \$124.3 million of debt². This is a relatively low level of debt compared to other New Zealand City Councils³, and a low level of debt compared to our rates revenue (being 1.7 times the rates revenue).

Council's asset position as at 30 June 2023 showed total assets of over \$1.2 billion including cash and equity investments of over \$136 million, with no significant liabilities outside of term debt (\$124.5 million at 30 June 2023).

Council is forecasting a further operational deficit in 2024, principally due to the increase in depreciation charges. This does not have a significant impact the cash position given the non-cash nature of depreciation. Council also has significant revaluation gains from property plant and equipment which maintains the overall equity position.

¹ Local Government (Financial Reporting and Prudence) Regulations 2014, regulation 10.

² Debt balance as at 30 June 2023.

³ Using the debt per rating unit measure as published by New Zealand Taxpayers Union in its annual ratepayers report.

Council also has its credit rating from Fitch Rating currently at AA+ stable, which further supports Council's strong financial position. Any negative change in Council's rating would result in an increased cost of borrowing.

Continued Uncertainty

This Financial Strategy has been prepared on the basis that the Affordable Water Reforms begun by the previous government did not go ahead, as has been indicated by the new government. Unless stated otherwise, all forecasts and figures in this document are provided on the assumption that Council will continue to provide three waters services. Further information on the impact of a change to a more centralised provider for three waters delivery is provided in Appendix 1.

Council is entering a period where significant investment in renewals, new capacity and upgraded infrastructure to meet changing regulatory and consent requirements is required in our three waters infrastructure.

Increased regulatory requirements

In tandem with the potential Affordable Water Reforms there has been significant pressure on Council in relation to increased regulatory requirements of Central Government. The most progressed of these is water.

This Long-term Plan has seen Council having to significantly increase the level of operating and capital expenditure in the three waters areas to ensure we continue to comply with new increased drinking water standards, the expectations of the water regulator and anticipated requirements for future consent conditions by the Regional Council and Iwi.

The changing nature of the regulatory environment means that the expected cost to renew the resource consents for our wastewater plants has significantly increased. Both the Bluff and Clifton Water Treatment Plants' consents will need to be renewed during the first ten years of this strategy. This investment is currently estimated to be approximately \$111.4 million.

There is an expectation that the Resource Management Act reforms will have an impact on Council structure and costs. However, as at the date of drafting this Strategy, the full impact is as yet unquantified, and may change depending on the direction taken by the new government.

Significant Capital Expenditure

This strategy operates in line with the Infrastructure Strategy and observes that over the next ten years the cost to the Invercargill community to preserve, renew and maintain our infrastructure assets will be significantly higher than previous years. Because of this, future years' rates increases and the amount of debt held will be higher. When looking at this Strategy it is important to understand where Council is starting from and where it wants to get to in ten years. As at 30 June 2023 the financial situation of Council is one of good health, with reasonably strong capacity to invest for the future.

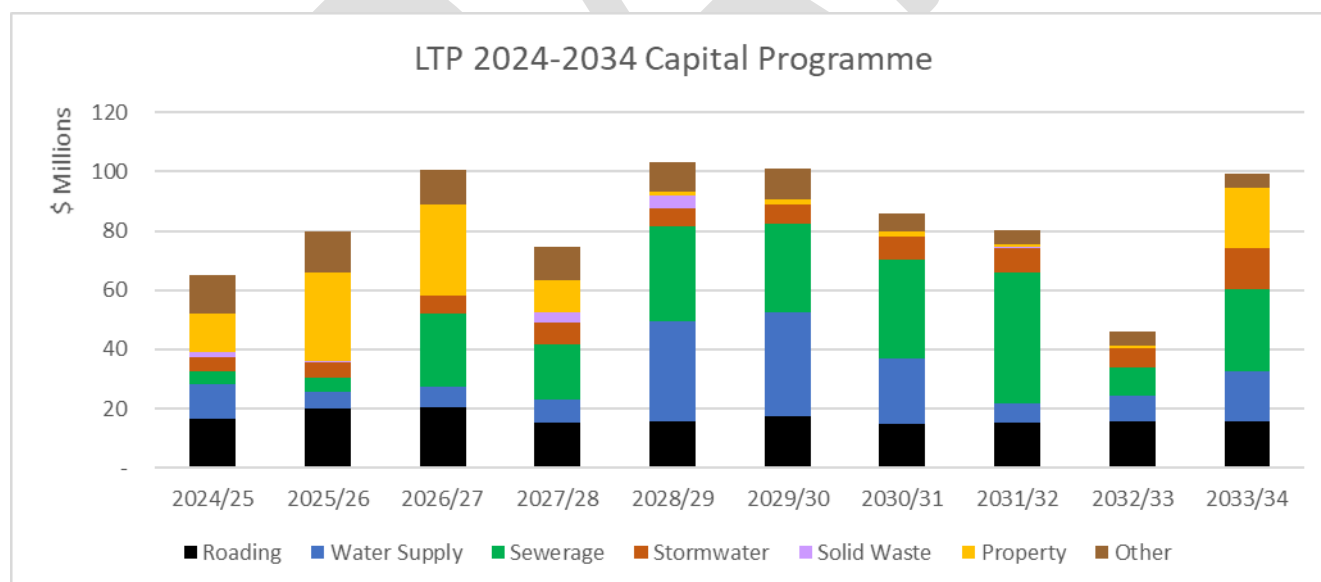
The ten years covered by the Long-term plan does present Council with challenges financially. This is in response to Council's increasing knowledge of its infrastructural assets and the increasing demand for improving infrastructure. This is of particular importance for Water Supply, Sewerage and Stormwater, as work is required to maintain and improve drinking water quality, to reduce contaminant entering our waterways via stormwater runoff and likely to our approach to managing discharge of wastewater.

Traditionally Invercargill City Council, like many other Councils, has a pattern of under-delivering on its capital spending plans. Plans put in place in the last Long-term Plan have seen capital delivery increase, with \$102.5 million in capital being completed in 2022 and 2023 combined. Council has a significant capital programme and historic peaks in its capital investment, which means renewals of assets may also have similar peaks. There are two potential methods to address this:

1. Continue the increased focus on programme development and delivery. Taking this path would require greater knowledge of the obstacles related to capital projects, and indicates a sense of certainty that does not exist in reality.
2. Recognise that there is a sense of guess work in the programme and recognise that it will not all be delivered within the arbitrary timeframes that are an integral constraint of financial planning. That constraint is the accounting concept of a financial year.

Council will continue to take a joint approach:

- Dedicated resource monitors capital project delivery. Alongside this, we develop a whole of Council capital programme that balances roadmap, strategic and renewals projects and applies the appropriate level of resource and focus depending on the nature and risk associated with each project
- Development of a capital programme that is able to be delivered both by Council staff and by the contracting market, while remaining within the constraints of the Financial Strategy.
- Recognition that a portion of the capital programme will not be able to be delivered in a financial year and adjusting the funding requirements accordingly. This is especially true in relation to the asset renewal programme.



Council continues to have an ambitious capital programme. In planning the capital delivery the asset owners and managers have worked to put together a programme that has approximately \$80 million of capital expenditure a year for the life of the Long-term Plan. These amounts have been set by reflecting on both the capability of Council and contracting partners to deliver, as well as maintaining financial prudence.

Given the age of the City's reticulation networks the infrastructure strategy indicates that continued significant investment will be required to ensure that resilience is improved and service delivery standards maintained. The investment also needs to recognise the risks associated as assets age, and improved asset condition data

is available to support the needs for renewal of particular assets. Investment decisions will be made taking into account risk profile and asset criticality.

The level of funding provided for the renewals component of the capital programme will gradually rise from 80% to 100% of the programme over the first six years of the Long-term Plan. This recognises that the assessment of work and timing is uncertain, there remain constraints in the contractor market, and that this is a programme which needs continued attention to ensure delivery percentages are maintained.

The renewal capital programme is based on average lives, supported by asset condition information and other evidence. Council's significant assets have long lives – 50 – 100 year lives are not unusual. However, due to many external factors assets may sometimes need to be replaced sooner or later than their estimated life.

Statistically almost all assets need to be replaced within three standard deviations of their average life. What this means is that if the variation is five years (which would be a reasonably conservative number), then it is almost certain that the asset will need to be replaced within the 15 years (three times five years) before or the 15 years after its average life.

In regards to renewal projects, a delivery target of 80% would effectively mean that the projects would be delivered 20% later than what is indicated in the Long-term plan. For example, a two year project will actually take 28-30 months to complete. This is a significant improvement compared to our historic delivery rates.

Over the period of the strategy the renewal delivery target is expected to range from 70-90% of the renewal programme. This will mean renewal focus will be on critical assets while, non-critical assets will be allowed to operate to or beyond the expected life. This approach is not without risk and it may be necessary to reprioritise renewals or provide additional funding in particular years.

Council is also focused on growing Invercargill's community assets and reinvigorating Invercargill's Central Business District, growing He Ngākau Aroha, Our City with Heart. A number of large community projects are planned throughout the ten years of the Long-term Plan, all part of making Invercargill a more desirable place to live and work. These initiatives are also designed to complement and support the Beyond 2025 Southland Regional Long-term Plan. The main Roadmap to Renewal projects that fall within this category include Te Unua Museum of Southland, a new urban play facility, and the scoping of new pool facilities, which are likely to include hydrotherapy and other facilities desired by an older population.

The end goal for Council is to provide its citizens with a City that is maintaining and improving its key infrastructure assets while understanding that a City needs to also be a vibrant, entertaining and interesting place to live, work and play.

Financially this means that Council will continue to increase its debt over the life of the Long-term Plan in order to achieve what it has set out to do.

Funding asset renewals

Council re-values its operational buildings and infrastructure network assets at least every three years, to ensure that increases in the replacement costs of these assets are recognised. Depreciation of these assets changes after each revaluation to ensure that the annual depreciation charge is sufficient so the asset is fully depreciated by the end of its remaining useful life.

The goal of depreciation is to spread the cost of the asset or consumption of its service potential over its expected life.

At 30 June 2022 Council conducted a full revaluation of its operational buildings and infrastructure assets. This resulted in an increase in asset value of \$215 million and an annual increase in depreciation of \$11.8 million.

This significant increase in asset value reflected the increase in contracting costs post Covid-19, together with the significant inflation in labour and materials since the last revaluation in 2019.

Annual depreciation for 2023 reflects 31% of operating expenditure, which is a 4% increase from the prior revaluation.

In order to balance its budget, the last Long-term Plan (2021-2031) saw Council move to an approach to fully rates fund its annual depreciation charge. The current strategy is:

- depreciation is funded at a global level.
- depreciation is not transferred into special reserves, but for some targeted rates (Water, Sewerage, City Centre and Bluff Community Board) any cash surplus after meeting all costs (excluding depreciation) and capital spending will be placed in a targeted reserve, so that rates for that purpose will only be used for that purpose.

Depreciation acts as an indicator of the true long-term cost of a service, as it reflects a level of asset consumption in a particular period. However it does not solve all issues regarding the long term sustainability of a given service.

Assets are purchased using a combination of debt and annual revenue.

The goal when funding Council activities and services is to achieve a level of equity or fairness between generations (Intergenerational Equity). In other words, each generation should pay a fair share and should pay for what they use. Often we can use depreciation as a substitute for this equity, but there are a number of circumstances where this does not work. In particular, new assets purchased with high debt will have to meet the costs of both debt and depreciation. Over time, inflation means that debt actually has a lower cost. So future generations face a lower cost for that debt compared to the earlier generations who are paying it off.

The current period of much higher than predicted inflation has resulted in a conflict between the key goals of the financial strategy, being:

- a prudent approach to debt and intergenerational equity via fully rates funding the depreciation charge;
- rates affordability and
- a balanced budget.

The significant increase in depreciation following the last asset revaluation meant maintaining the above three goals was not possible in the 2023/2024 Annual Plan. Council decided to partially fund asset renewals in order to maintain rates affordability. Looking ahead to the ten years covered by this Strategy, that conflict will remain and intensify.

This creates a significant challenge for Council. To fully fund depreciation on top of the investments needed to maintain the current level of service to the community would mean an additional 7.72% in rates, and therefore a potential rates increase of 16.89% in year one – which is the polar opposite of our objective of keeping rates affordable.

Noting that it will not be possible to achieve a balanced budget right away, in light of the above considerations it is proposed that Council modify the current strategy, as follows:

- Partially fund depreciation on all asset classes

- Sewerage, stormwater and property at 80% in Year 1, increasing by 4% per annum.
- Roothing 85% every year.
- Set the initial rates funded depreciation in the infrastructure network asset classes at a level which:
 - At least covers the proposed renewal programme for that asset class in all years, and
 - Increases incrementally so that by year 6 of this Long-term Plan depreciation is fully funded (with the exception of roading, which remains at 85% in all years due to NZTA subsidy funding).

The assumption on asset value increase will be set with reference to the BERL inflation index for capital expenditure for assets.

Taking this approach to the Financial Strategy continues to reflect:

- Depreciation is still considered to be the best proxy for the use of our assets, and by rating on use we better allocate the cost to those ratepayers that actually use the assets.
- Staging the recovery of the significant asset increase reflects Council's commitment to rates affordability.
- Ensuring we get to a position where we have a balanced budget reflects our core commitment to financial prudencey.

Demographic changes

In recent years Invercargill has seen and continues to see and project population growth. Property values have lifted and we have seen a shortage of some types of housing.

Forecasts for population growth reflect the Beyond 2025 projections for new industries in the region, along with the long term retention of the Tiwai Aluminium smelter. A 1% network growth assumption is included to reflect the as yet unknown location and requirements of industries which is expected to require some form of network extension. 0.9% rating base growth is forecast reflecting a combination of population change, household size change and industry growth.

In relation to growth, the district already has most of the infrastructure needed to service the population for most of the growth identified in the Long-term Plan. Council has already identified a need for an alternative water supply to mitigate the risks of a single source of water. That need will accelerate as the population rises, or as new industry demand requires. Certain water-intensive industries have been identified in the Beyond 2025 Regional Long-term Plan as having growth potential in the region. The costs of an alternate water supply are highlighted in the water activity. Another effect of growth will be on the volume of sewage outfalls. An increased population may create additional pressure to improve the quality of the outlets for treated sewage, although it is expected that the standards for these will be lifted in any event when the current consents need to be renewed.

An increasing population will likely see the current increase in house prices continue, in addition to more houses being built to cope. Subdivision capacity for growth is not unlimited, but is able to respond to market demand. Developers of new subdivisions are responsible for providing all of the infrastructure for the new properties (including roads, footpaths, stormwater pipes and water and sewerage pipes) so the increase for Council comes from the maintenance of those assets, which is funded from the increased rates. Costs only fall to Council if the major arterials and collector pipes need to be upgraded through growth. This is not envisaged to be a factor in the next 10 years. A decision is expected around any requirement for network extension in the middle years of the Infrastructure Strategy.

If the population reduces it can have different impacts:

- The same number of properties but a lower average of persons per property.
- Sales prices of properties reduce and they take longer to sell. The Market adjusts for these changes.
- Properties are unable to sell and get abandoned, and then subsequently demolished. This has occurred in New Zealand in past decades but typically in much smaller communities than Invercargill. A trend at this level takes time to emerge and so there would time to manage it if it did appear. Communities need to be mindful of this possibility. The sooner it is identified the better it can be managed.

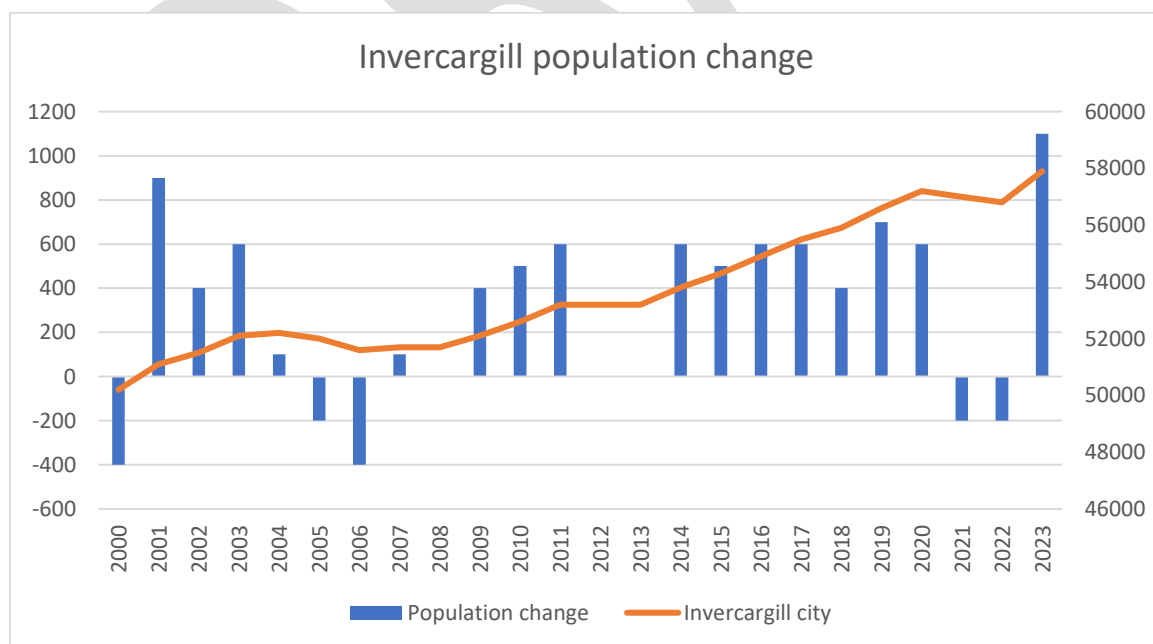
Changes in the composition of population by age group and ethnicity are also expected to continue.

Ageing population

Current projections suggest that our population is ageing, and the over 65s are expected to make up 24% of our population by 2034. This change is not expected to have a significant change in the services provided by Council, although Council will adapt to these changes as they emerge. Changes may occur in the nature and shape of Council's activity programmes for operating activities. These changes will not be significant and will occur within the current funding envelopes.

Diversifying population

Current projections also suggest the population will continue to become more diverse. By 2034 it is expected that our population will include 25% Māori and 13% Asian residents. These changes are not expected to have any significant impact on the services provided by Council, but Council will remain committed to our relationship with tākata whenua, and mindful of differing cultural needs. Any changes are not expected to be significant and will occur with current budgets.



Information prepared by Infometrics shows the population change for Invercargill between the years 2000-2023. The orange line shows the reasonably steady growth since 2000 which has put pressure on existing

housing supply. That pressure has built-up and the latest Rating Values show very large rises in residential property values, averaging around 50% since 2017.

Council is committed to improving community wellbeing by focussing on social, cultural, economic and environmental wellbeing. Council seeks to do this through the development of growth projects and sustainability of existing services.

Council notes that the current infrastructure network is set to service the community, including projected growth, provided it is renewed when required. Council's infrastructure network has been built to service a population much larger than that which currently resides within the City.

The historic pattern of Invercargill growth and development means that a number of Council's assets were built at the same or a similar time, and therefore generally require renewal at a similar time. As a result there will be peaks in renewal costs which are evident within this Strategy as the expected life of a number of key assets is drawing to an end.

Growing pressure of climate change

Climate change has been noticeable in various forms for a number of years. There is no doubt that weather patterns have developed more extremities. The Southland Climate Change Report 2018 by NIWA forecasts more extreme weather events including both droughts and floods. These higher extremes place more pressure on Council infrastructure services. Higher frequency of storms leads to increased costs on roads to recover from storm damage. The frequency of flooding could lead to a need to upgrade the capacity of the stormwater network to mitigate flooding of buildings. Droughts create more frequency and longer duration of peak water use, and that puts stress on the current single source of water. Pipe renewals are being installed on the basis of the forecasts provided by NIWA in line with Council's climate change assumptions.

In addition to the weather pattern changes, rising sea levels are a future concern. Invercargill is a flat and low-lying city, parts of the city are likely to be impacted by rising sea levels. Council is working with the Regional Council to identify the further modelling and analysis required to identify areas of risk following the recent completion of LIDAR flights. There remains significant modelling needed at a regional level to understand likely sea level rise and its potential impact. There are known risk areas including the Airport and Bluff which need further investigation. Council has invested in major infrastructure upgrades at Stead Street to increase protection for the city. Further work will be required on associated flood banks to maximise this investment. Environment Southland has responsibility for managing and maintaining the remainder of the city's floodbank network.

It is expected that rising sea levels will have an impact on some Invercargill properties, especially those that are low lying and close to the sea. However, current assessments of the impact of the mid-range forecast of sea level rise for the Southland region shows that the number of areas impacted by a 1m rise in Invercargill are very minimal. The potential impact of more significant sea level rises will emerge over time and individual property owners will become aware of the impacts well in advance. Again, Council is aware of the need for further modelling and analysis on these issues.

Council will be aware of future developments and will be mindful of rising sea levels when considering Resource Consents for new properties, and the impact on future District Plans. Council will not impact individuals' property rights by taking pre-emptive action on existing properties while the current uncertainty remains. Such action could turn a future possible loss for a property owner into a certain current loss. At this stage that would be unfair to both the property owner and the ratepayers who may then have to fund that loss.

Intergenerational Equity

The services that Council provides are costly due to the value and amount of assets that are used. Council's strategy is to ensure that both current and future ratepayers pay their fair share of the cost of providing services. Intergenerational equity is achieved through loan funding long-term assets and drawing rates to pay for the servicing and repayment of the loan over an extended period of time. Also, depreciation assists in intergenerational equity by ensuring that a cost is recognised for the consumption of the assets.

Where debt is low and future asset renewal is approaching, the generation that is consuming the asset should also be contributing to its replacement. For major renewal the level of service remains the same before and after replacement. This ensures that both current and future users pay for the assets. Examples of this can be found in the Invercargill City Council Infrastructure Strategy.

Debt Management

Net Debt

To aid understanding and predictability of funding requirements Council uses the concept of net debt.

Net Debt = total borrowings less cash and cash investments.

Council is able to borrow and invest money at relatively similar interest rates. Currently the interest rate paid on debt is about the same which can be earned on an investment. As Council is a conservative organisation it does not borrow for the sole purpose of investing. In some years there may be financial gain from that, but in other years it will have a cost. Borrowing for the sole purpose of investing is considered to be too close to speculation and it is not prudent to speculate with ratepayers' money. However, to gain future certainty of funding costs Council may decide to borrow in anticipation of capital spending. In such a case the funds will be invested for a short period.

Borrowings

Council's debt remains relatively low against Council's total assets base (9.65% as at 30 June 2023). However, Council recognises that it has \$100m of uncalled capital within ICHL. That capital can be called at the discretion of the directors of ICHL. Therefore when deciding the maximum level of debt which it would be prudent for Council to incur, we need to allow for the possibility of the capital being called.

In addition to the uncalled capital, Council needs to make provision for unforeseen shocks. It would not be prudent to be at the maximum debt level and then find a recession or a natural disaster impacts on our costs or revenue. This would have the potential to push us above our debt limits, and therefore not able to access the necessary cash.

As a borrower from the Local Government Funding Agency there is a maximum amount of debt that Council can borrow. As a credit rated Council that limit has been 300% of annual operating revenue. This will fall back to 280% by 2026.

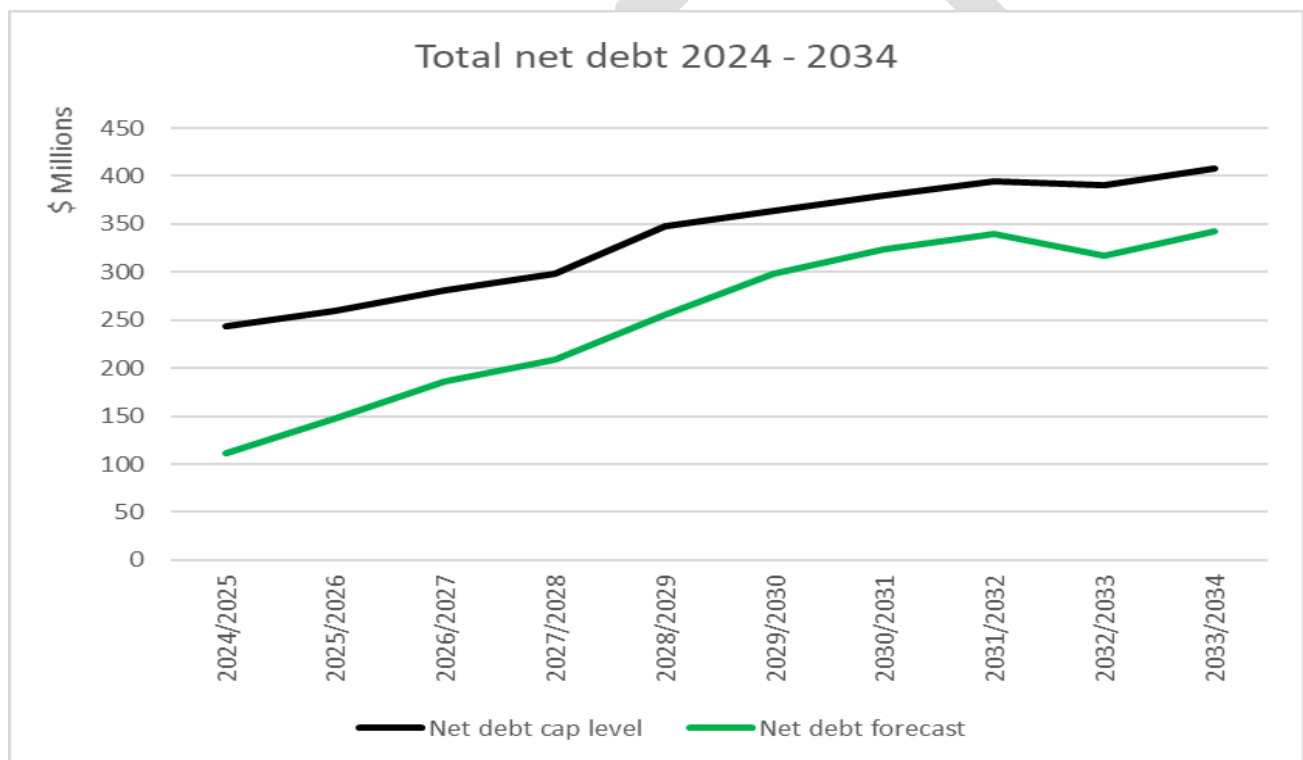
Council has traditionally taken a prudent approach to its maximum debt level, setting a maximum of 150% of revenue. However, given the level of investment required within the period of this Financial Strategy it is considered necessary to review this level.

It is proposed that the maximum debt level be increased from 150% to 180% for the first four years, 200% for the following four years, and then 190% thereafter, of operating revenue.

While Council remains focused on keeping debt to a manageable level over the course of the Long-term Plan, large infrastructure projects as well as future growth projects make it necessary for Council to take on an increased level of debt.

While Council could technically take on an even higher level of debt (closer to 280% of operating revenue) the interest cost associated with such borrowing would put a significant cost on ratepayers.

Impact of interest cost – combination of increased borrowing and increased interest rates



Debt servicing and repayment

A significant issue for this Long-term plan and this Financial Strategy is the increasing debt at a time when interest rates have increased considerably from the historic lows of recent years. This exposes the community to a significant risk of increased rates.

Debt levels are predicted to increase in the first five years of this Long-term Plan. As such it has been necessary to increase the debt limit. With new borrowing rates predicted to be as high as 6% rising from as low as 1%, there will be a significant impact on rates to service the debt. Every 1% increase in the interest rate will mean

a rates rise above the forecast rates increase of about 2.5%. So a 2% interest rate rise would become a 5% rates increase. Part of this impact can be managed through prudent borrowing, but only for a period of time.

In the interests of intergenerational equity Council should not go to the debt limits without a recognition that the debt will need to be reduced to allow future ratepayers to also undertake projects that will emerge in the future.

The funding strategy for rates will incorporate an amount of at least 1/30th of the outstanding debt to go to the repayment of the debt. This reflects the fact that funds are borrowed for assets and activities with a longer service life.

Security for Borrowings

Council borrows from the Local Government Funding Agency. As part of borrowing from that source, a standard security over rates is required. This is the most common security for Local Authority borrowing, and is well understood by the financial market lenders. What this means is that in the event of a debt default, a security agent is able to set a rate to meet the loan repayments.

Council currently maintains an AA+ credit rating.

Asset Sales

Council has recognised that it owns a large amount of land and assets that it may not be getting the best return on.

Over the course of the Long-term Plan Council will look to sell assets (land and buildings) that are not required for operations or strategic reasons. Income from the sale of these assets will be used to reduce the net debt balance of the relevant activity, effectively reducing the level of debt Council needs to borrow.

Cash and Cash investments

Council must ensure that each year's projected operating revenues are set high enough to meet that year's operating expenses, unless Council resolves that it is financially prudent not to do so.

As discussed above Council aims over the period of the Long-term Plan to return the balance between operating revenue and expenses (including depreciation). To maintain sound treasury practice Council holds a range of investments in cash deposits. These are in two groups: funds held for restricted and non-restricted reserves.

Restricted reserves are held for a specific purpose and money is only available to be used for that purpose. In contrast a non-restricted reserve can be accessed for a variety of reasons. These investments build up or reduce over time due to funding needs.

Holding a level of cash in investments provides a safety buffer for Council in times of uncertainty in the financial markets, as it gives us the option to use funds if the interest rates are considered to be artificially high. Having this flexibility is one factor contributing to Council's strong financial position and good credit rating. Council is targeting to maintain a term investment portfolio of at least \$20m, and this will fluctuate according to financial need.

Council will ensure that there are sufficient cash resources available to meet its obligations. Council's current assets need to outweigh current liabilities, where current assets include cash on hand and available lines of credit.

Rates

Every year Council reviews its operational expenditure to look for short and long-term cost savings. These savings are intended to improve efficiencies within activities and services, without impacting the current level of service being provided.

Rates are the "balancing factor" in the financial equations of Council. Revenue from all sources is also reviewed annually. Capital expenditure is evaluated for priority, need, and timing for maintaining levels of service. Capital expenditure is funded from rates and borrowing or use of investments. In the long term there is a limit on borrowing, and as a result either rates need to rise or the level of capital investment needs to reduce. This process repeats, with the aim to achieve the levels of service desired by the community, at a cost that is both affordable and which does not hit the "willingness to pay" trigger.

Rates are a tax on property, and are set based on factors relating to a property. One of the main factors that impacts predictability of rates is the three yearly revaluation of every property in the district to establish the "Rateable Values". When properties are revalued it creates a distortion in the rates increase which each ratepayer will have as compared to Council's stated rates rise. Unfortunately, there is very little Council can do change this. However, Council is mindful that the rates increases should be predictable, not just in terms of total rates rise but also in terms of impact on an individual property.

Between Long-term Plans, Council sets a uniform increase in rates, meaning that each rate type rises by the same percentage. This means each ratepayer has the same increase, unless the owner has made changes to the property that trigger a need for a revaluation. Council will continue this practice for years that are not a rates revaluation year.

Council limit on rates rises

Council has considered the level of capital spending required and also the limit on Council borrowing. To be able to undertake the capital works in the Long-term Plan, the total rates take in any year will be no higher than the Local Government Cost Index (LGCI) – Council's inflation rate plus a set percentage.

In this Strategy Council has focussed on the predictability of rates. Council also recognises that the Long-term Plan is a ten year plan, rather than being 10 one year plans. This means that the work programmes are established to maintain levels of service, and that if work is not completed in one year it still needs to be funded over the period of the plan.

Managing Financial Investments and Equity Securities

Council holds investments in companies, property and cash.

Investments in Companies/Trusts

Council is an equity holder in one company and has a controlling influence over two trusts. The principal reason for holding an equity interest in company investments is to provide a financial return on investment for ratepayers or for the delivery of services. The interests in the trusts are to enable more efficient and targeted community outcomes for the community. Trusts provide a good opportunity for community engagement with a particular outcome. Council does not seek financial return from the trusts.

Council's significant interests in the companies and trusts are as follows:

Company	Shareholding /Interest	Principal Reason For Investment	Budgeted Return
Invercargill City Holdings Ltd	100%	To undertake commercial opportunities and provide dividend returns to the City.	No less than \$5.2 million for 2024/2025 Special dividend of \$4 million per annum
Bluff Maritime Museum Trust	Controlling interest	To provide specialised governance for the Museum.	Nil.
Invercargill City Charitable Trust	100%	To provide access to recreational and cultural events within the City, in line with community outcomes.	Nil.

Council has no plans to change its shareholdings, although in accordance with good practice this is reviewed regularly.

Property Investments

Council maintains an Investment Property portfolio within the District. The properties are divided into two categories:

- Endowment Properties which have been either allocated or purchased from endowment funds.
- Trading Properties (fee simple, no classification on title, currently leased)⁴.

Council's objective is to maximise return from endowment and trading properties, however due to historic lease arrangements the return from these properties is below market rates. The objective for the net return on investment from both endowment and trading properties is at least equal to current market interest rates.

Council also has a portfolio of operational properties and properties acquired for a strategic purpose. Where a property acquired for a strategic purpose is no longer required for that purpose, it is placed in the Trading Properties portfolio and is considered to be available for sale. Council does not see itself as a property investor for profit, with the exception of the endowment property portfolio.

One significant property acquired for strategic purposes is the Don Street property developed by Council.

Cash Investments

Council holds cash for two main reasons:

- To ensure strong lines of liquidity and access to cash remains available to Council.
- To support the balance of reserves through short-term investments (90 to 360 days) to maximise return on investment.

⁴ Final categorisation to be updated following completion of the Activity Management Plan

Rates and Affordability

Council has come through a period of medium-level rates rises over the previous six years (2018/2019: 4.91%, 2019/2020: 3.50% and 2020/2021: 2.00% 2021/2022: 5.00%, 2022/2023: 6.53%, 2023/2024: 5.67%). This was due to Council focusing on ensuring that rates were low and consistent from year to year.

For future years there are some key challenges that will present themselves in relation to affordability. This will occur as Council enters a period of accelerated capital expenditure to develop our services whilst looking to be a growing and innovative city, combined with a period of higher inflation and interest rates.

Increasing costs of providing Council services is likely to intensify the affordability issues in 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 what Council would like.

A larger rates increase will not necessarily occur in these years as growth projects are loan-funded and will be paid back over time so as not to unfairly burden the current ratepayers with the large costs associated with these projects.

Council seeks to embrace innovation and change over the upcoming years, and with the constant evolution and growth of technology, is witnessing and experiencing the change first-hand.

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 Property Limited (ICPL), Invercargill Airport Limited and Electricity Invercargill Limited (EIL). Within ICPL sits an additional entity. Within EIL sits a number of utility based entities and investments in other utility operations. 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 recently consulted the public on a proposed restructure within the EIL group, this is yet to be implemented however, ICHL continues to work with EIL to improve the cash return from the Group. A special dividend of \$4 million per annum for the 10 years of the LTP has been included in the budgets as a result of the proposed restructure.

ICHL has provided Council with a dividend since 1999. In order to provide predictability for rates Council has set an expectation that the dividend is set at a level that allows ICHL to be able to pay an annual dividend that will increase with inflation each year. The dividend is forecast to increase over the next ten years with a minimum of \$5.2 million for the 2024/2025 year. Should this dividend fail to increase as predicted, Council would have less income received to minimise the impact on the general rates draw.

In the longer term, Council has noted that it cannot be financially reliant on an increasing dividends including from asset sales to reduce the general rates draw every year. The minimum dividend of \$5.2 million represents a 7% reduction in rates required. Whilst ICHL strives to produce greater dividends year on year this is not necessarily going to be in line with the anticipated rates requirement increase.

Disclosure Statement – Financial Benchmarks

The purpose of this statement is to disclose Council's planned financial performance in relation to various benchmarks to enable the assessment of whether Council is prudently managing its revenues, expenses, assets, liabilities and general financial dealings.

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.

It should be noted that all benchmarks are provided on the basis that three waters services will continue to be provided by Council.

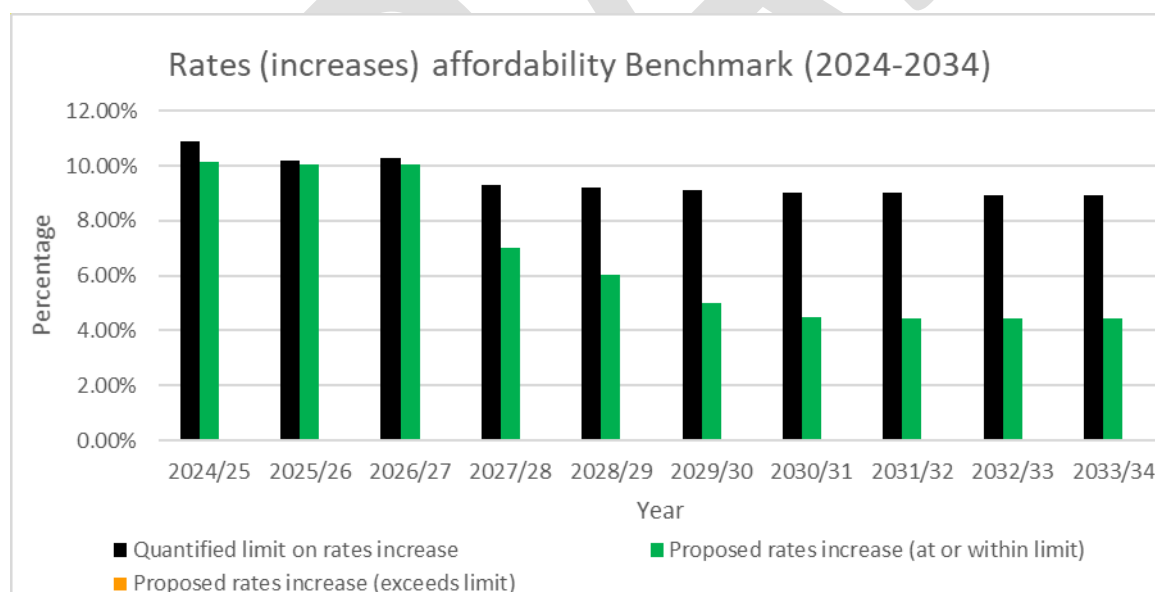
Rates Affordability Benchmark

Council meets the rates affordability benchmark if:

- Its planned rates increase equal or are less than each quantified limit on rates increases.

Rates (Increases) Affordability

The following graph compares Council's planned rates increases with a quantified limit on rates increases. The quantified limit is rates increases will not exceed the Local Government Cost Index (LGCI) plus 8% in 2024/2025 to 2026/2027 and Local Government Cost Index (LGCI) plus 7% from 2027/2028 onwards.



The forecast LGCI increases for the next ten years are shown in the table below but, for example, if the LGCI change was 2.20%, Council's rates increase would be no more than 10.20%. 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.

Council is also mindful of affordability issues amongst our ratepayers. Council continues to investigate cost-cutting methods to ensure that the revenue required to run Council is kept relatively steady. The rates increases reflect the money required each year.

Year	LGCI increase
2024/2025	2.90%
2025/2026	2.20%
2026/2027	2.30%
2027/2028	2.30%
2028/2029	2.20%
2029/2030	2.10%
2030/2031	2.00%
2031/2032	2.00%
2032/2033	1.90%
2033/2034	1.90%

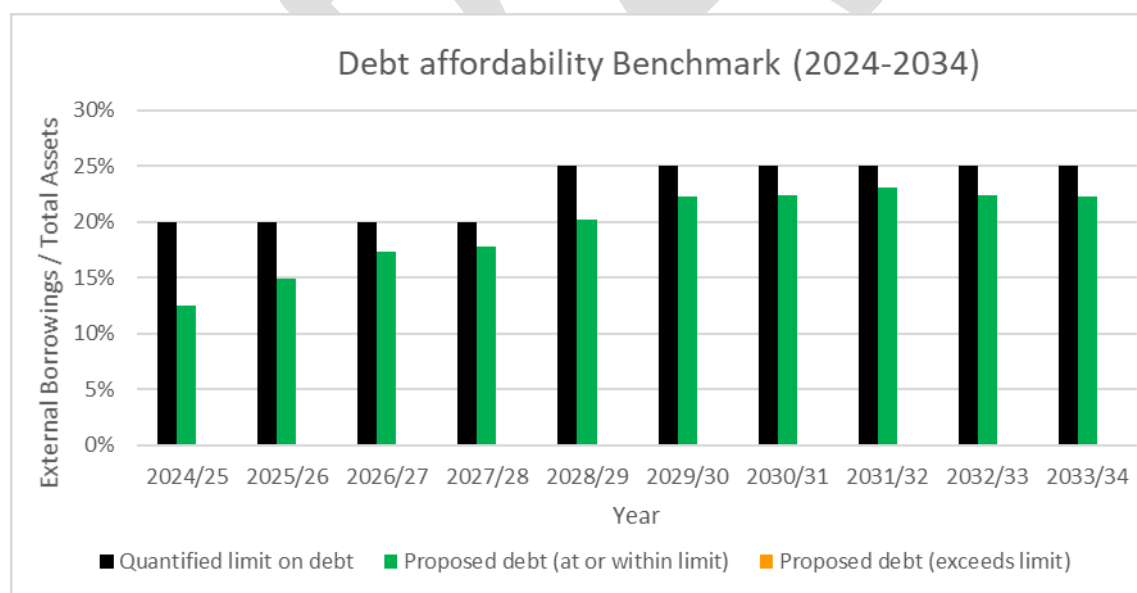
[Source: Cost adjusters 2023 final update, Berl, October 2023]

Debt Affordability Benchmark

Council meets the debt affordability benchmark if its planned borrowing is within each quantified limit on borrowing.

The quantified limit is that external debt will not exceed 20% of total assets from 2024/2025 to 2027/2028 and 25% from 2028/2029 onwards.

The following graph compares Council's planned debt with a quantified limit on borrowing.



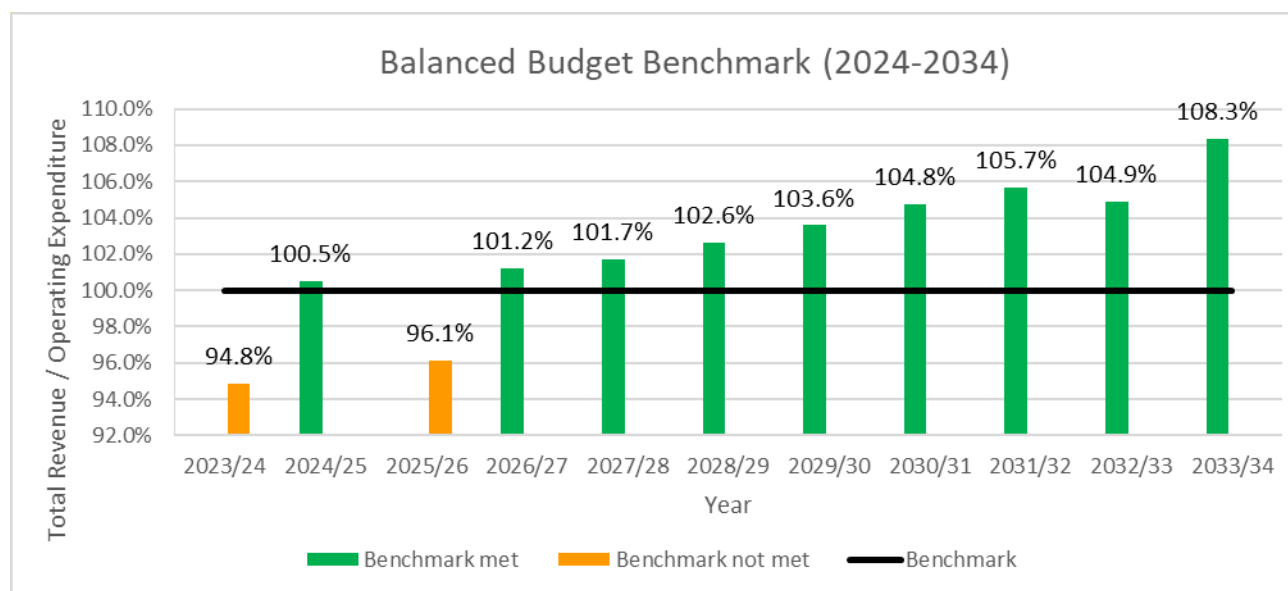
During the Long-term Plan period, the debt affordability percentage is expected to increase, peaking at 23.12% in 2031/2032 before decreasing again.

Council considers that setting a borrowing limit of 20% from 2024/2025 to 2027/2028 and 25% from 2028/2029 onwards of assets will assist in prudently managing Council's borrowing activities to ensure the

ongoing funding of Council activities. 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.

Balanced Budget Benchmark

Council meets this benchmark if its planned revenue equals or is greater than its planned operating expenses.



The above graph displays Council's planned revenue (excluding development contributions, financial contributions, vested assets, gains on derivative financial instruments, and revaluations of property, plant, or equipment) as a proportion of planned operating expenses (excluding losses on derivative financial instruments and revaluations of property, plant, or equipment).

Council meets the balanced budget benchmark if its planned revenue equals or is greater than its planned operating expenses. Section 100(2) of the Local Government Act 2002 (LGA) sets out the matters that Council must have regard to when determining whether 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.

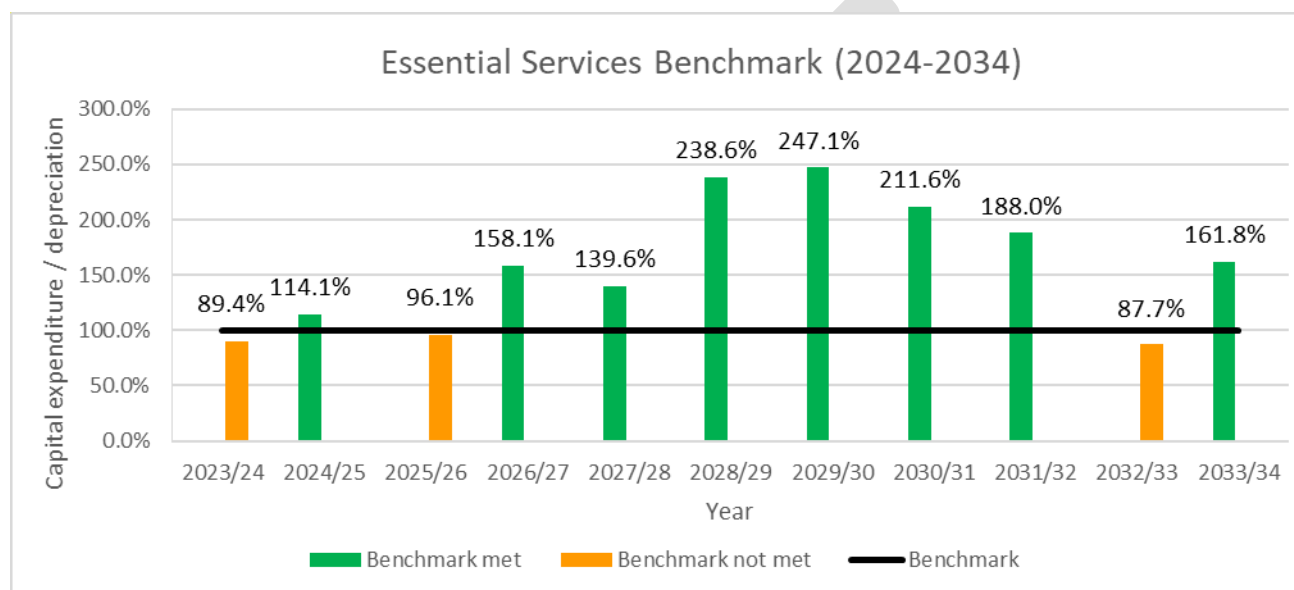
The proposed Long-term Plan has set projected operating revenues for 2025/2026 at a level that does not meet the projected operating costs. This reflects the challenge faced by Council of fully funding the depreciation on the infrastructure network assets which during the last three years have been subject to significant increases in asset value.

Over the period of the Long-term Plan the level of rates funding of depreciation has been increased to meet this challenge.

Essential Services Benchmark

The following graph displays Council's planned capital expenditure on network services as a proportion of expected depreciation on network services.

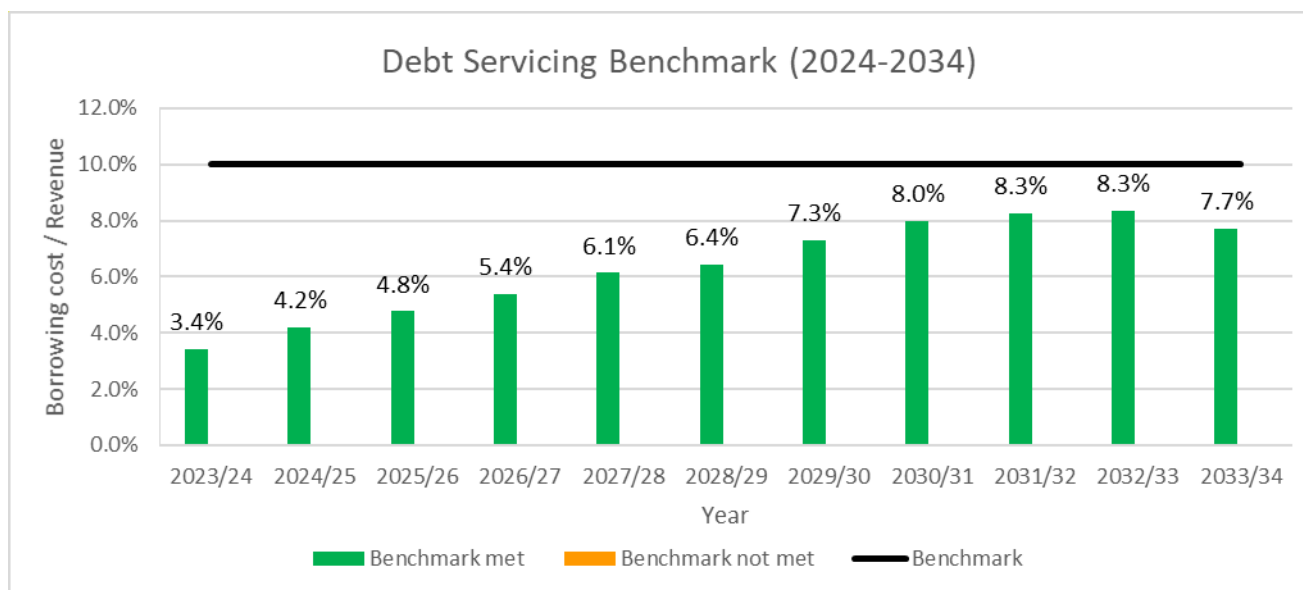
Council meets this benchmark if its capital expenditure on network services equals or is greater than expected depreciation on network services.



Debt Servicing Benchmark

The following graph displays Council's planned borrowing costs as a proportion of planned revenue (excluding development contributions, financial contributions, vested assets, gains on derivative financial instruments, and revaluations of property, plant, or equipment).

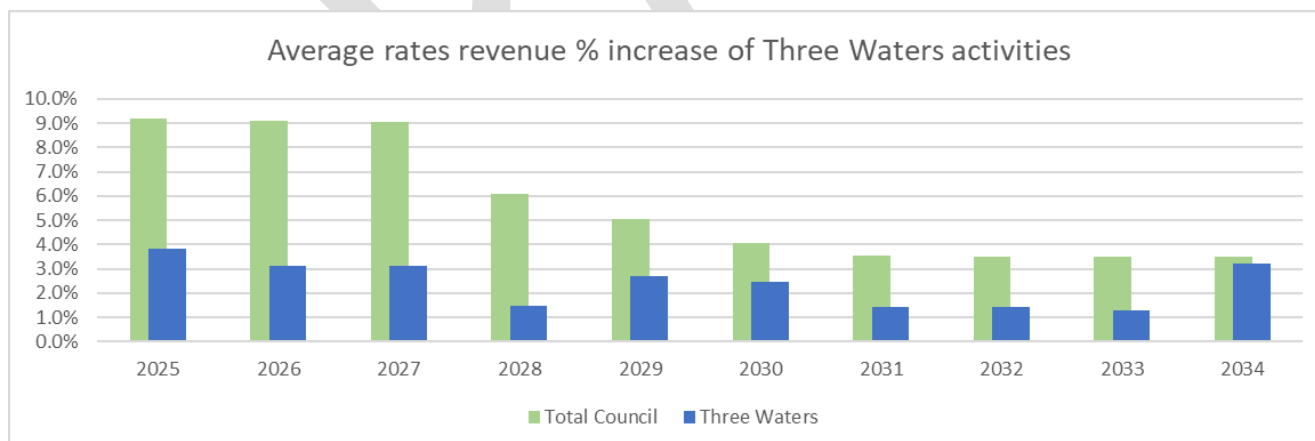
Because Statistics New Zealand projects Council's population will grow as fast as the national population is projected to grow, it meets the debt servicing benchmark if its planned borrowing costs equal or are less than 10% of its planned revenue.



Appendix 1: Impact of potential Three Waters Reforms

Proposals by the previous Government saw the beginning of a transition towards centralised delivery of three waters services. Under this policy, Council was expected to be transitioning its three waters on 1 October 2025.

Part of the proposal would have been to combine Otago and Southland's Three Waters activities. This would have had a significant effect on Council's financial strategy. With three waters going ahead in year three, rates increases would have reduced by between 1.76 – 3.57% per annum, the capital programme would have reduced significantly, there would similarly have been a significant reduction in capital, and potentially also in net debt.



The new Coalition Government which came to power in November 2023 has signalled that it does not intend to proceed with the Affordable Water Reforms, and that it will introduce legislation to repeal the Water Services Entities Act within the first 100 days of Government. This Council has therefore taken the approach of drafting its Long-term Plan and associated strategies on the basis that none of the water reforms go ahead.

However, uncertainty remains and until the legislation is formally repealed there is a chance that water reforms may continue in one form or another. Legally as at the time of drafting this Financial Strategy, Council's three waters services are to transition to a new provider on 1 October 2025.