FINANCIAL STRATEGY

INTRODUCTION

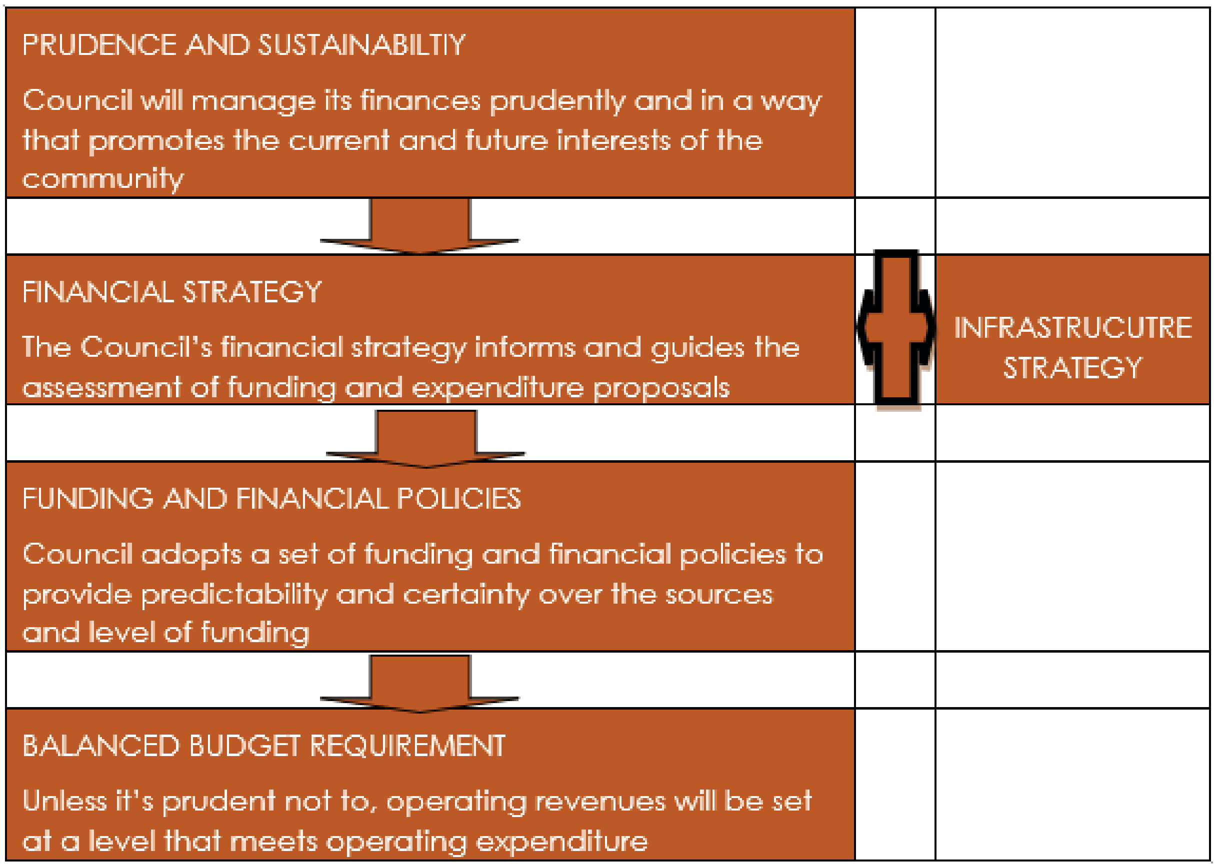
This financial strategy sets the overall direction for the Council's finances over the next ten years. The approach is consistent with the financial management of the Council outlined in previous Long Term Plans. Our approach for prudent financial management includes:

- spreading the cost across today's and tomorrow's users (inter-generational equity)
- having capacity to fund our future capital expenditure programme
- responsibly managing our reserves and investments to meet the inter-generational equity principle
- funding the costs of growth.

We prepare detailed plans every year and a 10-year plan and review of our funding and financial policies every three years. We produce summary versions of those plans for our community and ratepayers and we consult about what we plan to do. We report against those plans every year through our Annual Report which is audited by Audit New Zealand.

The goal of this financial strategy is to 'maintain service delivery while ensuring financial sustainability'. To deliver our services we need to maintain and renew the assets they depend on. To that end, asset management plans have been prepared and are the basis for the forecast renewal expenditure programmes.

THE COUNCIL'S FINANCIAL MANAGEMENT RESPONSIBILITIES



This financial strategy includes the limits on rates, rate increases and borrowing and describes our ability to provide and maintain service levels within these limits. It also outlines the Council's policy on giving security for borrowing and financial investments.

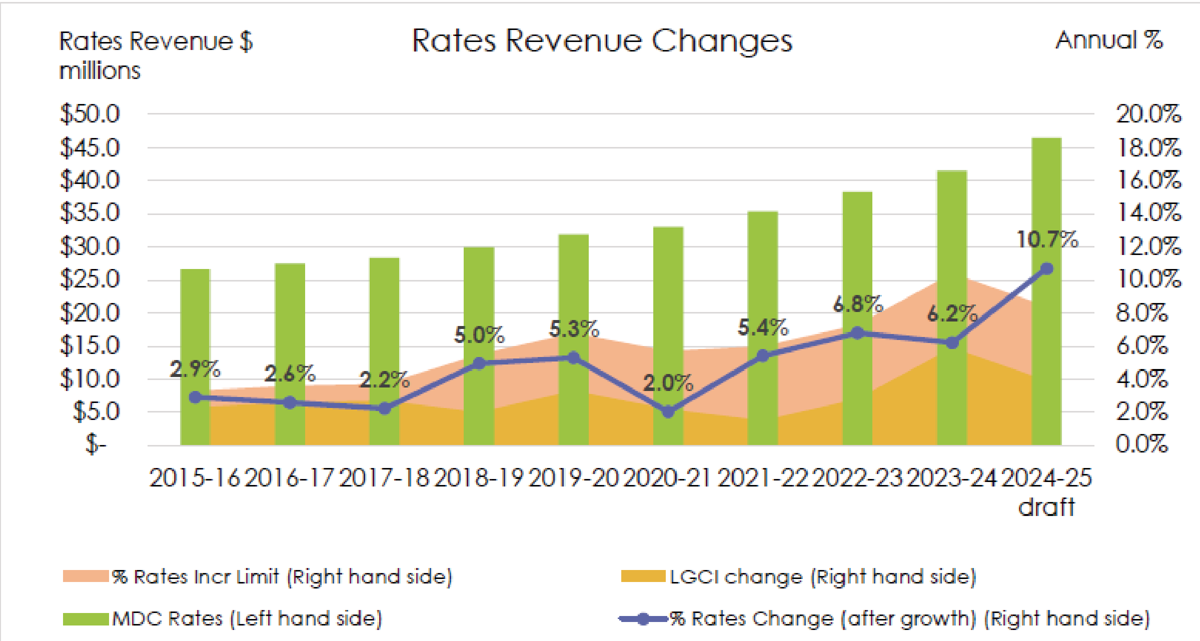
This financial strategy is closely linked to the Council's Infrastructure Strategy. The Infrastructure Strategy details the capital and operational budgets and specific projects in the areas of transportation and roads, water supply, stormwater, wastewater, solid waste management and community facilities.

OVERVIEW

Over the last three years the Council has continued to deliver services to the Masterton community while our local economy has bounced back from the impacts of the COVID-19 pandemic that disrupted our lives in 2020 and 2021. Masterton's economic recovery has had many positives, but there are also signs of slow-down as the inflationary aspects of the recovery have impacted our resident's willingness to invest and spend – the things that keep the wheels of the local economy moving.

On top of that, there has been an economic impact of two years of wet weather that included at least four significant storm events. The Council's ability to respond to those events and reinstate assets and service levels (particularly for roading and wastewater) has been a key focus of 2022 and 2023. The on-going investment in recovery and resilience and the costs of servicing the associated debt incurred is a factor in the Council's current financial position and strategy over the next ten years.

The drivers of our economy remain heavily influenced by the primary sector, the rural service sector and the government sector (education and health). We are less reliant on tourism than many regions. We have seen strong growth in population and new residential housing over the last five years. Council's revenue from rates has been held within the limits that were set by the Long Term Plans and Annual Plans.



Council's regulatory revenue streams from development and construction activity have held up well and are expected to remain steady. We have based our forward planning on the assumption that our economic recovery will continue on a slow, but positive trajectory.

Our financial performance and position over the last 15 years has been dominated by infrastructure expenditure, particularly on the Homebush wastewater treatment plant. Over the next ten years we have scheduled some high value infrastructure spending (renewals and service level increases) as well as construction projects to address areas of community well-being. The proposed library extension and new town hall are significant projects that increase the level of service to our community. We are committed to cyclone recovery roading works, an airport runway project and new animal shelter, all factored in before considering new projects for the 2024-34 Long Term Plan. The new debt associated with these projects will result in increasing rates in year 1 to pay for the increased levels of service.

We are looking to respond to the needs identified in our asset management plans, with a step change increase in maintenance and renewal spending on our roading assets to maintain the current level of service. Water resilience is also a major driver for expenditure as we look at water storage, reducing water losses (leaks), charging for water by usage and improvements to urban drainage and flood protection.

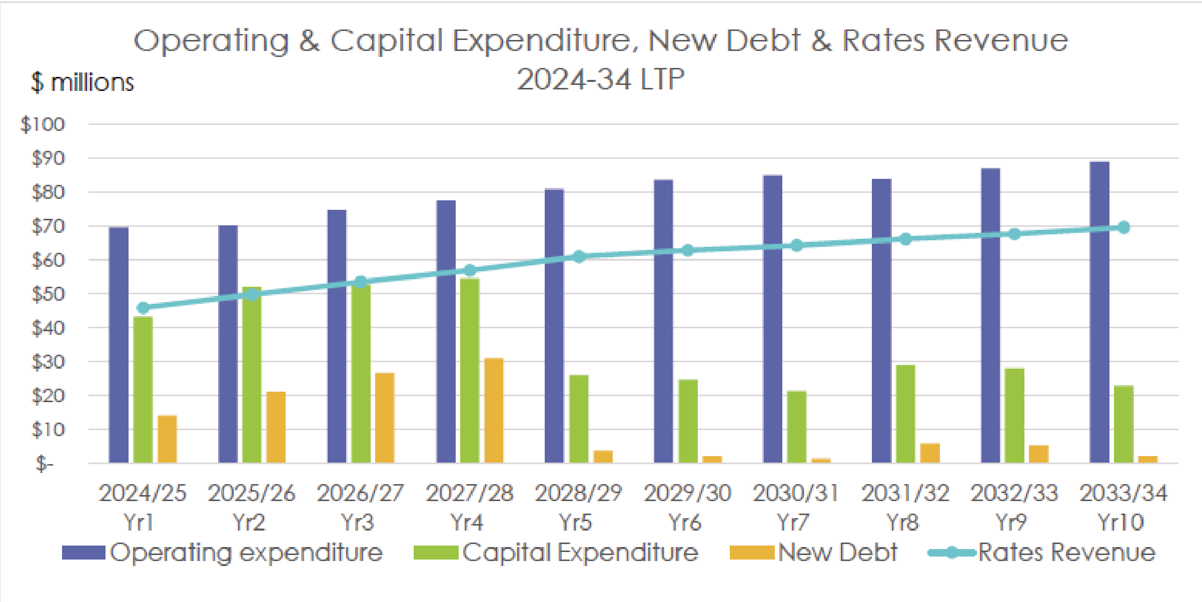
All of the above have contributed to the need to increase rates revenue by an average of 10.6% (after factoring growth in the rating base). This will breach the Council's policy of keeping rate increases below the rate of Local Government inflation (LGCI) plus 4.5%. Beyond year 1, the projected rate increases remain within this limit.

The level of net external debt is projected to increase from $38.4 million to a maximum of $108.6 million by Year 4 and then decline down to $75.6 million by Year 10.

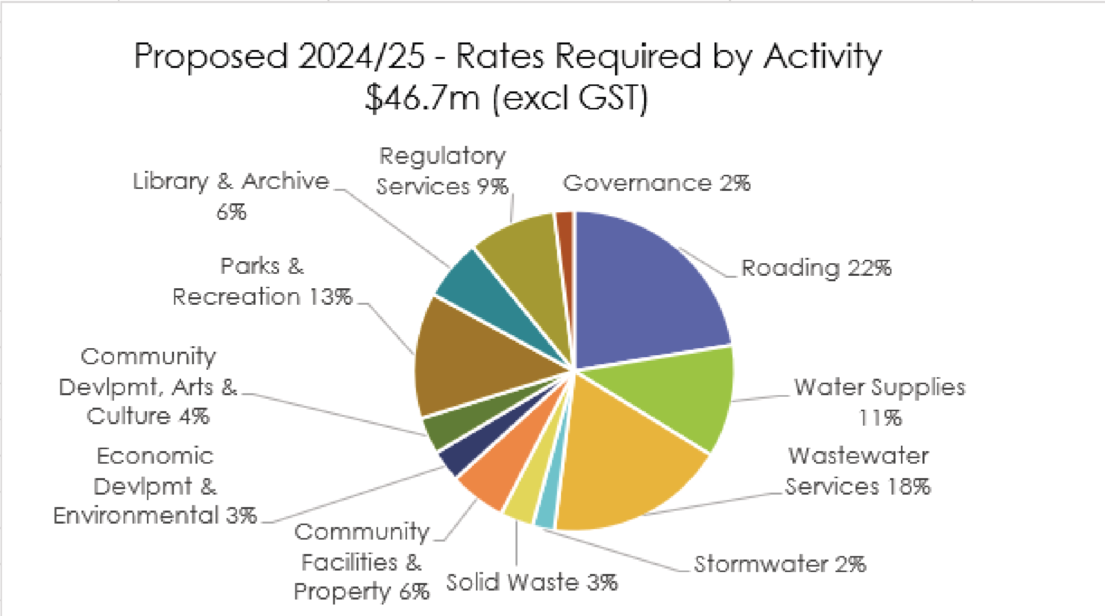
Beyond 2033/34 significant investment in wastewater treatment is included in the asset management plan at the time when the resource consent for the plant is due to expire. Other capital expenditure on water and stormwater infrastructure is planned and we will be in a good position to fund this work from both depreciation reserves and debt.

In the 2021-31 LTP, the Council smoothed rates increases by utilising reserve funds in the early years and building in the repayment in the later years. The unwinding of this smoothing mechanism also contributes to the need to increase rates in year 1 by more than the limit.

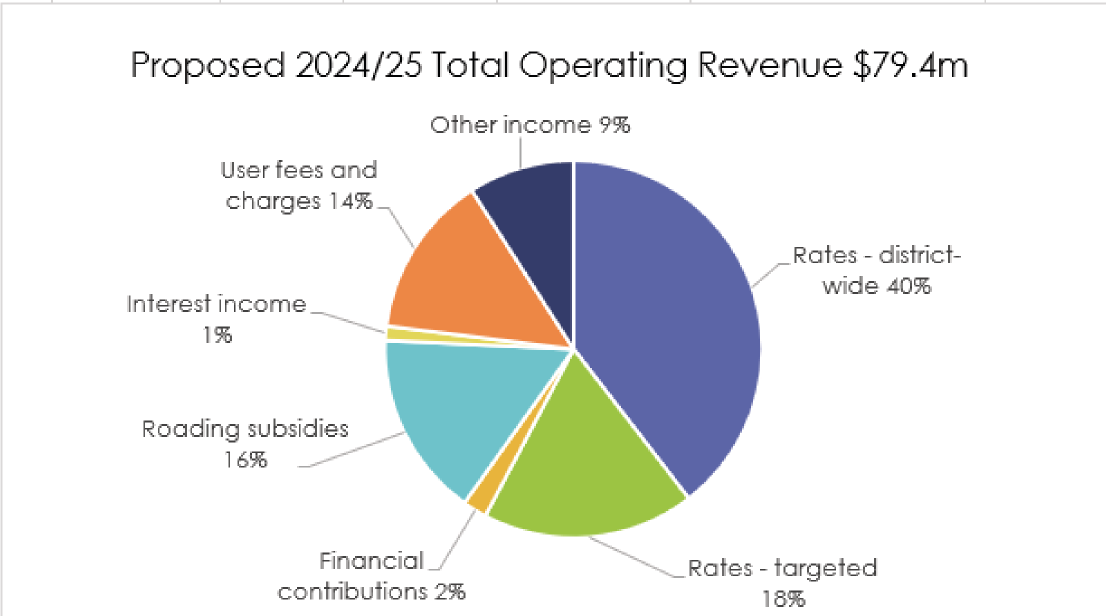
The graph below represents the financial picture of the forecast activity over the next 10 years. Some large capital projects are funded by new debt and the additional cost associated with those projects is the prime driver for the increasing rates required.



WHERE IS THE MONEY SPENT?



WHERE DOES THE MONEY COME FROM?



OUR DISTRICT

We expect to see population average annual growth of 1.5% per annum over the life of the plan. Masterton district's population is projected to grow from 28,900 in 2022 to 33,900 by 2032 (+17.3% over that ten years or +1.73% average growth per annum). Projections through to 2052 see the population increase to 42,100 by 2052 (+45.6% over the 30 year forecast or +1.52% average growth per annum) compared to the 2022 base.

Our population will continue to age faster than the NZ average. Infometrics data shows Masterton currently (at 30 June 2023) has more people aged 65+ (22.7% compared to 16.5%); similar numbers of people aged under 15 (18.2% compared to 18.5%) and a smaller proportion of 'working age' (15-64 years - 59.1% compared to 64.9%). Statistics NZ 2022 forecasts growth in the Masterton population aged 65+, from an estimated 6,600 people in 2023 to 8,900 in 2048 - an increase of approximately 35%. Youth (under 15 years of age) and 'working age' groups are expected to remain at similar levels throughout this period (a small decrease in under 15s and a small increase in 'working age' people). The combined effect is that the proportion of people aged 65+ will increase and Masterton's population will age, projected to move from an average age of 42.2 in 2023 to 47.7 in 2048.

We are currently working to ensure we balance demand at both ends of the demographic pyramid, providing services and opportunities that engage and contribute to the wellbeing of both our younger and older populations. We are also becoming more diverse and we are reflecting this diversity in all that we do.

Household numbers are forecast to grow from 12,352 in 2022 to 18,902 in 2054. This equates to average annual growth of 1.66% to 2054, with higher growth of approximately 1.95% expected in the first ten years and lower growth in the latter years.

Masterton has capacity for growth within its key infrastructure and services. Our 2021 Asset Management Plans indicated we could accommodate housing growth up to 1.8% per annum over the ten years from 2021-31 without significant impacts. We will test and reassess this as we develop the spatial plan scheduled for Year 1 of the 2024-34 LTP, noting also, that there are high levels of uncertainty regarding forecasts in the current environment.

OUR SERVICES

We are planning to provide the same services at the same standard in most of our activities, but there are some areas where we are investing in assets and adding to operating costs. This investment will mean we need to collect more money (in the form of rates) over the period of the plan.

The proposed library extension, new town hall and water assets investment, including increasing water storage are projects that will increase the level of service to our community. We are funding these projects with new debt and we will be increasing rates to pay for that increased level of service. Apart from year 1, rates increases will be kept below the limits defined in this strategy. We are responding to the needs identified in our asset management plans and increasing our operating spend on our water supply and roading assets to maintain the level of service delivered with those assets. Water resilience remains a major driver for expenditure, as is wastewater reticulation renewals with the aim of significant reduction of stormwater inundation into the network.

The Council is planning for regular and consistent renewal expenditure on roading, water, sewer and stormwater assets as well as 'business as usual' for all other Council services. We will keep debt below the borrowing limits defined in this strategy.

Water and Wastewater Infrastructure

Over the last 15 years finances have been dominated by the capital expenditure and associated loan funding needed for the $46 million upgrade of our wastewater treatment plant at Homebush. The completion of that project in 2015 and its subsequent successful operation have greatly improved environmental outcomes. We have progressively repaid the debt relating to Homebush with the intention that it be fully repaid by 2034 to enable further borrowing to invest in meeting expected higher environmental standards.

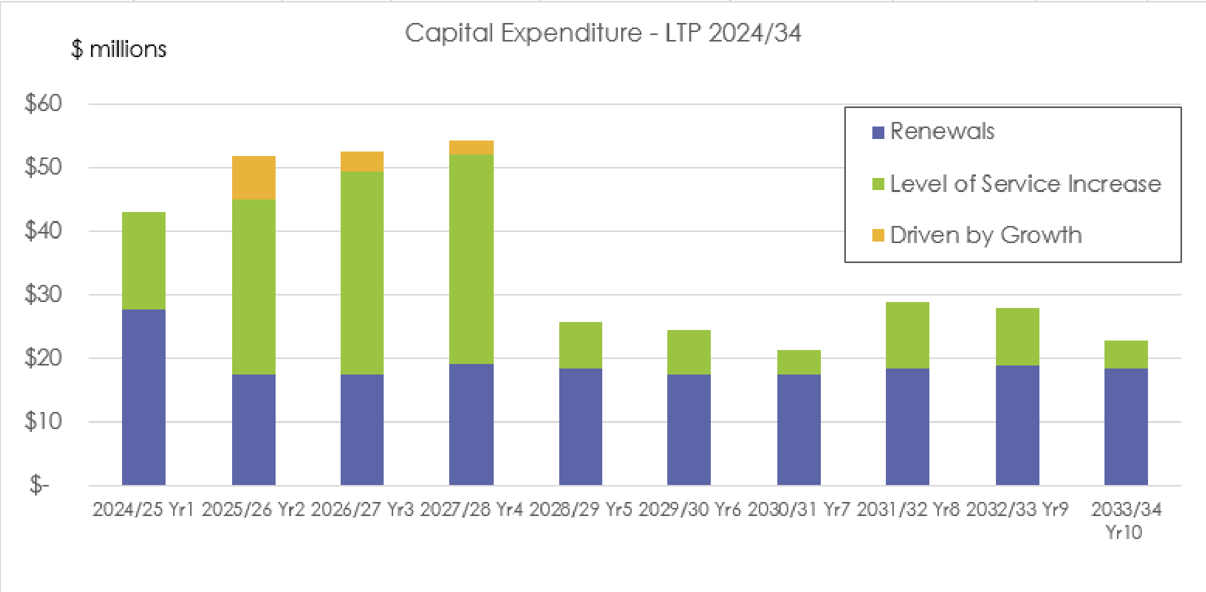
The Council has taken a proactive approach to the renewal of water and wastewater pipes over the last ten years. Since 2014, 11.5% of the water pipe network (25.2km) and 16% of the sewer pipe network (30.6km) have been renewed or relined. This has cost $18.1m and has been funded mainly by current revenue (from our depreciation reserves).

The Infrastructure Strategy indicates ongoing annual expenditure on renewal of our pipe networks. This financial strategy allows for those renewals to be funded by a combination of depreciation reserves, external funding and current rates revenue (via depreciation funding). Where planned capital renewals exceed the money in our depreciation reserve, the Council will borrow to fund the work (eg water trunk main renewals). The extent of new debt required to fund these renewals programmes is included in the projection of debt shown in the graphs on the following pages.

Investment on Masterton urban water supply infrastructure was a focus of the 2021-31 LTP. Three years on and the installation of water meters is nearly completed and we will start a regime of charging for water used from 1 July 2025. Still on our work programme is building more water storage, renewing the Upper Plain trunk main, building an additional reservoir in Upper Plain and continuing to invest in the water main renewal programme over the ten years of the LTP. The cost of the programme of work is a step increase and requires increases in rates to fund the renewals programme, matching the increasing depreciation expense that is driven up by increased costs of replacement (construction inflation).

Growing our Assets

Most capital expenditure over the next 10 years is driven by renewal of assets or increased levels of service from our assets. Where there is a need to invest because growth has caused additional demand, we will first use the financial contributions that we have collected from developers. These financial contributions are paid to councils under the requirements of the Wairarapa Combined District Plan.



FINANCIAL POSITION

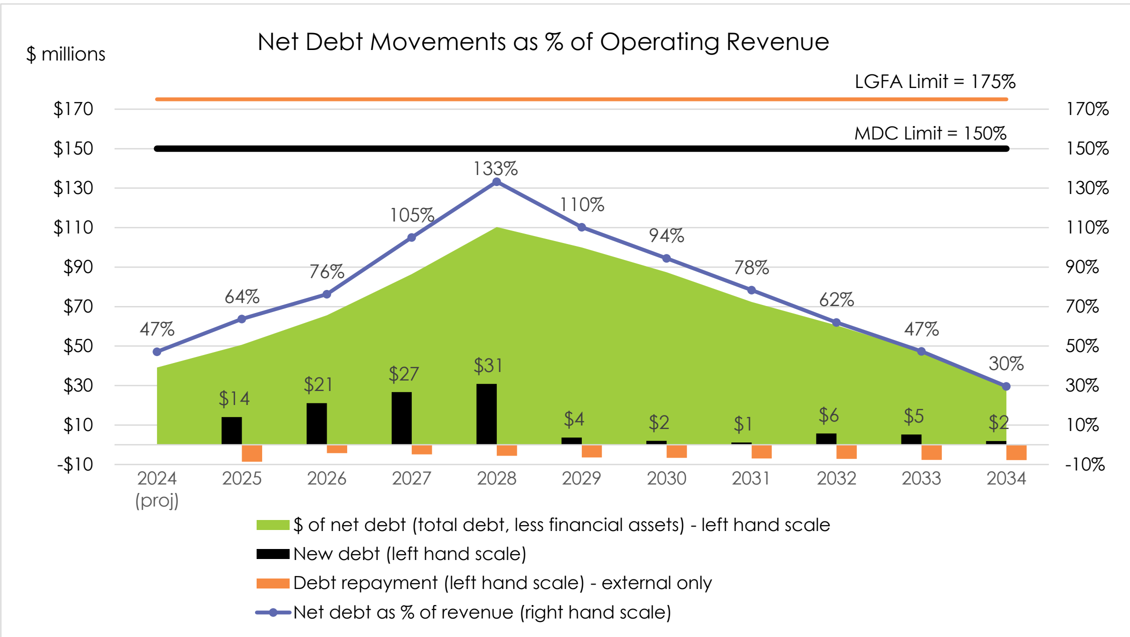
Council's debt

The level of external debt at 30 June 2024 is expected to be $56.4 million. Net Debt (external debt offset by cash and financial assets) is expected to be $38.4 million and will increase to $108.6 million by 2028 before reducing to $75.6 million by 2034 (see graph below under 'Debt Limits' section).

We are spreading the loan repayments on the Homebush debt over 25 years (the term of the consent). As described earlier, this will allow for further borrowing when additional investment is expected to be required in the early 2030s. Funding asset upgrades with debt allows the cost to be spread across current and future ratepayers. We have set prudent policy limits on our borrowing to ensure our community is not over-indebted (see graph below under 'Debt Limits' section). We use interest rate risk management policies to protect against interest rate movements and provide a predictable cost of debt. We are assuming an average interest rate of 4.8% on current debt and 5% on all new debt across the 10 years of the plan.

Our ability to borrow is based on our ability, via a Debenture Trust Deed, to offer rates revenue as security. We have invested in the NZ Local Government Funding Agency (LGFA) as a shareholding council and this enables us to borrow from them and take advantage of their access to favourable debt funding costs.

We are expecting little need for new infrastructure driven by growth in the district, however, where this does occur, financial contributions are taken from developers. These are both general and specific to areas where the growth is driving the need for a specific piece of infrastructure. Our Financial Contributions Policy is based on charging under the provisions of the Resource Management Act and the District Plan. The principle that 'growth funds growth' is one that up-coming revisions to the Wairarapa Combined District Plan (and the financial contributions set under it) will embed. We have assumed the level of contributions will remain constant under a new financial contributions scheme under a revised District Plan.



The chart above shows the net external debt increasing through to 2028, then reducing as loan repayments and financial assets increase. New debt and repayment of debt are separately budgeted and shown on the chart above.

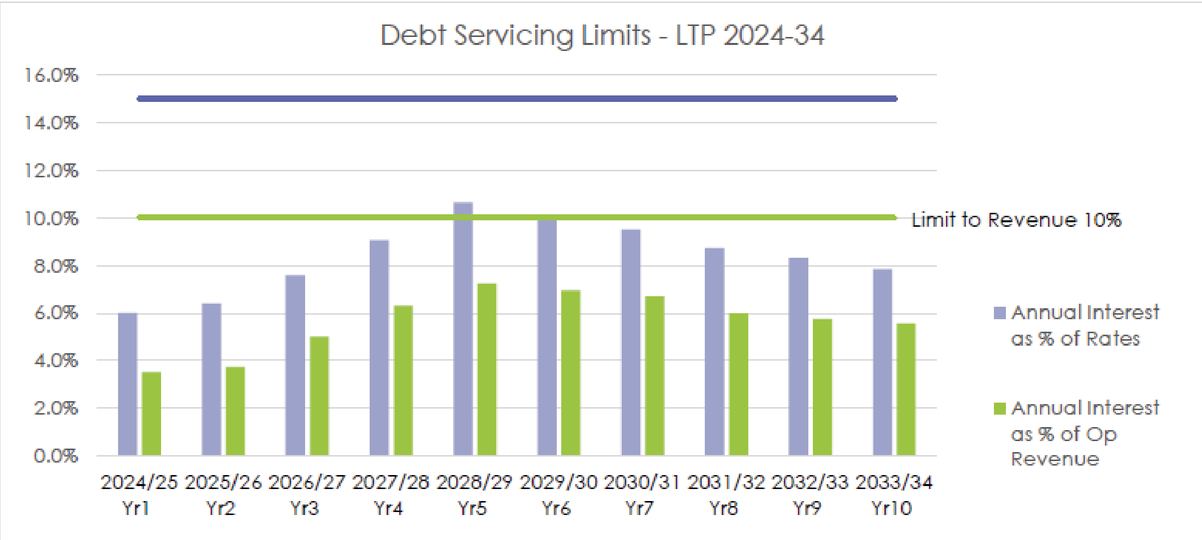
The limit of net debt being below 150% of Operating Revenue is considered prudent. There remains room to borrow more and stay below the debt servicing limit.

If interest rates increase, the liability management policy of maintaining a prudent proportion of fixed interest (using hedging) protects against those movements.

Debt limits

The level of debt forecast over the next 10 years is represented in the previous graph, alongside the limit we have set as maintaining a prudent level of debt. We have also set a limit on how much debt servicing costs will be as a percentage of rates income and operating income. The limits are:

- Net debt not to exceed 150% of Operating Revenue
- Interest on external debt not to exceed 10% of Operating Revenue
- Interest on external debt not to exceed 15% of Rates Income



Reserve Funds and Investments

We have modest reserve funds built up from asset sales and depreciation on assets, which are expected to be $24 million (to be confirmed) at 30 June 2024. The funds are invested in fixed interest instruments such as bond funds and term deposits and allow for internal borrowing/investment. The interest earned on funds invested is used to offset debt servicing costs for specific projects.

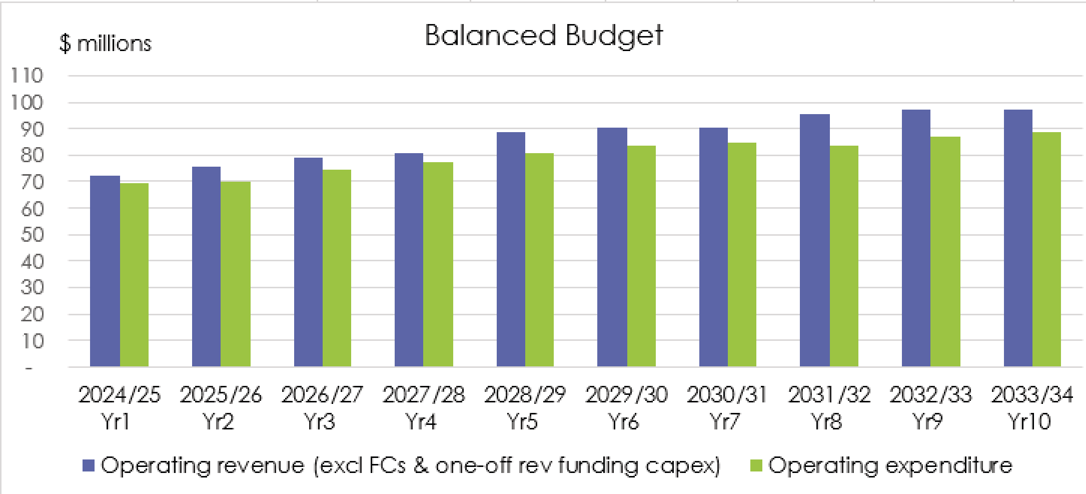
In the first five years of this LTP the roading and 3 waters reserve funds will be drawn down for renewals expenditure faster than they are replenished from depreciation, but not significantly. Across the balance of the 10 years there are projected funding surpluses that will build up the reserve fund balances. There is potential to repay debt earlier or utilise more internal borrowing but the LTP model assumes all debt required over the 10 years will be borrowed externally.

The rates smoothing that was allowed for in the 2021-31 LTP (borrowing from reserves to suppress the rates increase) has been allowed to be unwound by the end of year 2 and the borrowed reserve funds returned progressively over the next eight years. The extent of that borrowing is expected to total $4.0 million. The Net Debt position takes account of cash funds building up in the later years of the LTP.

Financial investments are administered within the guidelines of the Treasury Management Policy. The primary objective of investing is the protection of the investment capital, with a prudent approach to risk and return. In preparing the LTP, the Council has assumed an average return on fixed interest investments of 4.5% in year 1 and 4.0% pa from 2025.

Depreciation and the balanced budget

We have achieved a 'balanced budget' as per the statutory requirement across the life of the LTP. The first two years of this LTP includes provision for grant funding coming from central Government and other sources as one-off revenue to fund capital expenditure. These include 3-waters 'better off funding, airport expansion funding and external resilience grants tied to cyclone recovery projects. In the graph below, this one-off revenue that funds capital expenditure has been excluded. Revenue from financial contributions is also excluded.



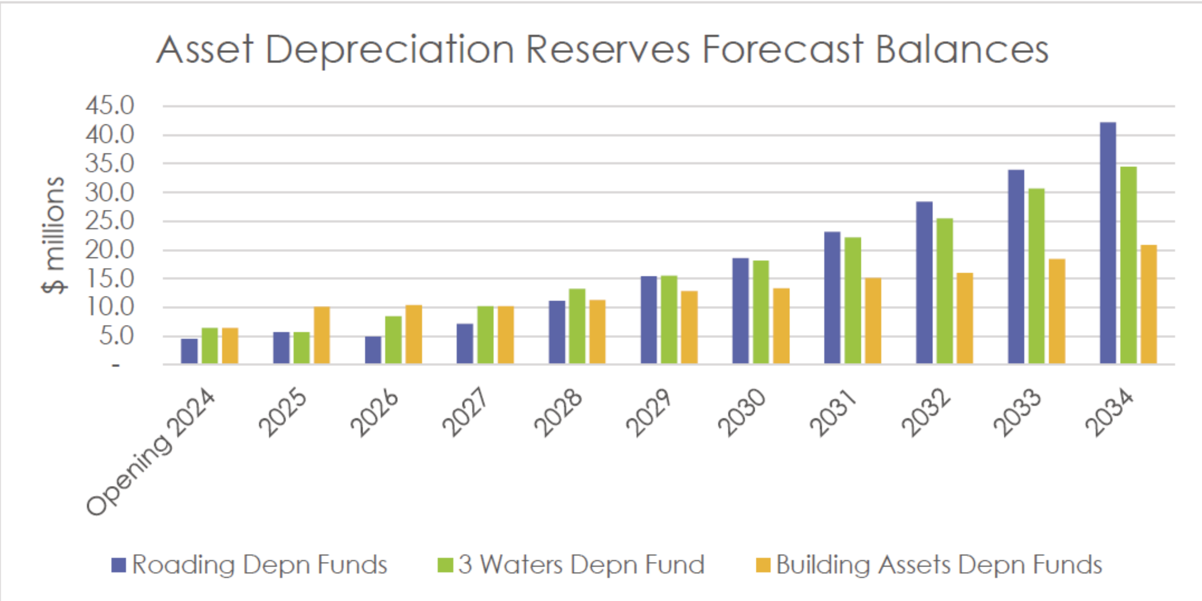
Over the 10 years of the LTP, revaluations of assets have been allowed for. In general revaluations increase the value of the asset and this generates an increased need for funding of the depreciation associated with the asset. We have built in consistent increases in the funding of depreciation, except on assets we do not expect to replace, allowing us to consistently achieve a surplus budget and remain financially sustainable.

Full depreciation on Council assets has been recognised as an expense, but we have decided not to fully fund all depreciation on a number of specific assets (i.e. not fully allow for revenue to match the expense).

In the roading activity, the renewals programme is designed to maintain the road network in a constant state. Depreciation expense is recognised and renewals are capitalised. The value of the capital programme is funded by way of subsidies from the Waka Kotahi/NZTA and rates revenue. Those assets in the roading activity that are not renewed on an annual programme will have funding from the depreciation reserves to cover our share (after the NZTA subsidy is received). Building up that depreciation reserves to achieve this will be done across the ten years of the LTP.

Other assets where the depreciation expense is not fully funded and the reasoning for each are as follows:

- Housing for the Elderly – to hold rents low and have no rates input, not all depreciation is covered by rental income. We have covered renewing components as required but full replacement of the homes at the end of their anticipated life will require external income assistance (e.g. government subsidies or more debt to be taken on). We have allowed to maintain and renew parts of the buildings appropriately, so we expect to extend the useful life of these assets and delay their replacement.
- Rural Halls – there is no intention to replace at least half of these buildings. This has been Council's policy for some time.
- Recreation Centre – the redevelopment of this facility in 2003/04 was half-funded with external contributions of approximately $3.5 million. We are funding sufficient depreciation to cover replacement of plant and equipment. Not all depreciation is funded as we have assumed the future replacement of the facility will again attract external funding when it is required.
- Water, sewerage and stormwater assets – we have chosen to increase rates revenue to fund the renewal programme. Debt repayment is also funded directly from rates revenue in order to ensure the cost of upgrades is allocated and paid for by the ratepayers who benefit from those assets. Where loan repayments are funded by rates revenue, full depreciation from rates will not be funded as well.

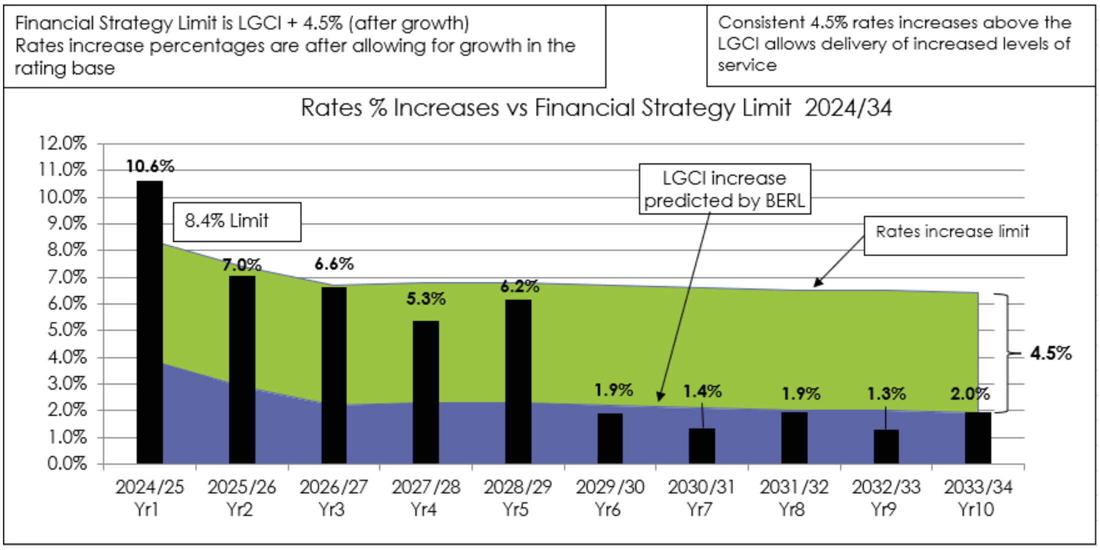


Rates increases

Rates revenue makes up between 60% and 70% of council's operating revenue. Rates are levied on the property owners of the district and keeping changes in rates affordable is a key aspect of our decision making framework. There are many drivers for the need to increase our rates revenue. Increases vary each year, with lower increases required in the later years of this LTP. In years 1-3 our roading programme has seen a step change in expenditure. In Years 2 - 5 the impact of the proposed investment in a library extension and new town hall are factors in the rates increases.

We have set a limit on how much rates revenue can increase – that limit is the LGCI movement plus 4.5%, plus growth in the rating base. For the year 2023-24 the LGCI is forecast to increase by 3.9%, so the Council would normally look to stay below an 8.4% increase in its rates revenue. The LGCI is the rate of inflation of Council costs, calculated independently by Business and Economic Research Ltd (BERL).

As noted above, unavoidable cost increases have seen the need for an average increase of 10.6% in 2024/25. Apart from the breach in year 1, we believe we can achieve rates increases within the limit the Council has set. The number of properties that we can levy rates on and the capital values of those properties is predicted to grow annually over the course of the 10 years. We believe that growth will generate an additional 1.4% of rates income in year 1, 1.2% in year 2 and 1% there-after. The extra revenue from this growth is taken up when comparing to the rates increase limits.



Risk and Resilience

Our financial resilience in the face of unexpected costs is based on having financial assets of at least $18 million (and growing each year) to meet the initial costs of an event. Those funds are a mixture of term deposits and bond fund investments and are easily accessible if required. We carry material damage insurance cover on all buildings and significant above-ground assets. We also cover our underground network assets – the Council is a member of the Local Authority Protection Programme Fund (LAPP) which is designed to meet our obligation to pay 40% of the costs to restore our underground infrastructure in the event of a disaster. The balance of 60% is expected to be met by central Government's Disaster Recovery Fund. Insurance products for our 40% of cover remain an option if the LAPP fund is not the most appropriate vehicle to cover MDC's share of the risk.

Damage to roads and bridge assets in the event of a natural disaster (including flooding) will be funded by our annual roading budget, NZTA subsidies and our roading and flood damage reserve funds (which are part of the $18 million noted above). We have assumed that the NZTA share of the costs will increase depending on the severity of the event. Flood damage reserve funds have been drawn on extensively in 2022 and 2023 and have a negative balance of -$1.6 million as at 30 June 2023. From 2023/24, subsequent budgets have allowed for the rebuilding of those funds at $500k per year from rates.