

**Reality Check – Long Term
Financial Planning and the Real
World**

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2002 Local Government Act

- Confirmed previous reforms, gave us Well beings and Outcomes
- Eased balanced budget requirements
- Added audits of triennial Long Term Council Community Plans.
- 10 year plans to be inflation adjusted


18 years on?

- 1989: necessary first steps
- 1996: empowering, focused – sector financial management matured quickly
- 2002: added complexity, prescriptiveness – issues



**What was wrong with Cash
Accounting?**

- Why was it the wrong Reality?
- The owners of public infrastructure delivering essential services could not answer the big questions:
 - What condition were the assets in?
 - When would they need replacing?
 - How would their replacement be funded?
 - How would rising expectations and new standards of service be funded?



Sustainable Financial Management

- What is it?
- What does it look like?
- Can you reach out and touch it?
- How will you know when you've got it?

No formula but will have something to do with:

- Maintaining asset service levels today and then having to raise them tomorrow
- Affordable debt levels
- Ultimately meeting Community needs and well beings.



Balanced Budgets (tsunamis, waves or swells)

- Balanced budget = funded depreciation
- As network depreciation is funded prior to renewal, cash flow is positive.
- This Dunedin's experience today.
- Will those parts of the City networks that reach the end of their theoretical lives in fact fail all at once, leading to big negative cash flows?
- Or will assets fail gradually in a discernible wave or gentle swell?



Balanced Budgets ctd

- Fundamental is knowledge of the asset
- Legal requirement to balance budget
- Council must explicitly resolve not to do so.
- Must demonstrate how a deficit budget can be "prudent financial management"
- Dunedin's 07/08 deficit in Water and Waste water is \$3.4m, phasing out in 3 years.
- Audit NZ considered this did not breach the balanced budget provision.



Keeping up

- Starting with the 1996 reforms, most NZ councils have fought their way up to balanced budgets and don't want to fall behind again.
- Too hard politically to fall back into deficits and then have to get back up again
- Best of all, regular revaluations and funding the increased depreciation has given them the cash flow to start investing in infrastructure again.
- Remember: funding depreciation has to do two things
 - 1) Repay debt
 - 2) Contribute to asset replacement



Is this Sustainable Financial Management?

- Service levels (Outcomes and Well beings) are maintained
- In some cases they are enhanced
 - Better quality water
 - Cleaner rivers, harbour, beaches
 - Reduced volumes to landfill
- Yet debt increase is \$39m out of \$352m capex.
- Depreciation forecast for 06/07: in 98/99 was \$21.9m, in 05/06, \$36.2m, Actual will be \$39.6m.
- Rates forecast for 06/07: in 98/99 was \$53.3m, in 05/06, \$78.0m, up 46% in 8 years.

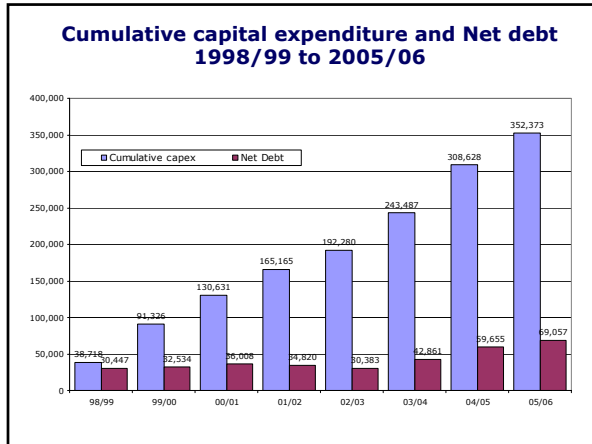


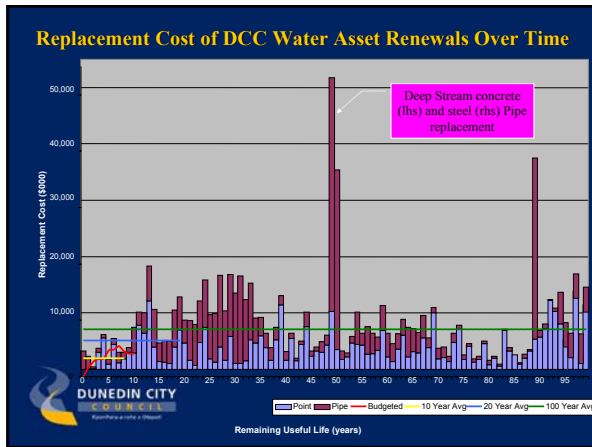
Debt and Intergenerational equity

- Attitudes vary in New Zealand
- North v South quite evident.
- It is needed to get things done of LTNZ
- There is a limit which community attitudes may prescribe
- There are risks (latest credit squeeze)
- Always competition for space on the balance sheet
- Its use needs judgement, common sense and a professional understanding of the risks.
- Overall it promotes financial discipline




Athol Stephens, Dunedin City Council -
 Presentation to 2007 Community Plan
 Conference, September 2007





Finding the money to replace the pipe - the old way

- Cash accounting focussed on repaying the debt.
- Aim: repay the debt, keep the rates down.
- We'll worry about replacing the asset some other time.
- One day the pipe fails but there is no money (unless, miraculously, the sinking fund is intact).



Finding the money to replace the pipe - the old way

- So more debt is raised to pay for the replacement of one pipe with another (like for like).
- Repeated many times over across the network.
- Impact: ever increasing debt servicing costs, shocks, surprises, political fallout.



Finding the money to replace the pipe - the new way

- Focus is on maintaining the asset
- Replacement (Renewals) of like for like assets seen as "maintenance" capital expenditure.
- Depreciation a crude estimate of the average replacement rate, like for like, across the network.



Finding the money to replace the pipe - the new way

- Ensuring replacement rate is funded provides the smooth, continuous cash flow to replace assets and maintain service levels.
- Community needs and expectations met
- No shocks or surprises ie no political fallout.
- Could this be sustainability?



Expectations rise

- Expectations - for customers, communities, countries they only rise.
- Stadiums, sports grounds, swimming pools (aquatic centres), art galleries, libraries – none immune from this principle.
- But, how to pay for them?
- Unusual for depreciation to be fully funded
- But can help maintain, prolong useful life.
- Rising expectations are healthy – but they are also a long term Reality



Standards rise

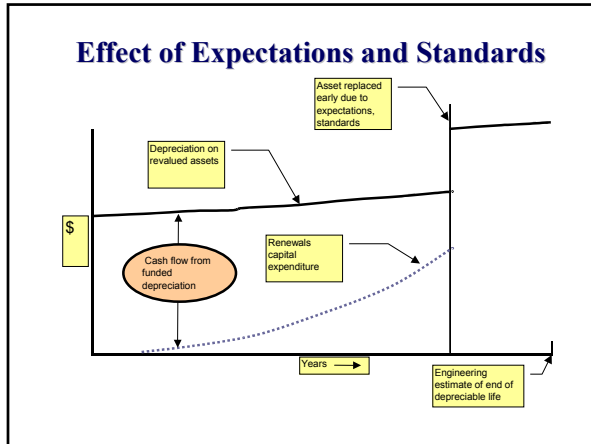
- Standards - Authorities sometimes impose them, communities sometimes want them: but the direction is always up.
- Dunedin - impact of central government imposed national drinking water standards – one day we meet the standard, next day we don't.



Standards rise


- Waste water discharge standards tougher – we want clean beaches, abundant, healthy marine life.
- The costs are massive; Dunedin will spend about \$300m on meeting higher standards.
- Rising standards are healthy – they are also a long term Reality.





Can funding keep pace with expectations, standards?


- Depends on the pace of them
- Likely that they crystallise before the asset reaches the end of its physical life
- Evidence piecemeal, anecdotal but Dunedin's new water treatment plant an example of a trend.
- Community wanted better water and prepared to pay for it, even though no evidence it was harmful.



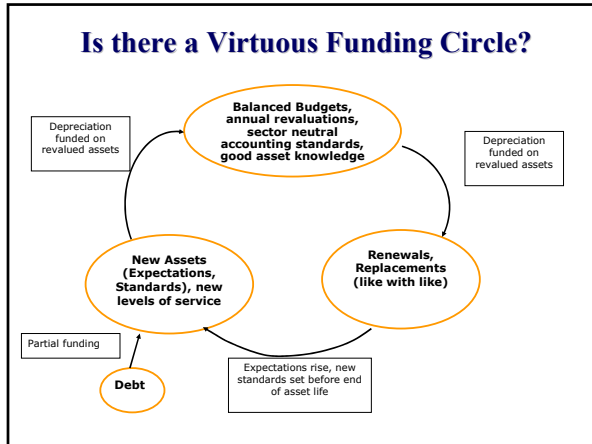
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Funding New Water Standards

- Dunedin has invested \$35m in a new water treatment plant
- \$23m funded from cash flow from funding depreciation on the network
- Only \$12m of debt required.
- Inter-generational equity calls for some debt
- But funded depreciation on assets valued on depreciated replacement cost, revalued annually, produces a long smooth cash flow that will sustain the old assets and contribute substantially to the new.



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Conclusion

The 4 Immutable Laws of Local Government

1. There is a never ending queue of Projects waiting to take up space on your balance sheet.
2. KEEP UP
3. KEEP UP
4. KEEP UP

