Draft 2024-34 Financial Strategy

Introduction

The financial strategy outlines our overall approach to managing our finances. It sets our limits on rates increases and debt, illustrates the overall financial impacts of decisions made in the Long Term Plan and is key in demonstrating prudent financial management.

Council key financial outcomes

Council aims to achieve the following financial outcomes over the next 10 years:

- Maintain a credit rating of at least AA (negative watch) from S&P Global.
- Generate sufficient funds to deliver the levels of service and undertake the capital investments within the 2024-2034 LTP, including the recovery of the storm damaged Marlborough Sounds roads.
- Minimise the impact on ratepayers through the appropriate use of reserves and debt, while ensuring intergenerational equity.
- Remain within a rates cap of the Local Government Cost Index plus 3%. The 3% comprises 1% for the cost of rising Government requirements and 2% for growth and improved levels of service.

	2025	2026	2027	2028	2029	2020	2031	2032	2033	2034
LGCI	2.9	2.2	2.3	2.3	2.2	2.1	2	2	1.9	1.9
LGCI + 3%	5.9	5.2	5.3	5.3	5.2	5.1	5	5	4.9	4.9

- Maintain a net debt cap whereby debt servicing costs are less than 15% of rates revenue.
- Maintain investments in MDC Holdings Ltd, Marlborough Regional Forestry, and the Local Government Funding Agency.
- Set aside easily accessible funds for emergencies whilst rebuilding the Emergency Events Reserve.
- Move progressively to return to a state of fully funding depreciation following the 2023 revaluation of Three Waters assets.

A balanced budget is essential to achieving these financial outcomes, and Council has considered how to balance:

- the levels of service to be provided and the cost of achieving and maintaining them during periods of growth;
- the priorities and timing of expenditure across all activities, especially expenditure of a capital nature and the link to the Infrastructure Strategy;
- the proposed levels of rates and charges across the full 10-year period of the LTP and their impact on the community;
- the proposed level of borrowing that current and future ratepayers will need to service;
- the funding required to rebuild the Emergency Events Reserve;
- the funding required to fund the increased value of Three Waters assets subject to revaluation.

Overall, Council considers that it has successfully balanced these six key elements in preparing the draft Long Term Plan 2024-2034. Community input is welcome on how the current result contained in this LTP can be improved.

Council must, under the Local Government Act 2002, manage its revenues, expenses, assets, liabilities and general financial dealings prudently and in a manner that sustainably promotes the current and future interests of the community.

Strategic direction of Council

Council's Mission Statement is set out on page 2 and Community Outcomes are set out on pages 24-25 of this Plan. Each Activity in this Long Term Plan identifies the outcomes that it contributes to.

Outline of factors that are expected to have a significant impact on the Long Term Plan

1. Environment

Marlborough provides a unique lifestyle opportunity for residents and visitors with the full range of geological features from mountains to fertile plains, rivers and the magnificent Marlborough Sounds, coupled with high sunshine hours and available water. These features support a wide range of business and leisure opportunities. Business opportunities have predominantly centred on "land and sea" based activities i.e. viticulture, forestry, horticulture, pastoral farming, aquaculture, tourism and the servicing sectors. The common thread for almost all these activities is having a quality environment with an emphasis on maintaining and possibly improving it. Availability of quality water is also a key factor.

2. Economy

The major industries identified above rely upon favourable international markets to provide a strong economic foundation for the District.

Source: Infometrics Quarterly Economic Monitor – December 2023

The Marlborough economy expanded by a modest 1.1% over the year to December 2023. Although GDP has declined slightly in the past two quarters, compared with the same quarters in the previous year, many of the economic indicators tracked reflect a resilient economy. Consumer spending was up 6.3% over the year to December 2023, which was above the inflation rate of 4.7%pa indicating an increase in the amount of goods households were consuming.

Marlborough's tourism sector is in relatively good shape reflecting the recovery of international visitor arrivals. Guest nights over the year to December 2023 were up 18%. The growth in tourism expenditure was less impressive, at 8.6%pa. The gloss is coming off New Zealand's tourism recovery as arrivals from key markets such as Australia and China stagnate and domestic tourism spending is starting to pull back, reflecting some households tightening their belts.

Marlborough's labour market is still very strong, despite the economic headwinds. Filled jobs for Marlborough residents increased 4.4% over the year to December 2023. Employment growth was broad-based across industries with agricultural support services, food and beverage manufacturing, health care, and accommodation and food services making the largest contribution. Strong employment growth has kept the average unemployment rate for the year to December 2023 at 2.3%, which is a post pandemic low.

3. Inflation projections

Council, along with the majority of other Councils in New Zealand, uses inflation projections provided by Business and Economic Research Ltd (BERL). These projections are used to inflate Council's forecast operating and capital expenditure in years two to 10 of the Long Term Plan.

BERL prepares projections for road, property, water, energy, staff, earth-moving, pipe lines and private sector wages. These are consolidated into an overall Local Government Cost Index (LGCI). To generate its forecasts, BERL estimates relationships based on historic data between price indices and a set of driver economic variables (e.g. GDP, employment, oil prices, construction, investment and CPI).

With recent central government announcements regarding Three Waters once again coming back into local government control, the preparation of this LTP has been subject to uncertainty. With the decisions now made Council has prepared this LTP using BERL indices including Three Waters. This "Legacy LGCI" is comparable to prior years.

In October 2023 BERL released the following increases in its LGCI basket:

Forecast BERL Legacy LGCI*

2025	2026	2027	2028	2029	2020	2031	2032	2033	2034
2.9	2.2	2.3	2.3	2.2	2.1	2.0	2.0	1.9	1.9

*Insurance is not explicitly included in these forecasts due to significant cost increases in premiums being experienced.

These increases make up a significant portion of the proposed rates increase over 10 years of the Long Term Plan contained on page 6 of this Strategy.

A result of recent inflation trends is the significant revaluation of Three Waters assets undertaken for the end of the 2022-23 financial year. This revaluation was not accounted for in the Annual Report for that year and Council received a qualified audit opinion.

As a consequence of the revaluation, depreciation expense has increased significantly. Ordinarily Council would fully fund this depreciation expense but is not doing so in the interests of better understanding the potential impacts of the new government's Local Water Done Well initiative and containing rates increases in the short term and moves to progressively fund this over the remaining Long Term Plan.

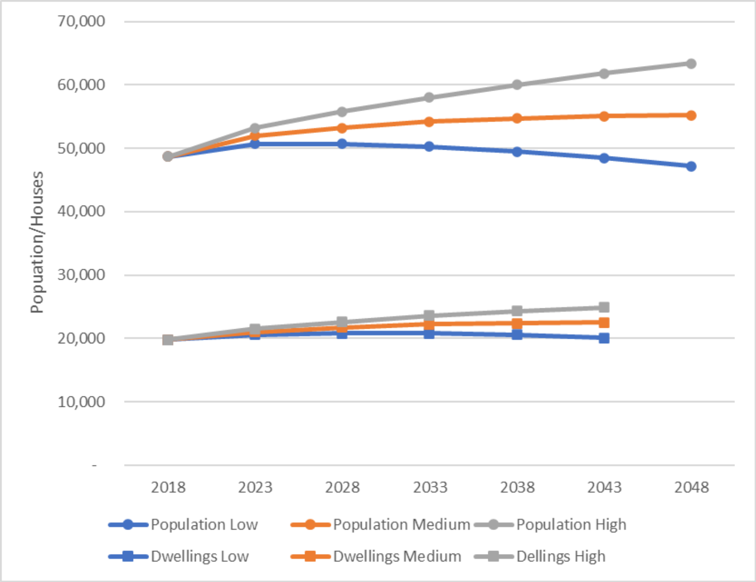
4. Growth and population composition

The number of people in the District, (both permanent residents and visitors), where they choose to live and the growth in economic activity directly affects the demand for land for development, infrastructure and other services Council provides. This growth underpins land use planning, infrastructure developments, where and when new services and facilities are required and their cost.

In June 2023, Marlborough's population was estimated at 52,200, an annual growth rate of 1.2% per annum over the 2022 population estimate of 51,600. More than 70% of the Marlborough population lives in Blenheim, with a further 14% in Picton and Renwick. Most population growth since 2006 has occurred in Blenheim and Renwick. Although Picton has recently seen an overall decline in usual resident population, there was strong growth in Waikawa. Prime building land in Waikawa is becoming less readily available and future growth in this area may be limited.

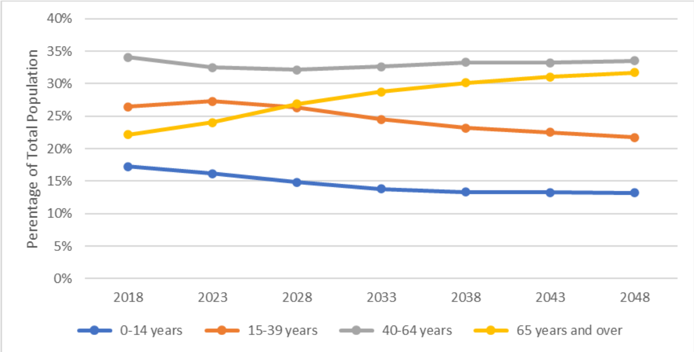
On 31 March 2021, Statistics New Zealand provided a range of population projections. These were updated for the latest numbers at the end of 2023. The low, medium and high growth scenarios for the Marlborough region for both population and houses are shown on the following graph. As the sunniest area in New Zealand, our climate, beautiful environments and healthy economy will continue to attract people to our area. This will help to counter balance the general trend for provincial New Zealand to lose population to the major centres.

Partly because of this uncertainty planners use the medium to high projection as a basis for planning future service provision in Marlborough. There are long lead-in times for major projects due to public consultation, land purchase negotiations, resource consent approval and construction. Planning conservatively for medium/high growth also provides some future proofing for assets that may have a useful life in excess of 80 years. This approach has proved sound with Marlborough's actual growth exceeding the "High" predictions.



(source: Statistics New Zealand 2018-2048 projections)

Marlborough has one of the highest proportion of older people in New Zealand, with 22.2% of our population aged 65 or more in 2018. By June 2023 that had increased to 23.5% (23.3% in 2021) and is forecast to increase further to almost 35% by 2048. The change in Marlborough's age distribution between now and 2048 is clearly shown in the graph below.



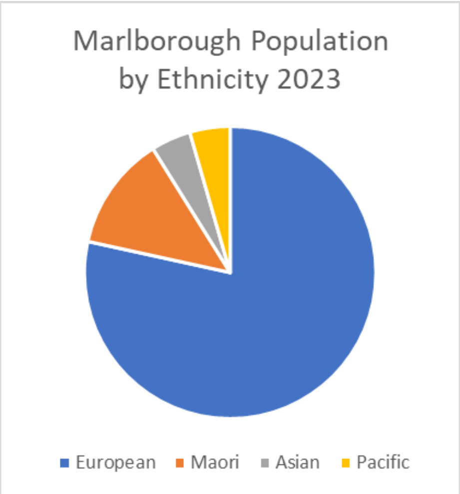
(source: Statistics New Zealand 2018-2048 projections, updated 2023)

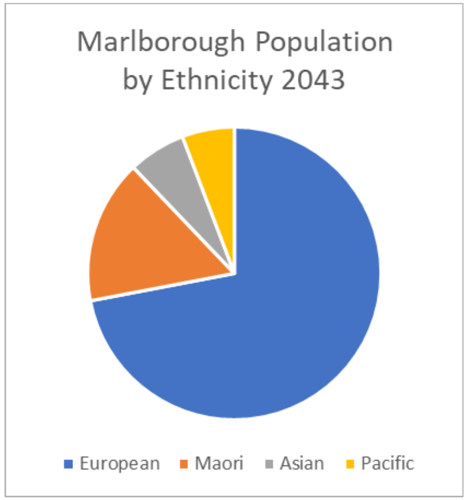
The increasingly elderly population and fewer working age people needs to be taken into consideration in financial planning, particularly when setting rates as affordability issues could arise as a large percentage of this group are on relatively fixed incomes.

The trend for growing urban centres and fewer people living in rural areas is expected to continue, as older people generally prefer to live closer to the services provided in larger centres. The provision of infrastructure in smaller settlements and the method of funding may need to be considered in light of these projections. This may also result in new and/or different levels of services being requested.

Older people are also more likely to prefer smaller houses and units, near the urban centres. Providing for this market could lead to urban intensification through regeneration of the existing housing stock.

Marlborough is also becoming a more ethnically diverse community. The Māori population is forecast to increase from 7,380(14% of the total population) in 2023 to 10,550 (19%) by 2043. Increases in all other ethnic groups are also forecast to occur however proportions will change. For example, while NZ Europeans will still be making up the largest percentage of the population, it will marginally drop from 88% in 2023 to 87% in 2043.





(source: Statistics New Zealand ethnic population projections updated 2023)

Changes in the age of our population and increasing ethnic diversity could change the demand for different Council services.

Also changing are settlement patterns. The current urban settlement pattern consists of an average of 10-11 properties per hectare. The Development Contribution Policy helps to encourage urban infill by offering reduced charges for the subdivision of small residential sections. Urban intensification would help to reduce further urban spread and subsequent extension to the linear infrastructure. Costs per connection would decrease and improve the affordability of these services. According to historic Building Consent and Development Contribution information, growth is estimated to increase by 125 household equivalent units annually for the next ten years within Blenheim. This demand is expected to be much higher in the first few years, and drop off over time. Blenheim traditionally accounts for about 60% of all building consents for new dwellings, the remainder in the wider district.

Council believes that, as development increases the consumption of its current infrastructure capacity and accelerates the requirement for new infrastructure, developers should bear the cost of this increased demand.

Through the application of its Development Contributions Policy to fund the cost of this additional infrastructure, Council is seeking to achieve an appropriate balance between encouraging growth and reduce the potential for additional burden on the ratepayer.

Undertaking development in a planned, co-ordinated manner can reduce costs as infrastructure development is not responding to “adhoc requests” for isolated, scattered, piecemeal development. Responding to adhoc development can mean that parts of the infrastructure networks are replaced earlier in their life than optimum while allowing other parts of the network to remain comparatively underutilised.

5. Government requirements

Currently existing government requirements are having a significant impact on Council’s cost structures. Government requirements affect the whole of Council, with requirements ranging from the level of training required for staff, to traffic management requirements, to infrastructure standards to monitoring standards. The anticipated impact is of such significance that Council continues with its increased “Rates Cap”. In addition to previously known Government requirements, there are further National Environment Standards, Environmental

Policy Statements, Resource Management Act reviews and the reverting to Council of the delivery of the Three Waters. Council has included into its budgets the anticipated costs of delivering Government's requirements where they can be identified with some certainty.

Council has included the full cost of operating, maintaining and developing the Marlborough Three Waters assets in this LTP.

6. Emergency Events, Response and Resilience

Emergency events and natural disasters are becoming more frequent. Storm events and flooding are causing damage to infrastructure and design limits to protect the community and these assets are being tested. This LTP sees a number of improvements to roading, water and flood protection infrastructure, debt funded with various debt servicing mechanisms through rates or reserves.

Council's ability to respond to these events and create resilience is a fundamental requirement. Over the past few years Council's reserves for responding to natural disasters and other emergencies have been depleted. Access to existing cash deposits and previously approved loan facilities enables rapid access to cash to fund response requirements but further improvement in the Emergency Events Reserve is a priority.

Balancing the budget

Council is required under the Local Government Act 2002 to ensure that each year's projected operating revenues are set at a level sufficient to meet that year's projected operating expenses, i.e., Council must demonstrate financial prudence.

In assessing financial prudence consideration is to be given to:

- the estimated expenses and required revenue to achieve and maintain the predicted levels of service provision set out in the Long Term Plan, including the estimated expenses associated with maintaining the service capacity and integrity of the assets throughout their useful life;
- the equitable allocation of responsibility for funding the provision and maintenance of assets and facilities throughout their useful life;
- the funding and financing policies.

During the development of the 2024-34 Long Term Plan, the Council considered how to maintain its current levels of service, operating expenditure and capital expenditure needed to replace existing assets and provide new infrastructure and facilities to meet the levels of growth that are forecast within the 10 years of the Long Term Plan. The Long Term Plan as presented should, for the majority of activities, enable Council to maintain current levels of service.

Council is forecasting that expenditure will increase from $183 million in 2023-24 to $245 million in 2033-34, an increase of 33%. The increase is primarily due to investments in infrastructure including community facilities, improvements in levels of service, especially in solid waste management, the projected movement in the LGCI and additional central government requirements.

Borrowing over the period of the Long Term Plan will increase. Borrowings net of investments and debt raised on behalf of subsidiaries (Port Marlborough and Marlborough Airport) are proposed to increase from the $119 million shown in the 2023-24 Annual Plan to peak at $290 million in 2030-31 year, to fund a $1 billion capital program. This falls to $192 million by 2033-34. Based on the experience gained from Council's previous plans, actual requirements are likely to be less than currently forecast.

Much of the increase in debt has been driven by Council's need to invest in infrastructure. Investment is needed to renew assets that are reaching the end of their economic life, to meet new standards and resource consent conditions and growth. Marlborough is currently experiencing higher levels of population growth than has been the case over the not too distant past. Higher levels of growth increases the demand for additional Council infrastructure and while the growth component is paid for via development contributions in the long term, Council must fund the cost upfront.

Development contributions have been reviewed accordingly to fund growth related expenditure. The "Financial Trends and Summaries" section of the report below provides the extent of capital works and the funding sources.

Over the course of the Long Term Plan borrowing specifically related to the recovery of the storm damaged roads in the Marlborough Sounds grows to circa $104 million. Council has developed a cost recovery strategy that sees costs shared amongst the communities affected as well as those ratepayers outside areas of direct impact. This methodology has resulted in an equitable distribution considering the social and economic benefits of the work being undertaken.

Under Section 101 of the Local Government Act 2002, Council considered its financial management responsibilities where it must manage revenues, expenses, assets, liabilities, investments and general financial dealings prudently and in a manner that promotes the current and future interests of the community. Council also considered whether it was sustainable to undertake the level of capital expenditure proposed in the Long Term Plan together with increased operating costs associated with the higher debt level. If Council has too much debt then future ratepayers will subsidise current ratepayers. If population growth, which is expected to fund the growth portion of assets incorporated into the capital expenditure programme, does not occur or occurs at a slower rate this may either increase rates or slow the delivery of capital projects.

Council has previously had the policy of fully funding depreciation except for community assets which is considered an appropriate measure to ensure the concept of intergenerational equity is maintained. That is, current ratepayers will pay for its use and a share of its replacement cost in relation to the assets provided. This practice has largely been continued in this Long Term Plan although the funding of depreciation on the 2022-23 revaluation of Three Waters assets is being paused for 2024-25 and 2025-26 in order to gain a better understanding the potential impacts of the new government's Local Water Done Well initiative and contain rates increases in the short term. From 2026-27 Council is planning to progressively return to fully funding Three Waters Depreciation by 2033-34.

In summary, the rate movements have been affected as a result of:

- Price increases – cost adjustors (inflation) that have been applied to the estimates within the Long Term Plan.
- Price increases – in many cases, particularly for infrastructure assets, recent cost adjustors have not matched what Council is actually seeing in terms of cost increases.
- Growth – while development contributions fund much of the growth related capital expenditure, additional developed land and services need to be maintained and add to Council's operational expenditure. Generally the additional costs are met by the rates recovered from the extra ratepayers.
- Service levels increases – for some services, such as water supply, sewerage and environmental activities, a greater total rate take will be required.
- Depreciation and interest payments – the increased capital expenditure programme will mean that there will be a corresponding increase in depreciation and debt servicing costs that will be required to be met through fees and charges and rates. This includes the effect of increasing interest rates.
- Additional central government requirements.
- A programme of funding a rebuild of the Emergency Events Reserve.
- A return to fully funding Three Waters Depreciation over the course of the Long Term Plan.

Rates, rates increases and rate increase limit

Council is very conscious of the impacts of rates increases in the community, the community's wish to maintain or enhance current levels of service and the underlying cost drivers that Council has limited ability to control. The underlying cost drivers particularly relate to the materials that go into building and maintaining infrastructural assets i.e., diesel, bitumen, pipes and other construction materials. Council has reviewed the capital expenditure programme and looked to defer projects where possible without significantly affecting levels of service.

Existing reserves and development contributions are the first sources for funding capital expenditure. The balance is generally funded by loans, predominantly on a 20 year table mortgage basis. Loans have a rating impact, but as their repayment is spread, they reduce the burden on current rates and spread the costs over those future ratepayers who will also benefit from the asset being created. Increased operating and, in the longer term, maintenance costs also result.

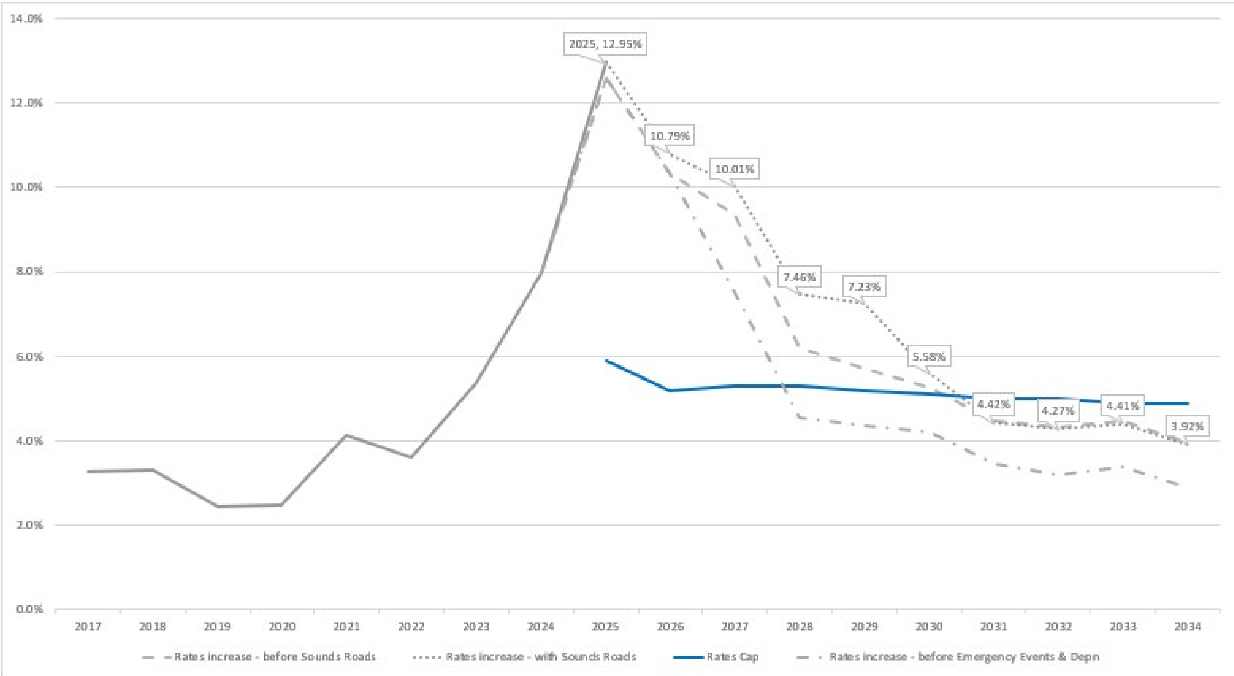
Because Council's costs are not the same as the costs faced by households e.g., food, housing, transportation, etc, as measured by the CPI, Council has decided to use the specifically developed LGCI as its inflation benchmark. It has further decided that it will aim to keep increases in total rates below the LGCI movement plus 3%. The following chart shows forecast rates increases, LGCI movements and the difference between the two showing where Council has exceeded the LGCI plus 3% stated above.

The impact of the voluntary targeted rates (clean heating and irrigation) has been removed as they only affect a relatively small number of ratepayers and are only incurred after voluntarily agreeing to receive the service.

In 2021 Council introduced the concept of the COVID Rates Relief Reserve which was to be funded by unallocated revenue from river leases and subsidiary dividends that would have become available had the previous Government's Three Waters reforms occurred. As the nature of water reform is now unclear Council needs to repay the ensuing funding deficit of $12.8 million and is proposing to create a 20 year loan for this purpose, to be serviced by rates. Council has elected to spread the impact of the removal over three years, 2024-25 to 2026-27, by a phased partial sale of NZ Units, which Council holds, as majority partner in Marlborough Regional Forestry, as part of the New Zealand's Emissions Trading Scheme. Over the past few years Council's reserves for responding to natural disasters and other emergencies have been depleted. Access to existing cash deposits and previously approved loan facilities enables rapid access to cash to fund response requirements but further improvement in the Emergency Events Reserve is a priority.

Council is proposing to establish a general rate to help rebuild this reserve to the value of $0.5 million in 2026-27, increasing by $0.5 million per year to 2033-34 by which time a balance of $7.4 million will be in the reserve. This is well on the way to the $15 million that was identified as a preferred amount by the Marlborough community in the last Long Term Plan consultation process.

The following graph shows Council is outside its "Rates Cap" between 2023-2026. In 2023 and 2024 Council marginally exceeds the rates cap due to operating costs associated with an increased capital programme. In 2026 the cap is slightly exceeded due to the start of the Flaxbourne voluntary targeted rate.



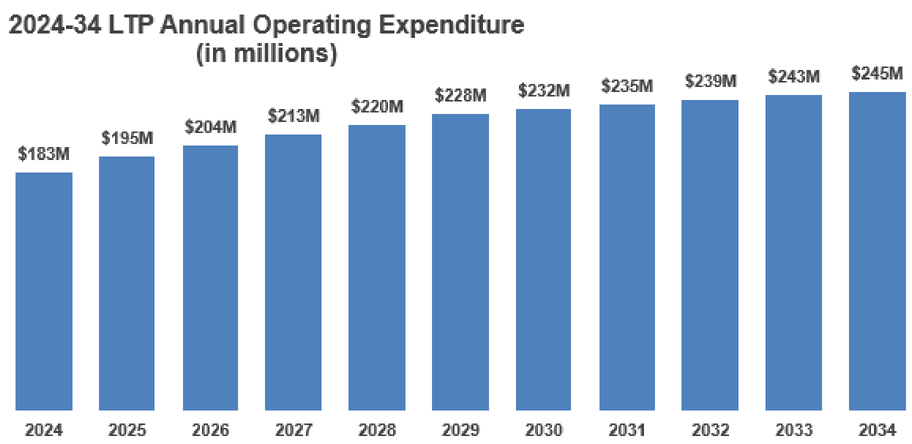
The amounts shown above are the total rates increases across the District and contrasts the increases in rates relating to core Council levels of service, the impact of funding the Emergency Events Reserve, a return to fully funding Three Waters Depreciation and the impact of the Marlborough Sounds roading recovery.

There will be properties that will pay less and others that will pay more, depending on the services that they receive. Samples for areas across the District are provided within the Long Term Plan Rates Movements section. The other point to note is that while this document sets outs Council's plans for the next 10 years, each year it reviews its priorities and need to undertake capital projects with the objective of reducing rates.

Financial trends and summaries within the ten year plan

Operating expenditure

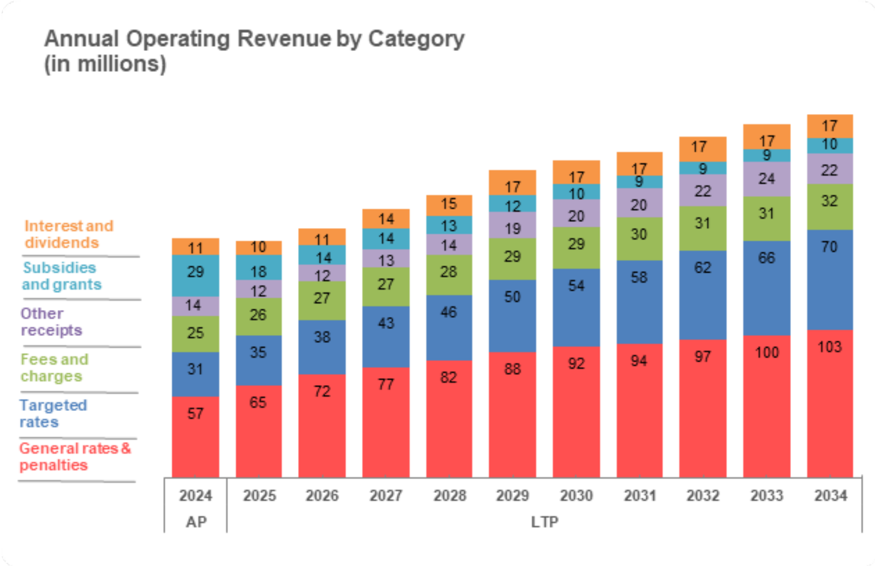
The following graph shows that total operating expenditure is forecast to increase from $183 million in 2023-24 to $245 million in 2033-34 an increase of 33%.



Operating revenues

Total operating revenue (from the Funding Impact Statement) is forecast to rise from $167 million in 2023-24 to $254 million in 2033-34.

The following graph shows the sources of operating revenue throughout the Long Term Plan.



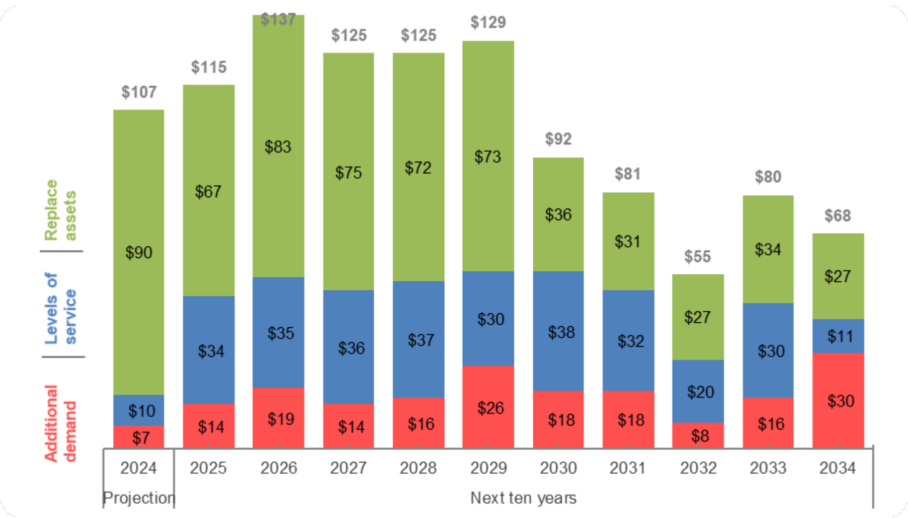
Capital expenditure

The Council currently has assets worth almost $1.9 billion. During the next 10 years Council is planning to undertake capital expenditure of:

$179 million to meet additional demand (including vested assets)
$304 million to improve the levels of service
<u>$524</u> million to replace existing assets including the recovery of the roads in the Marlborough Sounds
$1 billion in total.

The following graph shows the amounts being spent on each capital expenditure category to meet community expectations (levels of service), replacement of existing assets and additional demand/growth over the Long Term Plan.

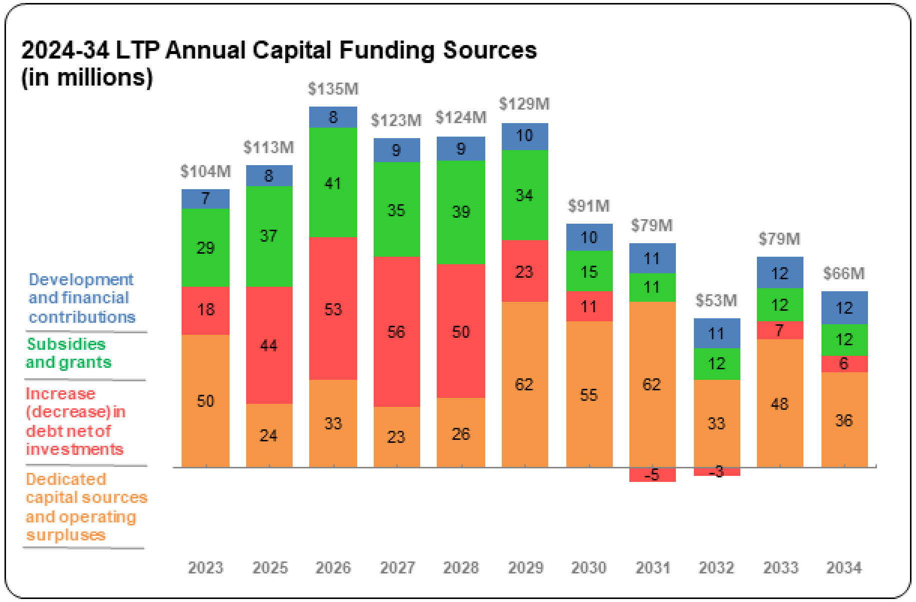
Capital Expenditure Drivers



In each Activity section there is a list of major capital projects planned over the 10 years of the Long Term Plan. A number of these projects have been spread out to coincide with growth, need and/or affordability.

Capital funding sources

The following graph shows the capital funding sources planned to fund the capital expenditure.



External debt

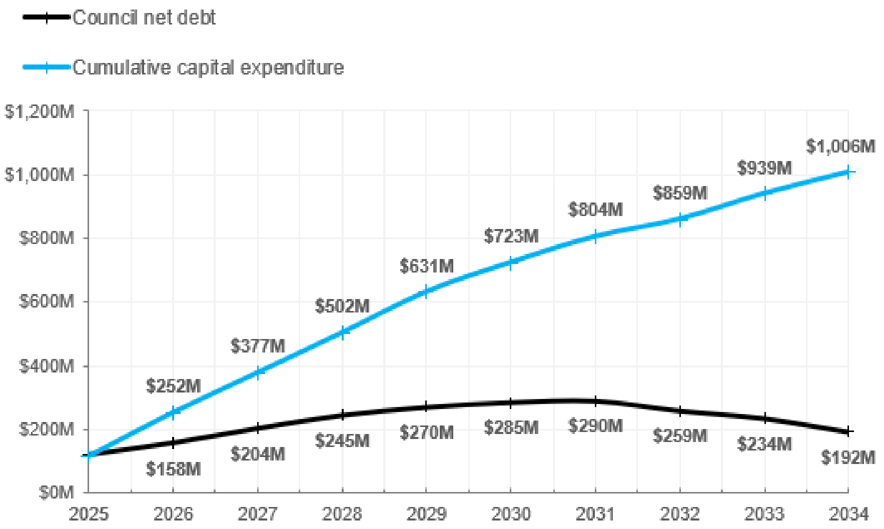
Council will continue to assess market interest rates and look to lock in longer term rates where possible and appropriate to do so.

External debt is only raised after development contributions, reserves and other funding sources have been used. Despite using external debt as a last resort, net borrowing is proposed to increase from the $119 million shown in the 2023-24 Annual Plan to $192 million in 2033-34 year, to fund the $1 billion capital program. However, as stated earlier, in actuality this level of debt is very unlikely.

Note: these values are Net Debt, after deducting and the borrowings made on behalf of the 100% owned MDC Holdings Ltd Group, which includes Port Marlborough NZ Ltd and Marlborough Airport Ltd.

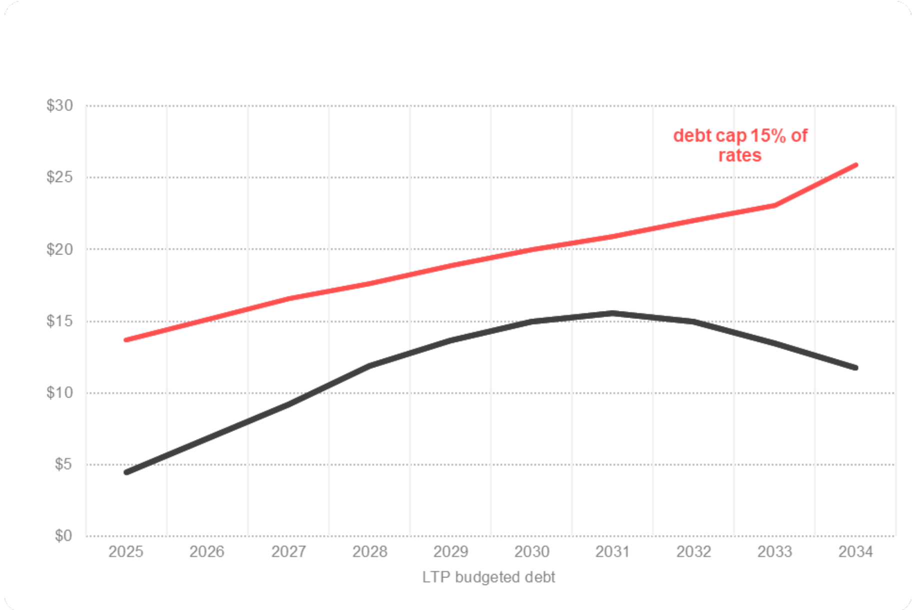
The following graph shows the trend over the Long Term Plan for Council's net debt and cumulative capital expenditure. This graph includes an allowance for price movements based on the BERL forecasts. This graph clearly shows the capital expenditure programme in the initial years is linked to a corresponding movement in loans required to fund this work. In outer years depreciation on the increased asset base funds capital expenditure and there is a reduced reliance on debt.

Council net debt compared to cumulative capital expenditure (in millions)



Debt levels and interest costs

The Council Treasury Policy includes the Investment and Liability Management Policies. Council has established a net debt cap based on net interest being less than 15% of total rates. As identified in the following table Council remains well within this cap over the full LTP period.



Council has adopted the LGFA's borrowing covenants in accordance with advice received from the Council's Treasury Advisor.

Council is a shareholder and lender of the LGFA. This has enabled Council to achieve a lower cost of funding. Council comfortably meets all the covenants the LGFA has set for councils to borrow from it.

The table below identifies each covenant and how Council compares against each one.

FINANCIAL COVENANTS	2025	2026	2027	2028	2029	2030	2031	2032	2033	2034
Net debt / total revenue <250%	59%	73%	90%	102%	108%	118%	119%	102%	89%	71%
Net interest / total revenue <20%	2%	3%	4%	5%	5%	6%	6%	6%	5%	4%
Net interest / annual rates income <30%	4%	6%	8%	9%	10%	10%	10%	9%	8%	7%
Liquidity > 110%	120%	116%	113%	112%	111%	111%	112%	113%	115%	117%

Security on borrowing

Council generally does not offer assets, other than a charge over rates or rate revenue, as security for general borrowing programmes through its Debenture Trust Deed.

Limit on borrowing

Borrowing is a means by which those who pay the cost of providing an asset can be better matched with those who benefit from the use of these assets.

Current ratepayers may form the view that borrowing is the answer to reducing rates increases. However, borrowing is not without cost. The immediate cost is interest. The less obvious costs are:

1. The loss of flexibility Council would face if debt levels rose too high. At the extreme is when sovereign nations are directed to undertake certain actions by their bankers as happened in the GFC. In Council's case it would be by its Debenture Trustee.
2. Council and, as a consequence, ratepayers are impacted upon more severely by increases in interest rates.

As a result Council must also look to keep debt within acceptable levels. The best way of doing this is to constrain capital expenditure. Council has done this by managing its investment levels in capital projects.

There are a number of benchmarks that exist for evaluating if Council's proposed level of debt is too high. These include obtaining a credit rating and adopting the LGFA's parameters as set out above. Currently Council has AA negative watch credit rating from S&P Global Ratings (formerly Standard and Poors). As can be seen from the above table, Council easily meets the covenants outlined above.

The cap for net debt has been changed in this LTP to represent net interest being less than 15% of rates. For 2024-25 this represents a debt cap of approximately $380 to $390 million. The change to basing the cap on rates directly links the cost of servicing such debt to revenue we can influence, which is rates. In short, the cap reflects debt we can afford. In this LTP Council remains comfortably within this cap.

Interest rate risk

Council enters into swap arrangements to mitigate against interest rate risk. However, because of Council's comparatively low level of current debt, it is unable to fix the interest rates until the forecast increased level of debt is actually required. Council only debt is currently forecast to peak at approximately $290 million in 2031. As a result, a 1% change in interest rates above the 5.5% forecast would result in changed interest costs of $2.9 million.

Funding depreciation

Council intends to continue funding depreciation in accordance with its Revenue and Financing Policy. This requires the funding of depreciation for all assets, with some exceptions:

- Depreciation on the revaluation impact of Three Waters assets in the 2024-25 and 2025-26 years which is not being funded. From 2026-27 Council begins to progressively fund the depreciation impact and by 2034 we will be fully funding depreciation.
- Some community facilities (cemeteries, street trees, plots and berms, halls and reserves).
- Rivers, quarries, drains.
- Roading where depreciation is only half funded because of the NZTA financial assistance rate of 51%).
- Southern Valleys Irrigation Scheme.

The revenue collected to fund depreciation will initially be used to repay the debt and then to finance new and replacement assets. Any unused revenue from depreciation will be separately accounted for in the appropriate depreciation reserve.

Operating surpluses

Council also generates operating surpluses each year. These accounting surpluses shown in the Forecast Statement of Comprehensive Revenue and Expense are driven primarily by:

- the need for revenue to meet the principal repayments relating to increasing levels of debt that have arisen as a result of Council's significant capital expenditure programme; and
- generally accepted accounting practice requires vested assets and capital contributions, including development contributions, and NZTA financial assistance for roading capital works to be treated as operating revenue. These items are used to fund capital as compared to operating expenditure.

Any remaining surpluses will be used to defer the need for increasing debt. As a result of the significant recent expenditure on new assets, Council is currently in a period of low renewals. However, as these assets age, the need for renewals will increase, as shown in Council's Infrastructure Strategy, particularly in the years post this Plan. As a result, it is important for Council to retain a strong balance sheet and continue to fund depreciation.

Equity investments and other interests

Council holds investments in:

- MDC Holdings Ltd and its subsidiaries - Port Marlborough NZ Ltd and Marlborough Airport Ltd.
- Marlborough Regional Forestry.
- Investment bonds and term deposits.

MDC Holdings Limited

MDC Holdings Ltd was established to:

- separate Council's commercial trading activities from the other functions it carries out; and
- bring Council's main trading activities into one structure.

For the most part MDC Holdings Ltd is charged with operating in a completely commercial manner. As such the only significant target is to generate a tax paid return on shareholder's funds of at least 7.0%. This target is reviewed annually when Council considers the MDC Holdings Ltd's Statement of Intent.

In addition to the commercial returns received, Council through MDC Holdings Ltd's subsidiaries (Port Marlborough NZ Ltd and Marlborough Airport Ltd) promotes Regional Economic Development as it provides means for the arrival and departure of visitors and the import and export of goods.

Marlborough Regional Forestry (MRF)

Council has an 88.5% ownership interest in MRF, with Kaikōura District Council owning the remaining 11.5%. MRF, a Joint Operating Committee of both Councils, has approximately 5,200 hectares of commercial forest. This forest is managed on a rotation period of approximately 30 years with minor variations in this period based on market conditions. The forest had a value of $35.2 million as at 30 June 2023. As a result of this holding Council is entitled to a share of 130,000 NZ Emission Trading Units (NZETUs) almost entirely from pre-1990 forest (current value circa $6.5 million). The current intention is to replant the forest following harvest. Providing the replanting policy is maintained, MRF should not be required to surrender NZETUs to meet the obligations imposed by the Emissions Trading Scheme on harvest. Council has recently sold 28,459 units in order to fund the purchase of an additional forestry block and will sell further units to finance the purchase of a further block.

Council is not expecting to generate cash proceeds from its investment in MRF for the majority of the period covered by the LTP as there will be insufficient mature trees available for harvest to generate a profit. It is currently projected that harvesting will begin in 2028-29 and from this period onwards significant returns should be generated depending on the internationally determined market price as the forest will be on its second rotation and not require expenditure on the development of roads and other infrastructure.

Council also has significantly smaller holdings of trees in its own right, but these are held predominantly for river protection and not for financial return.

Investment bonds and term deposits

Council holds approximately $13.0 million of investment bonds and term deposits as part of its Disaster Recovery Planning. It is expected that the rate of return received should be similar to the cost of Council's external debt.

LGFA

Council is a shareholder/member of the LGFA. The LGFA is a Council Controlled Trading Organisation (CCTO) set up by specific legislation. A key objective of the LGFA is to provide a funding vehicle that would enable local authorities to borrow at lower interest margins than would otherwise be available.

The LGFA is 'AAA - Stable' rated from S&P Global Ratings. This is the same as the New Zealand Government's domestic rating.

All local authorities are able to borrow from the LGFA. As at 30 June 2023 the LGFA had advanced $18.2 billion to local authorities, generating an estimated saving of approximately 0.25% in interest costs. The amount expected to be advanced by 30 June 2024 is $22 billion.

The LGFA's policy is to pay a dividend that provides an annual rate of return to shareholders equal to LGFA cost of funds plus 2.00% over the medium term noting, however, that the payment of any dividend will be subject to the LGFA Board meeting its legal obligations and its views on appropriate capital structure.