OPERATIONAL AND FINANCIAL ISSUES ASSOCIATED WITH THE REORGANISATION PROPOSAL FOR THE ABOLITION OF THE KAIKOURA DISTRICT AND ITS INCLUSION IN THE HURUNUI DISTRICT

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. Introduction

This report contains the findings of the study on service delivery and financial issues associated with the reorganisation proposal for the abolition of the Kaikoura District and either its inclusion in the Hurunui District, or part inclusion in the Marlborough District and part inclusion in the Hurunui District.

The report has been prepared by Brian Smith, Principal, Brian Smith Advisory Services Limited in terms of an agreement dated January 2009. The full terms of reference for the review are below.

Terms of Reference

The review was undertaken in two parts.

Terms of reference for **Phase One** of the Review (January/February 2009) were;

- Assessment of the sustainability of financial and service delivery arrangements relating to the main infrastructural and community services provided by Kaikoura District Council (KDC).
- Comparative analysis of Hurunui (HDC) and Marlborough District Council (MDC) financial and funding policies with those of KDC.
- Indicative assessment of the likely differences in costs associated with the proposal compared to the status quo.
- Assessment of the perceived risks associated with KDC's financial sustainability as identified by some submitters to the proposal.
- Delivery of a written report on the above to the Commissioners and Commission staff, with subsequent meetings.

The **second phase** of the review (March – May 2009) entailed;

- Analysis of updated information from KDC, HDC and MDC's Draft 2009-19 LTCCPs, and updated Asset Management Plans (AMPs) of KDC and HDC.
- Discussions with key staff of HDC and KDC
- Further detailed analysis as identified from the work, or feedback, from the first phase
- A written report on the above aspects

Phase One of the Review

(12 February 2009)

CONTENTS (Phase One Review)

Executive Summary (Phase 1 of Review)

This review contains the interim findings of a study of the financial sustainability and service delivery of Kaikoura District Council (KDC). The review is being sought by the Local Government Commission to inform on the efficacy of a proposal that KDC be abolished and included either fully in the Hurunui District or part included in Hurunui and part included in Marlborough District.

The review examines the overall financial position of KDC and its future financial sustainability. It also looks at key aspects of KDC operations such as infrastructure services and other significant issues arising from community and regulatory activities. The review also provides an initial assessment on the changes in corporate and governance costs associated with the abolition of KDC as an autonomous council. Lastly the review draws a comparison between selected financial and funding policies of Hurunui, Marlborough and Kaikoura District Councils.

On the basis of information reviewed thus far, KDC is in a sound financial position and is financially sustainable over the next ten years. This assessment is based on analysis of KDC's 2006-16 LTCCP, recent annual reports and asset management plans (AMPs). At this stage revised AMPs are being finalised and the Draft 2009-19 LTCCP is being compiled, so it may be necessary to reconfirm this assessment.

Infrastructure services are being well managed and there do not appear to be lurking issues of assets in poor condition or at risk of major failure. In fact extensive work has been done to upgrade assets and increase the levels of service that are being provided to the community. There do not appear to be cost saving opportunities for shared service arrangements in infrastructure activities.

In relation to other Council activities, there may be opportunities for shared services or pooling of inter-council resources in the regulatory area, but the monetary effect would be minor. A major issue is the proposal to construct a 'Community Hub' at an estimated cost of around $16million. The advancement of this proposal is now with appointed Trustees. KDC has, however, indicated that the maximum Council borrowing for the Hub would be $8million which is within the thresholds of its borrowing policy and is financially sustainable. The interest costs on $8 million, applying Council's 2006-16 LTCCP assumed interest rate of 7.2%, would be about $0.58 million per annum. On the basis of the funding sources for the Community Hub in the 2006-16 LTCCP, the interest would be met by rates revenue.

If KDC were to be abolished there would be an annual reduction of governance and corporate costs of around $450,000. This is an initial ‘narrow’assessment and comes with many assumptions and provisos – for example, it does not take account of one-off costs such as redundancies, and the largely hidden costs of disruption and more remote relationships that would occur if there was to be amalgamation.

An inter-council comparison of Revenue and Financing Policies indicates that KDC believes the benefits of its activities are more community oriented whereas Hurunui perceive the benefit is more to the individual. Marlborough sits in the middle. Also KDC’s levels of service and performance reporting reflect its emphasis on the environmental and social well beings when compared to the equivalent reporting for Hurunui. In regard to Liability Management Policies, the content and borrowing thresholds are broadly similar.

1 Methodology

1.1 In conducting the first phase of the review the following methodology has been applied;

- Desktop analysis of key planning and accountability documents
- Discussions with KDC personnel, Audit NZ Director and progress calls with Commission staff
- Review of submissions to the proposal

1.2 The key planning and accountability documents analysed were;

- KDC 2006/16 LTCCP
- KDC 2007/08 Annual Report and 2008/09 Annual Plan
- KDC Asset Management Plans for roads, water, sewerage and stormwater
- NZ Transport Agency reports on KDC road management
- KDC asset valuations
- KDC Management accounts detailing corporate and administration expenses
- Audit NZ management letters
- Selected aspects of the HDC and MDC 2006/16 LTCCPS

1.3 Discussions were held with;

Stuart Grant	CEO	}	
Sheryl Poulsen	Finance Manager	}	
Gallo Saidy	Asset Manager	}	KDC
Marlene Saidy-Roberts	Asset Manager	}	
John Mackey			Audit NZ Director

1.4 No discussions have been held with HDC or MDC personnel.

1.5 At present KDC's draft 2009/19 LTCCP is not yet available for analysis. Updated AMPs for each infrastructure network are due in February 2009.

2 KDC Infrastructure Services

In this section of the report each infrastructure network is examined under the following subheadings

- Asset description
- State of the assets
- Service provision
- Financial projections
- Future Sustainability

2.1 **Roading**

2.1.1 *Description of Roading*

KDC has a very small roading network of 205 kilometres, equally split between sealed and unsealed roads. KDC also has 40 bridges, 22kms of footpath and associated kerbs and channel, and 320 streetlights.

2.1.2 *State of the Road Assets*

A review of the Road AMP indicates that the roading assets are in reasonable condition, and streetlights and footpaths have been upgraded in the past few years.

The NZ Transport Agency (NZTA) regularly audits all Council roads (called a technical audit). NZTA also review the strength of Council roading AMPs. The technical audit in December 2008 stated that the "structural component of the network is in good condition". There were some suggestions for improvements in minor safety issues, corridor and data management.

The NZTA ranked KDC's roading AMP slightly lower than other Southern Region Councils roading AMPs. On examination, the aspects marked down in KDC were more process oriented than substantive issues.

2.1.3 *Service Provision*

The planned levels of service for road are well outlined in the 2006 LTCCP and targets generally appear to have been met.

KDC would like to undertake seal extensions but, as these are unlikely to meet NZTA's benefit/cost criteria and therefore not attract subsidy, no seal extensions have been formally planned.

KDC has a roading maintenance contract with Fulton Hogan. The contract (which expires in 2010) was perused, and it appears to be well formulated. The contractor has been performing well. Separate contracts are let for reseal and footpath upgrades.

Fulton Hogan (FH) staff and plant are based in Kaikoura and supervised from FH's Blenheim branch. While FH is also the contractor for the Northern part of HDC, their crew is based in Hurunui and is managed by FH's Canterbury operation. There appears to be little scope for Council shared services that would lead to a lower overall cost and higher effectiveness of roading operations. HDC, and KDC contractors and staff do 'network' and assist each other in emergency events.

2.1.4 *Financial Projections for Roading*

The 2006/16 LTCCP and the roading AMP indicate that roading operations are financially sustainable over the 10 years to 2016.

Tracking of actual 2007 and 2008 dollars against the 2006 LTCCP budget shows that actual operating expenditure and revenue is greater than originally forecast, but the net operating result is comparable. Depreciation expenses have tracked higher than estimated in the LTCCP because of new assets vested to Council from developers, and through later (and more robust) valuations. Development Contributions revenue, after an initial bubble in 2007, are now tracking at below the LTCCP forecast. This has however, been recognised in KDC's 2007/08 and 2008/09 Annual Plans.

Roading renewal expenditure is, cumulatively to 2008, tracking ahead of the LTCCP forecast.

Roading depreciation is fully funded.

2.1.5 *Future Sustainability*

From a physical asset perspective, the condition and performance of roading assets appears sound, with no lurking issues which would give rise to financial stress.

KDC has identified the need to increase road reseals from an annual average of 6kms to 7kms. This is due to a larger network from new subdivisions. This can be accommodated within present financial resources.

KDC may also want to increase walking and cycling facilities (following a recent strategy) but the degree to which this is implemented will be dependent on the extent of NZTA subsidies.

From a human resource capacity perspective, KDC has two infrastructure asset managers who manage the water utilities as well as the roading assets. They are backed up by consulting engineers based in Christchurch. If there was to be an amalgamated Council two asset managers would still, in my opinion, be required to plan and supervise the full suite of infrastructure services in the Kaikoura locality.

2.2 Water Supplies

2.2.1 *Asset Description*

KDC has six public water supply schemes. The largest scheme is the 1400 connections for the Kaikoura township, which accounts for 84% of all water connections.

2.2.2 *State of the Water Assets*

Extensive work has been carried out over recent years to

- put in a place a secure ground water source for Kaikoura township.
- replace aging pipe capacity infrastructure in Kaikoura township.
- increase storage capacity and treatment facilities for several smaller schemes.

A perusal of the 2006 Water AMP indicated a very sound approach to asset management and a clear articulation of future maintenance, renewals and new capital works. The AMP is due to be revised in February 2009.

KDC has also prepared Public Health Risk Management Plans (PHRMPs) for all six water schemes.

2.2.3 *Service Provision - Water*

The work recently done has raised the levels of service provided, particularly for Kaikoura township residents. The MoH water grading for Kaikoura is 'B' which is impressive for a small town supply. Further work is planned for leak reduction, which is an important aspect of KDC's environmental emphasis. Customer complaints on water issues have substantially declined.

Fulton Hogan also has the maintenance contract, with several staff based locally to provide routine services. The performance of the contract has been satisfactory overall.

There appears to be little scope for savings through shared services, particularly with HDC, who have had (anecdotally) much on their plate to maintain water services in their own townships.

2.2.4 *Financial Projections for Water*

The 2006 LTCCP projections show surpluses on water operations each year through to 2016. The actual position for 2007 and 2008 has resulted in lesser surpluses than forecast. In the 2008/09 Annual Plan a breakeven position is estimated.

As with roading, depreciation expenses have been higher than originally forecast. On the revenue side, development contributions have fallen significantly below LTCCP expectations.

The main funding sources are targeted rates for water operations and loan charges. For Kaikoura, the annual targeted rate per connection rises modestly from $172 in 2006/07 to an expected $194 in 2009/10. The targeted annual rate for water loan charges rises from $66 to $120 over the same period. An increasing number of connections have meant yearly targeted rates and charges rises from $435k in 2006/07 to an expected $557k in 2008/09.

Approximately $1.08million will be spent in the 3 years from July 2006 to June 2009 on new or upgraded water assets. Capex on asset renewals over the same period will be around $285k. Funding for all types of capex (i.e. renewals, new and upgraded assets) has been a mixture of loans, reserves and depreciation.

Water depreciation is fully funded.

2.2.5 *Future Sustainability*

From an initial examination, KDC has been able to substantially increase the level of service for its water activity at a relatively modest and affordable cost.

The Kaikoura township water charge increases (per connection) have also been modest. The development contributions revenue has, to date, been little over half that expected compared to the 2006 LTCCP.

The revised water AMP (due February 2009) and the draft 2009/2019 LTCCP will provide a clearer picture of future water projects and their funding. However, at this point, there does not appear to be any indications of impending asset failures or sub-optimal performance. Most projects are for proactive improvement of services rather than shortfalls in replacement.

The possibility of cost savings through shared services arrangements appear to be minimal given the strained asset management resources of HDC and the discrete, standalone nature of the KDC water schemes.

2.3 Sewerage and Stormwater Assets

2.3.1 *Asset Description*

There is only one public sewerage scheme which is for Kaikoura township servicing 1400 properties. There are 54 kilometres of pipe reticulation, 10 pumping stations and an oxidation pond. Sewage treated in the oxidation pond is discharged into the ground.

The stormwater network is very small with 17kms of pipes and 40kms of unpiped channels.

2.3.2 *State of the Sewerage and Stormwater Assets*

KDC has AMPS for both sewerage and stormwater. They are dated 2006 and well describe the asset management strategies.

A project is finishing about now to inspect, by CCTV, all (except the newest) pipes. This will give much more robust information about the condition of piped assets. The outcome of these inspections and the ramifications that arise from the inspections will be included in the revised AMP to be finalised in February 2009.

Upgrades to the sewerage infrastructure have recently been undertaken, including upgraded pumps, new main trunk pipes and improvements to the oxidation pond.

2.3.3 *Service Provision – Sewerage and Stormwater*

The planned levels of service and the reports on achievement of targets and measures indicate that a good performance framework is in place and that KDC is delivering to the planned levels of service. KDC's 2008 annual report states that all oxidation pond effluent tests for levels of nitrogen were within World Health Organisation standards.

Fulton Hogan has the maintenance contract and this appears to be working satisfactorily (Note: the FH contract applies to all three water services).

As in the case of water services, there appears to be little scope for savings through shared services. If KDC was to be amalgamated, there would still need to be in situ maintenance personnel and a defined contract for the Kaikoura sewerage scheme. The two asset managers present at KDC would still be needed to provide direction, planning, contract administering and supervision for the range of infrastructure services provided.

Further information on the outlook for levels of service and future service performance is expected in the revised AMP and Draft 2009/19 LTCCP. That may show more emphasis toward stormwater improvements.

2.3.4 *Financial Projections for Sewerage and Stormwater.*

The 2006 LTCCP projects, for each year to 2016, significant operating surpluses for the sewerage activity. Several years show a very high forecast surplus, but this is explained by the anticipated receipt of subsidies of $1.6million.

Actual operating surpluses in 2007 and 2008 have been slightly less than anticipated. This is mainly because not all the Ministry of Tourism subsidy had yet been received.

Actual operating expenditure is tracking closely to forecast operating expenditure.

The sewerage targeted rate for connected Kaikoura properties increases modestly from $216 in 2006/07 to an expected $252 in 2009/10. Over the same period the sewerage loan rate charge per property will halve from $28 to $14.

The sewerage upgrade works for the period July 2006 to June 2009 will be around $2.01million; the LTCCP forecast for this work over the same period is $2.5 million. This has been principally funded by the subsidy mentioned above and depreciation funds.

At present the extent of sewerage and stormwater renewal capex is very small, although it is forecast to increase to around $120-$130k per year from 2010 onwards.

2.3.5 *Future Sustainability*

KDC has accommodated a substantial sewerage upgrade through a subsidy. Targeted rates and charge increases have been modest and operating expenditure close to forecast.

More information on the state of the assets, and the consequent renewal profiles, will be clearer when the 2009 AMPs are finalised. There is no indication of any impending asset failures that would have significant financial effects.

Asset and service performance is satisfactory in comparison with planned levels of service.

For the same rationale given in water services (paragraph 2.2.5) there appears little scope for cost savings through shared service arrangements in the sewerage and stormwater activity.

2.4 Refuse and Recycling

2.4.1 *Asset Description*

Through Innovative Waste Kaikoura (a Council Controlled Organisation), the Resource Recycling Centre has a landfill, green waste and organics composting facility, a recycling centre and a hazardous waste disposal facility.

2.4.2 *State of the Assets*

The major issues here is that the existing landfill will run out of physical capacity around 2012 and, recognizing that zero waste is unlikely by this time, KDC will need to find a solution.

2.4.3 *Service Provision*

The Levels of service for Refuse and Recycling at KDC are predicated on the environmental values it promotes. The levels of service are well articulated in the 2006 LTCCP and measured in the annual reports.

While the 'objective' service measures of "Solid waste taken to landfill" and "Percentage of recyclable Material diverted from landfill" show the desired trends, residents surveys show a slip in satisfaction. I understand, from discussions with the CEO, that measures have been taken to improve staff attitudes at Innovative Waste Kaikoura.

2.4.4 *Financial Projections*

The 2006 LTCCP indicates that the Refuse and Recycling activity is funded from General Rates. The LTCCP forecasts that the funding from General Rates will almost double over the period 2006-16 (from $335k to $608k).

In 2006/07 the actual General Rates funding was very close to the LTCCP projection, but the actual General Rates funding was less than expected in 2008 and is tracking below the LTCCP forecast for the current 2008/09 year.

In relation to capex the 2006 LTCCP has forecast $371k in capital expenditure in 2012 related to the new site and assets that might be required.

KDC has recently increased its annual provision for meeting post closure costs associated with the existing landfill.

2.4.5 *Future Sustainability*

It would be neither feasible nor affordable for KDC to construct a new landfill.

Fortunately KDC is permitted access to the Kate Valley landfill in North Canterbury, and I understand talks are underway to progress this further.

It is still expected that another site will be obtained for refuse facilities and, from discussions with the CEO, negotiations are underway with a property developer for transfer of the facilities to a business park. Whether the $371k identified as capex in 2012 is sufficient for this potential site is still unknown and may be clearer in the Draft 2009-19 LTCCP.

3. Community and Commercial Services

3.1 Introduction

This section looks at Council Services other than infrastructure, Governance and Corporate Services.

The services include;

Community Services	Parks and Reserves library toilets cemeteries pools pensioner housing
Commercial activities	Forestry Harbour Airport Commercial Properties
Safety and Wellbeing	Civil Defence Fire Control Environmental Health Community Development
Regulatory	Building Control Statutory Planning Animal Control
District Development	District Planning Environmental Planning Tourism Planning

Rather than separately examine each activity, the major activities and/or major issues have been selected for comment

3.2 Aspects selected for comment are;
- library (3.3)

- toilets (3.4)
- regulatory (3.5)
- proposed ‘community hub’ (3.6)
- tourism planning (3.7)

3.3 **Library**

This was selected for review because library operations often lend themselves to shared services arrangements.

In the 2006 LTCCP the cost of library operations for 2006/07 was estimated at $189k, with a gradual rise to $207k in 2016. In the two completed years of the 2006/16 LTCCP period (i.e. 2007 and 2008) actual expenditure was below the LTCCP estimate. Expenditure in the current year is set to increase markedly as the library has taken over vacated space in the existing library building, thereby increasing the rental cost.

There is a fulltime librarian with three part time staff, and the library is open 5.5 days of the week.

The CEO advised that the possibility of library shared services arrangements with MDC was looked at three years ago, but neither the financial or operational outcomes of the study were attractive to KDC. However there is co-operation with MDC and HDC librarians. There is a sharing of “talking” books and large print books, and KDC stock purchases are often done through MDC to gain better purchasing deals. KDC also has access to books through the National Library Service.

Having regard to the modest annual expenditure of the library, the reasonable level of service (in terms of hours of operation and increased space) and the “low key” shared services being achieved now, cost savings through alternative service delivery would be small and may erode the levels of service now in place.

3.4 **Toilets**

For a small Council, KDC has a large number of public toilets. There are 7 identified in the 2006 LTCCP, and three have been constructed since then.

Maintenance is mostly carried out by a Christchurch based contractor, who has a maintenance worker located in Kaikoura.

The 2008 residents survey shows increased satisfaction with public toilet, halting a declining trend over the previous 2 years.

Unfortunately the LTCCP does not separately disclose toilet operational and capital costs. It is expected that operational and depreciation costs will increase substantially, and this may be an aspect to follow up in the draft 2009/19 LTCCP. There is no AMP for toilets (or for other community facilities) and this is a planning aspect KDC should address in the future.

3.5 Regulatory

Expenditure on Building Control in the period 2007 and 2008 has been 39% above that estimated in the 2006 LTCCP. This is attributable to costs associated with gaining Stage 1 accreditation as a Building Consent Authority. Further costs are expected for KDC to gain Stage 2 accreditation by June 2009.

KDC has used reserves to meet some of this cost, and the expected fee revenue in future will fall with the drop in building activity.

KDC has two building control officers and an administrative assistant.

This may be an area for further study on shared services. It may be feasible (if KDC were to remain an autonomous council) for KDC Building Control Officers to perform work in the northern localities of HDC or the southern localities of MDC. Alternatively, there could be a ‘pooling’ arrangement between Councils.

3.6 Proposed Community 'Hub'

This is obviously a contentious issue in the community judging by the submissions to the abolition proposal.

The 2006 LTCCP (P124) shows the capital estimate for the then named 'Combined Community and Sports Complex' as $16.4million expended over a 3 year period 2008-2010. Funding was planned from loans ($8.7m) and grants of approximately $7million.

In discussion with the KDC Chief Executive on 23 January 2009 it was established;

- A Trust is being set up to examine all aspects of the proposal including location, and fundraising.
- Physical works on the Hub (should it proceed) will not occur before 2012/13.
- The LTCCP estimate of $16million is a conceptual design estimate only of the building itself and building services.
- In the 2009/19 LTCCP KDC will inflation adjust the $16million and include the revised amount as projected capex from 2012/13.
- KDC will limit their borrowing on the Hub to $8million. The CEO advises that the Council's bankers (BNZ) are comfortable with this level of borrowing.
- Other KDC funding may be from surplus property sales (depending on the locality of the Hub, should it go ahead)
- KDC is working on the consequential operational and depreciation costs and that would arise from the completion of the Hub. These projected costs are expected to be included in the draft 2009/19 LTCCP.

3.7 Tourism Planning

It was noted that the nature and extent of KDC's involvement in tourism planning and promotion was the subject of a number of submissions regarding the abolition proposal.

KDC's 2006-16 LTCCP forecasts tourism planning expenditure rising from $100k in 2006/07 to $123k in 2015/16. However, actual expenditure in both 2006/07 and 2007/08 has been significantly higher than forecast.

3.8 Summary

In respect of KDC Community and Regulatory activities there appears to be four particular issues.

KDC has previously assessed whether the library function could be delivered by way of shared services. This did not prove feasible but a 'mild' form of shared services is actually in place.

KDC's public toilet expenditure is likely to rise now that there are 10 toilets and there are high expectations for levels of service.

There may be scope for shared services in building control. KDC has invested significantly in the accreditation process, has three building control staff, and faces the prospect of reduced building consent revenue.

Lastly the 'big ticket' item – the Community Hub – is being reassessed by appointed Trustees. KDC appear to have put a 'line in the sand' on the borrowing limit ($8m) and this appears financially viable in terms of the borrowing policy. Of equal or greater significance is the potential impact of the ongoing operational and depreciation costs of the Hub on KDC finances. This is being worked on at present.

4 Governance and Corporate Services

4.1 Introduction

KDC's LTCCP and annual reports are categorized by activities. One activity is Governance and Leadership. This activity includes the costs of Mayoral and Councillor Governance and also the CEO salary and associated costs.

Corporate Services costs are not shown as a separate activity in the accountability documents. This is usual in local government, as corporate services are seen as an internal activity. The costs of 'external' activities such as roads, regulatory etc however include an allocation of the Corporate Services costs.

In the following subsection the present KDC Governance, Leadership and Corporate costs are listed, and compared to an approximate assessment of the ongoing annual costs assuming a combined Council with HDC or the HDC and MDC (i.e. no separate or autonomous KDC)

4.2 Governance and Leadership Costs

4.2.1 *Governance*

Governance Items	Present KDC annual Cost $	Potential annual cost for an enlarged council (i.e. no KDC) $	NOTES
Mayor	45,000	-	
Councillors	110,000	48,000	1
LGNZ Costs	27,000	-	2
Kaikoura Community Board -Chair -4 members		 10,000 24,000	 3
Travel		10,000	4
	$182,000	**$92,000**	

NOTES

1 An amalgamated Council (i.e. HDC and KDC) would have an additional 3 councillors at an assumed honorarium of $16,000 each per annum.

2 It is assumed that the LGNZ membership and conference travel costs would be absorbed (at no additional cost) to the amalgamated Council.

3 Membership of a Kaikoura Community Board would be four members (each with an honorarium of $6,000pa) and a Chair remuneration of $10,000pa.

4 It is assumed there will be additional travel costs because of greater distances to travel to meetings.

4.2.2 *CEO Leadership*

Items	KDC Cost (2008) $	Potential cost for an enlarged council (i.e. no KDC) $	NOTES
CEO Conference and Travel	163,000 3,000	80,000 3,000	1
	$166,000	**$83,000**	

NOTE

1 CEO remuneration is sourced from Note 14 to the 2008 KDC annual report financial statements.

If there is a Kaikoura Service Centre, it is assumed there will be a Service Centre Manager with a salary (including associated employment expenses) of $80,000.

4.3 CORPORATE SERVICES

	Estimated KDC costs 2009/2010	Predicted reduction factor assuming Amalgamation (NC = no change)	Corporate cost for Amalgamated Council	NOTES
Operating Expenses	$		$	
Advertising	15,000	25%	11,250	
Audit Fees - Annual Report	53,350	90%	5,335	} 1
Audit Frees – LTCCP	12,000	90%	1,200	}
Bad Debts	6,000	NC	6,000	
Bank Fees	9,757	50%	4,878	} 2
Bank Interest	25,000	50%	12,500	}
Catering	1,000	NC	1,000	
Depreciation (Funded)	9,058	NC	9,058	
Donations	500	NC	500	
Insurance ,	19,550	50%	9,775	3
Legal Fees	6,162	NC	6,162	
Loan Interest	2,368	NC	2,368	
General Expenses	30,000	50%	15,000	
Photocopying & Printing	20,000	50%	10,000	
Photocopying Lease	14,676	NC	14,676	
Postage	10,000	25%	7,500	
Public Relations (Radio Talkback)	1,335	NC	1,335	
Public Consultation (LTCCP)	2,500	NC	2,500	
Stationery	14,378	25%	10,783	
Subscriptions	21,000	50%	10,500	
Telephone Fax Rentals	3,697	NC	3,697	
Telephone Fax Tolls	9,000	NC	9,000	
Vehicle Expenses	1,071	NC	1,071	
Valuation NZ Fees	44,100	NC	44,100	4
Consultation	7,500	NC	7,500	
Operating Expenses Total	**$339,002**		**$207,688**	
Personnel Expenses				
Salaries	250,064			
KiwiSaver	1,053			
ACC Levies	3,060			
Staff Medical Insurance	15,943			
Conference Expenses	4,088			
Superannuation	2,077			
Training and Seminars	4,000			
Uniforms	3,000			
Staff Expenses/Meetings	4,000			
Personnel Expenses Total	**$287,285**		**$143,642**	5
Principal/Capital Expenses				
Loan Principal	8,290	NC	8,290	
Equipment	9,757	NC	9,757	
Less Revenue				
Commissions	(21,218)	NC	(21,218)	
Valuation Fees Recovered	(6,060)	NC	(6,060)	
External Sales	(4,108)	NC	(4,108)	
Net Corporate Expenditure	**$612,947**		**$337,990**	

NOTE	ASPECT	Comment
1	Audit Fees	Assumption that one combined Council will attract additional 10% of KDC audit fees to the amalgamated council audit fees. Reduction excludes audit fees for CCOs, which are unchanged.
2	Bank Fees	Assume 50% reduction for one Council enlarged Treasury operation
3	Insurance	Assume economics of scale in a larger council with more scope for risk mitigation and self insurance
4	Valuation Fees	No change as charges are largely based on property numbers
5	Personnel Expenses	Assume a 50% reduction at this stage. Personnel expenses of KDC represent 6 employees including the Finance Manager. It would be expected that a Kaikoura Service Centre would have a Senior Account clerk and at least 2 other administration personnel (in addition to the Service Centre Manager whose salary is shown in section 6.2.2)

4.4 Summary

ASPECT	Present KDC annual Costs $	Potential annual costs for an amalgamated council $	Potential Annual Savings $
Governance	182,000	92,000	90,000
Leadership	166,000	83,000	83,000
Corporate Costs	613,000	338,000	275,000
TOTAL	$961,000	$513,000	**$448,000**

4.5 Notes and Assumptions

The above summary is an approximate ‘first cut’ of potential annual cost savings. Assumptions underlying the above assessment include;

- The analysis does not factor in the cost of disruption and "wheel spin" associated with amalgamation/abolition. Based on the nationwide amalgamations in 1989 this could be up to 3-4 years.
- The analysis does not factor in the cost of any redundancies
- The analysis does not factor in the stakeholder relationships and government department relationships that would be disrupted (for example an amalgamated council based in Amberley would have to deal with some Blenheim based government department branches, whose jurisdiction includes Kaikoura).
- The analysis excludes additional corporate costs that might be identified by the amalgamated Council.
- The analysis excludes additional remuneration that could reasonably be expected for the CEO and second tier managers of an amalgamated council.
- The analysis excludes additional travel time and costs associated with senior management of the amalgamated council travelling to Kaikoura.
- The analysis excludes any potential reduction of information system expenditure.
- KDC has indicated that the corporate expense budget may be trimmed by $40k in 2009/10. This may reduce the savings in corporate expenses.

5 Overall Financial Sustainability of KDC

5.1 Introduction

In this section the overall financial viability or sustainability of KDC is examined. The examination is based on the existing 2006-16 LTCCP, the AMPs, and the financial outturn in the years 2007 and 2008 sourced from council annual reports. Although verbal updates were obtained from KDC's CEO and Finance Manager, the expected AMP updates and the draft 2009-19 LTCCP will shed more concrete evidence on the future finances of KDC.

The comments are set out as follows:

-Projected surpluses/deficits	(5.2)
-Projected income	(5.3)
-Projected expenditure	(5.4)
-Projected cash and investment assets and reserves	(5.5)
-Projected liabilities	(5.6)
-Audit NZ comment	(5.7)
-Overall comment	(5.8)

5.2 Projected Surpluses/Deficits

In the 10 years of the 2006-16 LTCCP, the collective surplus is $21.5million or an average of $2.15m a year. The $21.5m includes one off capital grants relating to the Community Hub, so the realistic average is $1m-$2m surplus a year. No deficits are predicted.

In 2007 the actual surplus was $10.5million but this included vested assets of $6.82million, meaning that the 'realistic' surplus was $3.71m against an expected surplus of $2.7million

In 2008 the actual recorded surplus, adjusted for vested assets, was $0.6million against an estimate of $1.3million – i.e. the surplus was below expectations.

KDC's projected statement of Cash Flows has annual net cash inflows from operating activities ranging from $2.6million to $7.9million over the 10 year period.

5.3 **Projected Income**

5.3.1 In KDC's 2006 LTCCP total yearly revenue averages around $8-9million, except for the period where grants are assumed for the Community Hub.

In 2007 total actual revenue was $9.5m (adjusted for vested assets) against an expected $8.0million.

In 2008 total actual revenue was $7.8million (adjusted for vested assets) compared to an LTCCP estimate of $7.08 million i.e. a drop of $700k on that expected.

5.3.2 Total **rates** revenue forecast in the LTCCP climbs from $3.6m in 2006/07 to $5.1m in 2015/16. A significant proportion of the increase relates to growth in the rating base rather than inflation or individual property rate increases. The effect of proposed rates over 10 years on an individual property basis is shown in the LTCCP. The examples used show moderate increases in the early years of the LTCCP period, a levelling and then a gentle decline.

Actual rates revenue for 2007 and 2008 is tracking fractionally short of LTCCP expectations (2007 forecast $3.6m; actual $3.55m and 2008 – forecast $4.0million; actual $3.968million).

The continued growth of the rates base is an important factor in keeping individual property rates movements to a moderate level as a boosted rates base provides a small council with greater economies of scale. The CEO advised that a key preliminary assumption for the 2009-19 LTCCP is that, on average, close to 90 lots a year will be added to the rating base for the 2009-19 period. The CEO provided a breakdown of the figure, but this has not yet been corroborated. This is a suggested task for Phase 2 of the review.

5.3.3 **Development Contribution** revenue was significantly higher in 2007 than forecast ($2.7 million versus $0.9 million) but dropped below expectations in 2008 ($0.76 million versus $1.014 million). From discussions with the CEO Development Contributions revenue is expected to fall significantly in 2009-2012 and this will be reflected in the Draft 2009-19 LTCCP.

5.3.4 **User Fees and Charges** revenue is tracking ahead of 2006-16 LTCCP forecasts. The LTCCP shows a rising trend in User Fees from $1million in 2006/07 to a projected $1.55million in 2016/16. In both 2007 and 2008 actual revenue is about 5% higher than the LTCCP forecasts.

5.4 Expenditure

5.4.1 Actual operating expenditure for 2007 and 2008 is significantly higher than forecast in the LTCCP. In 2008 the combination of increased expenditure in a number of activities, increased depreciation expense and write-downs in fair value of forestry and investment properties meant that total actual expenditure was $7.3m compared to an LTCCP estimate of $5.8m. The council, however, still showed a surplus, albeit smaller than expected.

5.4.2 KDC's capital expenditure on fixed assets was $2.6m and $2.0m respectively for 2007 and 2008. This is significantly less than the LTCCP forecast, but the forecast was based on expected capex for the Community Hub.

5.5 Projected Cash and Investment Assets and Reserves

The 2006 LTCCP forecast an increase in **cash deposits** from $974k in 2007 to $5.1million in 2016. The actual cash deposits at 30 June 2007 were $2.06m (budget: $0.974m) and at 30 June 2008 $2.84million (budget $2.1m). In addition there are sinking fund investments of $916k in 2008. Sinking Fund investments are used to repay loans at maturity.

Projected **investments** in the LTCCP were relatively small (around $1m each year) but it appears that some assets previously described as land and property have been reclassified as Investment Properties. At 30 June 2008, Forestry and Property investments total $7.3million.

In the 2008 annual report KDC showed balances in Special Reserves of $939k and Special Funds of $2.1million i.e. a total of $3.1million. There appear to be no equivalent projections in the 2006 LTCCP as the LTCCP's Equity and Reserves disclosure is consolidated into summary figures. It should be noted that the Reserves of $3.1 million are not investments in addition to that described in the previous paragraphs; the Reserves are represented by those investments.

5.6 Projected Liabilities

In the LTCCP, borrowings were set to rise from $4.8m in 2007 to $13m in 2010, and then decline to $8.5m by 2016. The sharp increase was for funding of the Community Hub.

The actual borrowings at June 2007 was $4.2million (estimate $4.85m) and June 2008 $4.1million (estimate $6.95million) reflecting the deferral of the proposed Hub.

5.7 Audit NZ Comment

Discussion with the Audit NZ director in charge of the KDC audit and a review of the last two audit management letters did not raise any major issues or identify any potential financial sustainability issues.

5.8 Overall Comment

Overall, KDC's revenue has been holding up well compared to the LTCCP estimates. Rates revenue is on track, as are NZTA subsidies and user fees. Development Contributions, after an initial bubble in 2007, are now tracking below forecast. This is not unexpected and is being felt by almost all Councils. The draft 2009/19 LTCCP is likely to reflect a lower level of contributions.

Operating expenditure was much higher in 2008 than forecast, partly due to recognising the decline in investment values, but also reflecting the under-estimate of depreciation in the LTCCP. Also, several activities appear to have overspent.

Notwithstanding the above, KDC has recorded surpluses in 2007 and 2008.

Actual cash deposits and investments held in 2007 and 2008 are higher than expected.

Borrowings have been lower than forecast because of the deferral of the community Hub. Had the Hub gone ahead as planned it would have meant a peak total borrowing requirement of $13.1million and a peak annual loan servicing requirement of $945k in 2010/11. KDC's liability management policy was changed to allow the ratio “Interest expense to Rates Revenue’ threshold to be increased to 20%. This percentage is not unusual in local authorities. Another common measure adopted (though not by KDC) is that ‘Net Cash Flows from Operations’ should be at least two times the interest expense. Looking at KDC’s peak borrowing year (2010/11) this threshold is satisfied.

In short, there is nothing in the 2006/16 LTCCP, 2007 and 2008 Annual Reports, and underlying AMPs that indicate KDC is not financially sustainable. A key factor in the 2009-19 period will be the robustness and certainty of the assumption on rating base growth.

6 Comparative Financial Policies of KDC, HDC and MDC

6.1 Introduction

In this section a brief analysis is undertake of two financial policies of each of the three Councils – KDC, HDC and MDC.

At this juncture it is only relevant to look at two policies – the Revenue and Financing Policy and the Liability Management Policy.

6.2 Revenue and Financing Policy (RFP)

6.2.1 This policy gives an indication of Council thinking and perception to consideration of public versus private benefits, exaberator pays and how the Council believes activities should be funded. The RFP is required by Section 103 of the LGA and is contained in the LTCCP.

6.2.2 To give an idea of the different approaches of Councils, a number of common activities were selected and the funding consideration shown in the following table;

Activity	KDC	HDC	MDC
	Community/Individual benefit ratio	Community/ Individual benefit ratio	Community/ Individual benefit ratio
Building Control	25/75	0/100	20/80
Reserves & Playgrounds	100/0	30/70	100/0
Cemeteries	50/50	0/100	Not identified
Animal Control	40/60	0/100	10/90
Library	85/15	50/50	20/80
Land Transport	100/0	0/100	80/20
Pools	100/0	0/100	Not identified

6.2.3 As can be seen from the above table HDC has a philosophy that many activities have a greater individual benefit than community benefit (“user pays”). This can be contrasted with KDC which is inclined to see greater community benefits in activities. MDC sits in the middle.

6.2.4 Care must be taken with the above table, as the ‘theoretical’ perception of benefits often does not fully translate into actual funding mechanisms because of practicalities or because the desired funding mechanism may not be permitted.

6.3 Liability Management Policies

6.3.1 The following table shows key item of Borrowing Limits from the three councils’ liability policies. The Policy is required under section 104 of the LGA.

6.2.2 It has been selected for review because of the assertion that KDC is borrowing significantly (in relation to its rating base).

KDC	HDC	MDC
Gross interest expense of all external borrowing not to exceed 20% of rates revenue Or Gross interest expense of borrowing will not exceed 15% of total revenues	Total borrowings no greater than $8,000 per rateable property or 4 times annual total rates Total interest expense to be no greater than 20% of average total rates levied for the last 3 years Net cashflows from operating activities to exceed gross interest expense by two times Liquidity ratio of 1.5:1 Total liabilities to total assets are not to exceed 25%	Revenue before interest and tax at least 2.5 times net interest Gross interest cannot exceed 10% of operating revenue Net cashflows from operating activities to exceed gross interest expense by two times

6.3.2 Commenting on the above table, KDC altered their policy from 18% to 20% to ensure their borrowing in the LTCCP period did not exceed previous thresholds. The peak of KDC's borrowing, as projected in the LTCCP, would have seen borrowing at the equivalent of $5, 864 per rateable property. This is well within HDC's specified threshold of $8,000 per rateable property. Arguably HDC has the best suite of thresholds for borrowing limits.

6.4 Other Financial Policies

Under the LGA 2002, other mandatory financial policies are

- Investment policy
- Development contributions or financial contributions policy
- Policy on partnerships with the private sector
- Rates remission policy
- Rates postponement policy

At this point, there seems limited relevance in conducting a comparative analysis of these policies in terms of the financial and operational sustainability review of the KDC.

7. Observations of Submissions advocating HDC abolition

7.1 Introduction

Commission staff sent me the written submissions on the initial proposal. The submission compilation is dated 20 October 2008.

I have perused the submissions advocating KDC abolition for the operational and financial matters pertaining to this review. In other words, I have not commented on governance, leadership, consultation, community of interests and general political matters.

7.2 Themes of submissions relating to operational and financial matters.

In the following table I have outlined the common themes of the submissions advocating KDC abolition, and my comments relating to each

ASPECT	COMPLAINT	COMMENT
Planning	Poor LTCCP and planning documents Lack of forward planning	Not supported from documents reviewed. While 2006 LTCCP received a 'technical' audit qualification, overall it is a very good long term plan. AMPs are good to very good.
Infrastructure Services	Inadequate maintenance of roads, footpaths	Not supported by AMP, NZTA audits, or actual reporting of service achievement against targets.
	Lack of promised seal extension	Proviso in plans that seal extensions linked to receiving NZTA subsidies

	Faltering waste management Poor state of dump; contaminant discharges	} May have been staff issues } issues at waste centre in 2008. } Council advise that there have } been no breaches of discharge } consents
	Rubbish not regularly cleaned up	2008 residents survey indicates dissatisfaction. Council has put addition resource in this area.
	Continual deferral of infrastructure works	Not supported by evidence of water, sewerage, wharf and roading works performed in past few years.
Regulatory Services	Ineffective District Plan	(Not covered in this review)
Tourism Services	Amalgamated Council could better facilitate Tourism activities	(Covered in Commission's deliberation)
Community Facilities	Concern with process regarding Combined Community Complex project	Now being considered by appointed Trustees. Councils 'bottom line' on loan limit will be financially sustainable, but uncertainty over ongoing operational costs.
Staffing Resource	Staff duplication (between Councils)	See section 4.2.2 and 4.3
	Lack of skill and capacity	Not supported by reviewer's observation
	High staff numbers Staff numbers have rapidly increased	} No evidence of surplus/ } excessive staffing } }
	Abolition would obviate need for new offices	Reasonable assertion – but community may still wish for community hub where service

		centre could be integral to hub.
Financial viability/sustainability	Amalgamation would have beneficial effects (Great Barrier Island and Banks Peninsula cited)	Examples cited not analogous to KDC situation, where there are smaller Councils involved, and perhaps less Community of Interest. HDC and MDC could not be expected to subsidise KDC residents.
	Ratepayer base too small.	To date, ratepayer 'burden' in relation to services provided is not excessive.
	Economies of scale with an amalgamated Council and better utilization of staff	Cost of Council services unlikely to change markedly if KDC is abolished, other than a portion of corporate costs.
	KDC struggles to meet cost of services	Not evident from a review of financial and service performance from 2006 to date.
	High Debt levels	Debt of KDC was predicted to peak in 2010/11 if the Hub had proceeded as planned. The borrowing limits at that point would still have been within policy thresholds, and thresholds of comparable councils.

PHASE TWO OF THE REVIEW

(May 2009)

CONTENTS (Phase Two Review)

Executive Summary (Phase two report)

This report was commissioned to study the service delivery and financial issues associated with the reorganisation proposal for the abolition of the Kaikoura District and either its full inclusion in the Hurunui District, or part inclusion in the Marlborough District and part inclusion in the Hurunui District.

The key work streams of the study included assessing the sustainability of financial and service delivery arrangements for infrastructural and community services provided by Kaikoura District Council (KDC), analysis of KDC's and Hurunui District Council's (HDC) financial position and outlook, and an indicative assessment of the likely differences in costs associated with the proposal compared to the status quo.

The methodology of the review included close examination of both KDC and HDC's 2006-16 LTCCPs, their Draft 2009-19 LTCCPs as well as recent annual reports. To delve below these public documents, both Councils infrastructure asset management plans were perused and corporate services costs analysed. Discussions were held with senior management of each Council as well as Council auditors. Marlborough District Council's financial position was also briefly examined.

In relation to **KDC finances,** the picture portrayed in the Draft 2009-19 LTCCP is not as rosy as that painted in the 2006- 16 LTCCP. This is principally a reflection of the straitened financial environment faced by all councils. KDC has recognised the changed environment by scaling back the proposed community 'hub' and shelving new civic offices. KDC has dramatically reduced Development Contributions forecast revenue in the next two years but increases its forecast of Development Contributions revenue to a significant level in succeeding years . Rates are proposed to increase by an overall average of 2.9% a year to 2019. Relatively small surpluses are predicted in the next ten years. A significant increase in borrowing in the middle years of the LTTCP period is associated with the Community Recreation Facility proposal. Overall KDC remains financially viable with the financial ability to deliver core services. If revenue is less than expected this may impact on Community Recreation Facility proceeding and on the timing of infrastructure new works.

In relation to **HDC finances** the Funding and Financial policies have limited flexibility. There are a lack of depreciation reserves for replacing assets, the existing financial assets and cash balances are modest, and the draft 2009-19 LTCCP does not contemplate term borrowing other than for the development of the Hanmer Springs Thermal Pools. Services within each locality tend to be "standalone" in terms of funding, which can deter local communities from committing to the high costs of upgrades. There is a degree of Council reliance on the financial success of the Hanmer Thermal Pools. Therefore, while HDC is financially sound, it is facing demands for better infrastructure and the current funding policies are somewhat inflexible in helping facilitate improved services.

For **KDC services** there is good evidence, in the Asset Management Plans and LTCCP capex forecasts, that Council will replace or renew water, sewerage and stormwater assets as and when required. New capital works are also proposed but the quantum is moderate as priority capital upgrades have already been achieved for utility services. Roading new works will focus on foothpaths and walkways; it is unlikely that planned seal extensions will proceed because it will not meet NZTA assistance criteria. The KDC asset management plans are of good quality as are the levels of service targets and performance measures. There appear to be only mild risks on the ability of KDC's infrastructure to deliver desired services. There is limited scope for shared service arrangements, especially in infrastructure services.

HDC services appear to be more 'hard pressed' in regard to asset management and meeting desired levels of service. Taking water services as an example, the 13 council owned water schemes have problems in water quality, lack of up-to-date asset management and risk planning, and the inflexibility of current funding mechanisms to fund future works. This is exacerbated by a lack of engineering resource.

Finally in relation to the **costs that potentially could be saved if KDC were to be abolished**, the phase one report indicated an annual reduction of governance and corporate costs of around $450k. This figure was couched with many assumptions and provisos. Of that figure, $360k related to leadership and corporate costs and $90k to governance (elected member) savings. That assessment was from a 'KDC-centric' perspective. Overlaying the HDC perspective, the $360k saving is quite small in relation to total expected HDC corporate costs of $4 million in 2009-10. If HDC's corporate costs were to increase by 9% to absorb corporate responsibilities of an abolished KDC, then the 'savings' would be lost. If the increase was more than 9% then the combined council corporate costs would be greater than the corporate costs of a standalone KDC.

1. Methodology

1.1 In conducting the review the following methodology has been applied;

- Desktop analysis of key planning and accountability documents
- Discussions with KDC and HDC personnel, and progress calls with Commission staff

1.2 At KDC the key planning and accountability documents analysed were;

- Management Draft of the 2009/19 LTCCP
- Draft 2009-19 LTCCP (made available to the public on 5 May 2009)
- Updated Asset Management Plans (dated February 2009) for roads, water, sewerage and stormwater

At HDC the key planning and accountability documents analysed were;

- Draft 2009/19 LTCCP
- Asset Management Plans for roading, sewerage and water
- Spreadsheet build-up of Corporate Services Costs

1.3 At HDC discussions were held with;

- Garry Jackson, Mayor
- Andrew Dalziel, CEO
- Bruce Yates, Manager-Engineering Services
- Jason Beck, Manager- Financial Services
- Audrey van der Monde, Manager- Community and Corporate Services

Discussions were held with KDC personnel during April 2009.

No discussions have been held with MDC personnel.

2 . Hurunui District Council (HDC) Financial and Service Assessment

From my interviews at HDC and examination of the Draft 2009-19 LTCCP, I have traversed a number of issues relevant to the KDC abolition proposal. These issues are;

- Summary of HDC's financial outlook
- HDC Funding and Financial Policies
- HDC's Corporate Overheads
- HDC's Water Services
- Miscellaneous observations

2.1 Summary of HDC's Financial Outlook

2.1.1 HDC is predicting modest surpluses for each of the years from 2009 to 2019. Excluding non-cash items such as vested assets income and gains on asset revaluations, the annual surpluses range from just under $1 million (2011/12) to $4.2million (2018/19). The cumulative forecast surplus for the ten years is $23.9million, giving an annual average of $2.39 million.

2.1.2 A marked feature of HDC's revenue is the income from the Hanmer Springs Thermal Pools. Over the ten year period forecast gross income from the Pools is estimated at $90million or 28% of total HDC revenue. After deducting Pool expenditure, the forecast operating surpluses returned to Council increases from $1.2million (2009/10) to $3.1million (2018/19). The total estimated Pools surpluses for the ten year period 2009-2019 is $20.4million.

2.1.3 Development Contributions forecast revenue is relatively low, rising from $507k in 2009/10 (recognising the economic downturn) to a plateau of around $800k-$900k per year thereafter.

2.1.4 Forecast User Fees and charges varies from approximately $3.5million to $5.5million a year over the course of the ten year period. This is in a range of 12% to 17% of total Council revenue.

2.1.5 HDC's forecast financial assets and cash investments are also modest. At June 2010 these are estimated at $3.4million rising to $6.1million by June 2019.

2.1.6 Term borrowing is set to increase in the next two years, peaking in June 2011 at $9.5million. Thereafter term debt is being repaid with only $500k of term debt balances forecast for the final three years of the ten year LTCCP period. A significant proportion of the increase in borrowing in the next two years is to fund major capital developments at the Hanmer Springs Thermal Pools complex.

2.1.7 In relation to forecast operating expenditure, employee costs are set to rise from $4.3million in 2009/10 to $5.4million in 2018/19, a 25% increase over the ten years. Depreciation 'book' expenditure is $5.6million in 2009/10. This is about 22% of total Council operating expenditure. While this percentage is comparable with local authorities as a whole, it does appear light when compared against peer councils (i.e. small rural councils with significant infrastructure).

2.2 HDC Funding and Financial Policies

2.2.1 District Wide Rates (General Rates and UAGC) are forecast at $5.1million for 2009/10, rising to $5.98million by 2018/19- a 17% rise over the 10 year period. As a proportion of total Council revenue, District Wide Rates are 18.6% in 2009/10 falling to 16.1% in 2018/19. Compared to most other councils this is a low percentage and is explained by the significant revenue from the Hanmer Thermal Pools, and HDC's preference for Targeted Rates as a funding mechanism.

2.2.2 Targeted Rates forecast for 2009/10 are $6.6million (24% of estimated total Council revenue) climbing to $9.0million by 2018/2019 – a 35% rise over the ten years. There is a 6.2% rise forecast for 2009/10. The proportion of Targeted Rates compared to total rates (i.e. Targeted and District Wide rates combined) increases from 57% to 60% over the ten year period. The increases in targeted rates are earmarked for water and stormwater capital works.

2.2.3 HDC has a policy of not funding the majority of depreciation expenses. It is estimated that only $500k of the $5.6million depreciation expense for 2009/10 will be funded. This policy has been in place since 1999 and was consulted upon at the time with the general community.

2.2.4 In the phase one report I commented upon HDC's Revenue and Financing Policy and drew attention to HDC's philosophical stance, in the 2006-16 LTCCP, toward "individual" benefit from Council services as opposed to "community" benefit. The language has been softened a great deal in the 2009-19 LTCCP's Revenue and Financing Policy. However, it doesn't appear to have greatly influenced the nature of the actual funding mechanisms applied.

2.2.5 HDC's funding policies are geared toward targeted rates for services within each locality. Thus work required to be done on a service (say Sewerage) within a township will necessitate funding sourced from the service users within that township. HDC policy also states that asset renewals or any new work will be financed by loans or targeted rates. However, as the majority of anticipated borrowing is for the Hanmer Springs development, it appears that targeted rates are the prime funding mechanism.

2.2.6 Council is relatively dependent on the surpluses generated from the Hanmer Springs Pools. The operating surpluses expected to be generated by the Pools over the next ten years are $20.4 million compared to the overall Council forecast surpluses of $23.9 million over the same period. Council is restricted to applying the Pools operating surpluses towards the costs of Reserves in the District. Fortunately for Council, because public toilets and the main Library are located on Reserves, they are able to utilise the Hanmer Pools surpluses to defray the costs of these activities. Council also take another 'cut' from the Pools operation. In the borrowing about to be embarked upon for the Pools capital development, Council 'on lend' to the Pools at a 2.5% margin over Council's own external debt interest expense. This gives rise to an internal profit which has been used to keep the District Wide rates increase in 2009/10 to under 1%.

2.2.7 Summing up, the Funding and Financial policies of HDC could, arguably, be described as having limited flexibility. There is a lack of depreciation reserves for replacing assets, the existing financial assets and cash balances are modest, and the LTCCP contemplates external term borrowing only in the first two years of the ten year plan. A significant proportion of the external borrowing is to fund the Hanmer Springs Thermal Pool development. Services within each locality are "standalone" in terms of funding, which can deter local communities from committing to the high costs of upgrades. Finally there is a degree of Council reliance on the financial success of the Hanmer Thermal Pools.

2.3 HDC's Corporate Overheads

2.3.1 HDC's Corporate Overhead costs are estimated at $4.0 million in 2009/10.

2.3.2 I asked the CEO whether there was any room for HDC to absorb KDC's corporate responsibilities within the forecast HDC Corporate costs. The CEO doubted whether there was the capacity to absorb such costs within existing budgets. The CEO advised that he is conscious that some desired corporate tasks are not being performed now. He has recently revamped the reception area of HDC's main office in order to better utilize present resources and he may look at reorganising other corporate areas. However, even if this does free up resources, he sees the time being used for tasks that are not presently being performed.

2.3.3 In the phase one report I commented that, if KDC were to be abolished, there would be an annual reduction of governance and corporate costs of around $450k. This figure was couched with many assumptions and provisos. Of that figure, $360k related to leadership and corporate costs, and $90k to governance (elected member) savings. That assessment was from a 'KDC-centric' perspective. If we now overlay the HDC corporate cost perspective, we can see that the $360k saving is quite small in relation to total HDC corporate costs. Put another way, if HDC's corporate costs were to increase by 9% to absorb corporate responsibilities of an abolished KDC, then the 'savings' would be lost. If the increase was more than 9% then the combined council corporate costs would be greater than the corporate costs of a standalone KDC.

2.4 HDC's Water Services

2.4.1 The Commission's officers asked that I look at one infrastructure area in HDC and use that as a point of comparison with the same service in KDC. The agreed service area was Water Services.

2.4.2 HDC's 2009-19 draft LTCCP well describes the challenges the Council faces. The LTCCP (page157) states "The quality and quantity of drinking water in the Hurunui District has been of concern for Council for some time". In summary there are 13 Council owned water schemes. None of the schemes fully comply with the 2005 NZ Drinking Water Standards (NZDWS). Two schemes have Ee gradings ("E" being assessment of water source and "e" being the assessment of the state of reticulation). Two schemes have permanent "boil water" notices. Cheviot, the HDC township closest to Kaikoura township, has an Ee rating and a boil water notice.

2.4.3 From an asset management perspective, there is still much planning and information gathering to be done. Preparation of an up-to-date water asset management plan (AMP) is earmarked for the 2010/11 year. No Public Health Risk Management Plans (PHRMPs) have been prepared- a separate plan is required for each scheme. These tasks are earmarked for 2009/10. The LTCCP indicates that extensive pipe renewal is anticipated over the next 20 years, but the renewal priorities are not yet confidently known. Level of service information in the LTCCP about water performance goals and measures is rather brief,. Four of the ten measures are new; none specify water conservation although this mentioned elsewhere in the LTCCP as important. The goal for all water schemes to meet NZ Drinking Water Standard is to be achieved "2012+".

2.4.4 HDC is ramping up its capital expenditure on water. In the draft LTCCP, capex of $10.1 million is forecast in the next ten years. In Cheviot, capex of $908k is planned over the next three years for a new treatment plant and renewal of pipes and reservoirs.

2.4.5 There are potential ‘road blocks’ to the above improvement actions. The first is the lack of engineering resource within the Council. The LTCCP is predicated on the basis that most engineering effort is from in-house resources, yet it seems a daunting task for HDC’s engineering services- in addition to their everyday duties- to prepare robust asset and risk plans (AMPs, PHRMPs), deal with numerous water committees to “sell” the need for enhanced water services, and to deliver the projects noted in the LTCCP. Secondly there is the funding of the projects. The LTCCP assumes subsidies from central government in order for the work to proceed as budgeted. Also the present funding policy regards each water scheme as a separate funding ‘jam jar’, with the inevitable effect that any major work is a heavy funding imposition on the smallish number of consumers in a typical scheme. For example the Targeted Rate for the Cheviot Water Scheme in 2009/10 is a “fixed charge per unit provided” of $511.15. This rises to $563.55 in 2011/12, an increase over the three year period of 10.25%. The LTCCP hints that Council wants to move to a “smoothing out” of water rates across the District. I understand that water committees have been resistant to previous suggestions of District wide water rates.

2.4.6 It was interesting to note that National Radio’s *Morning Report* on Tuesday 24 March had an item on the perceived threat to 20% of NZ’s population through at-risk or low graded water supplies. The Cheviot water scheme was specifically mentioned. The Mayor of Hurunui later came on the programme and mentioned what they hope to improve in the coming years.

2.4.7 I understand that the local Medical Officer of Health has been pressing Council to improve treatment of the Cheviot water and made a presentation to Council in February 2008 seeking to have upgraded water by July 2009. It was observed that an estimated 100,000 vehicles per month pass through Cheviot with many stopping for refreshments and/or comfort on their way north or south, so the exposure to at-risk water is not confined to local residents who know the situation. HDC, in its meeting on 26 March 2009, agreed to immediately install a chlorination treatment plant at Cheviot.

2.4.8 As a point of comparison with KDC water schemes management, KDC has prepared up-to-date Asset Management Plans and Public Health Risk Management Plans. The levels of service targets and measures are a significant step up from those of HDC. While some of the smaller KDC rural water schemes are still ungraded by MoH, the Kaikoura township water quality (which accounts for 84% of all water connections) is graded B with the strong prospect of moving to A within a year. Further work is planned by KDC for water conservation.

2.5 Miscellaneous Observations

2.5.1 From discussions with various HDC officers there were two common themes that pervaded their thoughts on a combined Council with its headquarters in Amberley. Firstly there would be the logistics of servicing Kaikoura from Amberley. The Hunderley hills north of Cheviot still act as a physical barrier and Cheviot, the most northern HDC township closest to the southern border of KDC, is still an hour plus drive away from Kaikoura. Many of HDC's staff live in Christchurch, so both the physical and time drain of staff and management visits to Kaikoura shouldn't be underestimated. Secondly the "invisible" costs associated with a combined council could be substantial. Again this is mainly management and staff time to align procedures and systems- these costs could reduce over time, but it has taken years for Hurunui District itself to take on its own persona and identity from the numerous small councils that preceded it.

2.5.2 Discussions with the HDC Mayor, Garry Jackson, centred on Communities of Interest. While this was not the subject of this particular review, the Mayor indicated there are distinct differences in values and community outlook between Hurunui and Kaikoura Districts. He felt that it has taken a while for the 'North Canterbury' values to meld amongst the various townships and inferred that attaching Kaikoura to the boundaries would be a stretch too far. He added that KDC and HDC do collaborate on connected issues such as tourism, health and a joint effort to get NZTA to take over ownership on the inland Kaikoura road (parts of which are presently owned by both councils).

2.5.3 An interesting point was made by an HDC officer who said that many residents and farmers in HDC gravitate to Christchurch for their shopping, business affairs etc and often stop at the Council Office in Amberley to do any Council related business on their way through to Christchurch. In Kaikoura the residents gravitate more to Blenheim. If the main office of a combined Council is in Amberley this might be detrimental to the work-leisure travel plans of Kaikoura residents.

2.5.4 Discussion with Council officers, particularly the manager of engineering services, did not identify any areas that would lend themselves to any substantive shared services arrangements.

3. Analysis of KDC's Draft 2009-19 LTCCP

3.1 Introduction

As indicated in the Phase one report, a complete up-to-date picture of KDC's financial forecasts and service predictions would not be complete without an analysis of the latest LTCCP.
An initial analysis was undertaken on a 'management draft' of the LTCCP and this was updated or confirmed when the Draft 2009-19 LTCCP was publicly released on 5 May 2009.

The Draft LTCCP contains the report of Council's auditor. A 'clear' audit opinion has been issued by Audit NZ.

The Draft 2009-19 LTCCP is analysed under the following headings;

- Forecast Revenue
- Forecast Operational Expenditure (opex)
- Forecast Surpluses
- Forecast Capital Expenditure (capex)
- Forecast Borrowings
- Forecast Financial Assets and Investments
- Major issues in Council Services and Activities

3.2 Forecast Revenue

3.2.1 Over the 10 years to 2019 overall Council Forecast Revenue rises from $7.2 million in 2009-10 to $9.8 million in 2018-19, a rise of 38% or an average of 3.8% a year. In analysing this figure I have excluded the "vested assets" revenue which is non cash item.

3.2.2 Rates revenue increases from $4.2 million in 2009-10 to $5.5 million in 2018-19, an average increase of 2.9% a year. In 2009-10 rates are 59% of total revenue, but this drops to 56% of total revenue by 2018-19, as increased development contributions and user fees contribute a greater proportion of overall revenue. Recently Council consulted the community about changes to the rating system. It is proposed, from 1 July 2009, to remove the differentials on the General Rate and introduce a number of targeted rates.

3.2.3 Forecast Development Contributions total $9.8 million over the 10 years. . In the first two years of the LTCCP period DCs are only $9k each year reflecting the current economic recession. However, in year 3 (2011-12), forecast DCs increase dramatically to $1.2 million and stay around that level for each remaining year of the LTCCP. The timing and the quantum of DC forecast revenue are very dependent on the growth assumptions that lie behind these forecasts. A prolonged property and economic downturn may impact on the revenue that is derived from Development Contributions.

3.3 Forecast Operating Expenditure

3.3.1 Forecast operating expenditure (opex) rises from $6.8 million in 2009-10 to $9.6 million in 2018-19, an increase of 41% over the ten years.

3.3.2 Forecast personnel costs, which account for 24% of opex in 2009-10, increases a modest 28% over the ten year period. By 2018-19, personnel costs drop to 22% of total opex.

3.3.3 Forecast depreciation expense rises from $1.5 million in 2009-10 to $2.4 million in 2018-19. This is a 55% increase over the ten years. While this seems high it is consistent with the magnitude of forecast depreciation expense increases in other territorial local authorities.

3.3.4 Forecast Financing Costs are set to rise from $0.46 million in 2009-10 to nearly $1 million to 2016-17 before dropping to $0.8 million in 2018-19. At the peak year in 2016-17, financing costs represent 10% of opex and 17% of forecast rates revenue for that year. The increase in financing costs is mainly for the servicing of loans associated with the proposed community recreation facilities construction in 2014 and 2015.

3.4 Forecast Surpluses

3.4.1 After removing the non-cash revenue represented by physical assets vested to Council and the funding of $3.2 million towards the proposed community recreation facilities, the ‘core’ forecast surpluses for the ten years total $5.5 million or an average of $0.55 million a year. In several years the forecast surplus is very small- in 2010-11 it is estimated at only $98k.

3.4.2 Bearing in mind the small ‘core’ expected surpluses, the degree of certainty of forecast Development Contributions revenue is of importance. If, over the ten years, the actual DC revenue is only half that forecast (i.e. $5 million compared to the forecast $9.8 million) then the ‘core’ surpluses over the same period ($5.5 million) effectively evaporate.

3.5 Forecast Capital Expenditure

3.5.1 Forecast capital expenditure (capex) over the ten years to 2018-19 is around $30 million. There are significant capex peaks in 2014 and 2015 which mainly represent the construction of the community recreation facilities. These two years alone account for about half of the ten year capex spend.

3.5.2 Notwithstanding the above comment, infrastructure asset renewals and new works have been included in the capex forecasts. A perusal of the most recent Asset Management Plans (AMPs) for water, sewerage and stormwater networks indicate that the recommended level of asset investment is being incorporated into the LTCCP.

3.5.3 As a point of comparison, KDC's 2006-16 LTCCP provided for 10 year capex of $37 million. A closer comparison reveals, however, that the earlier LTCCP made provision for a larger 'Community Hub' for $16 million. This has now been scaled down to remove new KDC office accommodation and library. In addition, extensive infrastructure investment was made in the 2006 to 2009 years; these years are of course excluded from the 2009-19 LTCCP. Therefore there is no indication that KDC is 'skimping' on its infrastructure investments in the draft 2009-19 LTCCP.

3.6 Forecast Borrowings

3.6.1 Debt levels are set to increase from around $6 million for the next five years to nearly $12 million from 2015 to 2018. The debt level then gently declines to $10.5 million by June 2019.

3.6.2 The increase in debt is to fund a substantial proportion of the proposed Community Recreation Centre.

3.6.3 The loan servicing costs will, even in the peak borrowing years, be within Council's Liability Management Policy.

3.7 Forecast Financial Assets and Investments

3.7.1 Forecast Financial Assets include (in formal accounting terminology) cash and cash equivalents, current financial assets and term financial assets. I have excluded investment properties from this definition. In the draft 2009-19 LTCCP investment properties are shown at a constant value of $3.8 million for each year.

3.7.2 Forecast Financial Assets increases from $3.6 million in 2010 to $6.6 million in 2019.

3.7.3 Council has assumed a return on investments in a range of 3%-4.25% which appears reasonable in the prevailing monetary market.

3.8 Major issues in Council Services and Activities

From a perusal of the ‘activities’ section of the draft 2009-19 LTCCP and the Asset Management Plans the following are the major issues which are apparent;

3.8.1 *Roading* - the LTCCP notes that the NZTA subsidy will drop from 47% to 46% from year two of the plan. Council is unlikely to be eligible for NZTA funding assistance for seal extensions even though the LTCCP has capex of $1 million forecast for this. If the funding assistance is not forthcoming, the work will not proceed. The LTCCP also notes that 12 of the 40 bridges will not be replaced when they reach the end of their life. To quote the LTCCP “ Either fords, culverts or nothing will go in their place”. It is not clear if this will occur in the LTCCP period. While this sounds dramatic, in fact a number of local authorities are signalling that old bridges servicing perhaps one or two farms will not be replaced with like for like bridges.

3.8.2 *Water Services* – the Kaikoura township scheme is largely in place and producing good quality water. A new main line and reservoir will be constructed in the middle years of the LTCCP period at an expected cost of $1.5 million. Water meters will be installed to help Council in its water conservation efforts. Asset renewals are estimated at a total of $1.4 million over the 10 year period. In the small rural water schemes, efforts will be made – for several of the schemes - to improve MoH water quality gradings.

3.8.3 *Sewerage and stormwater* - Recent CCTV inspections of pipes has provided a more accurate picture of the condition on assets. The inspections highlighted lengths of pipes that require urgent replacement. The LTCCP provides for renewals of almost $2 million for sewer pipes, of which $1 million is scheduled for the next three years.

3.8.4 *Refuse and Recycling* – Council’s existing landfill is expected to reach capacity in 2012. Arrangements are in train to freight solid waste to the Canterbury Regional Landfill (at Kate

Valley) from then. The existing landfill site will need to be reconfigured as a transfer station. The expected cost is around $380k and will be financed mainly by loan.

3.8.5 *Community Services* – In the 2006 LTCCP the expected cost of the then proposed 'Community Hub' was $16 million. The 2009 draft LTCCP indicates a scaling down of the proposal to incorporate a swimming pool, gymnasium and indoor sports complex but to exclude a library, museum and Council civic offices. The new capex estimate is $12 million for construction in 2014 and 2015. Funding is mainly by way of loans ($6 million), anticipated external grants ($3 million) and Development Contributions. In respect of the facilities now excluded, the existing library has already been expanded (through an adjoining accommodation lease coming free), the museum has provision for separate funding of $921k in 2012 and the proposal for new civic offices has been shelved.

3.9 Summary

3.9.1 The **financial** picture of KDC portrayed by the Draft 2009-19 LTCCP is not as rosy as that painted in the 2006- 16 LTCCP. That is a principally a reflection of the straitened financial environment faced by all councils. KDC has recognised;

- The originally proposed community hub has had to be scaled back by shelving new civic offices. The cost estimate is now $12 million from a previous estimate of $16 million and the timing pushed out to 2015.
- A dramatic reduction in the forecast Development Contributions revenue in the next two years. Subsequent forecast increases in Development Contributions will be dependent on the certainty of growth assumptions.
- Total Rates increasing by a moderate average of 2.9% a year.
- Relatively small 'real' surpluses in the next ten years. If DC revenue falls short of expectations then these surpluses will be in jeopardy unless other revenue streams increase to compensate. On a like-for-like comparison, the collective surplus estimates for the ten years 2006-16 (from the 2006 LTCCP) was around $16 million. The equivalent figure for 2009-19 is $5.5 million.
- A significant increase in borrowings in the middle years of the LTTCP period associated with the Community Recreation Facility proposal. Loan servicing expenditure remains within the covenants of the KDC liability management policy.
- A reasonable level of financial assets to meet obligations as they fall due.

3.9.2 In relation to **Council Services and Activities** there is evidence, in the Asset Management Plans and LTCCP capex forecasts, that KDC will replace or renew water, sewerage and stormwater assets as and when required. New capital works are also proposed but the quantum is not large as much of the desired capital upgrades have already been achieved for utility services. Roading new works will focus on foothpaths and walkways; it is unlikely that planned seal extensions will proceed because it will not meet NZTA assistance criteria. While road reseal renewals are incorporated in the LTCCP capex forecasts, Council has signalled that some bridges may not be replaced.

Council is working through changes to solid waste, which will necessitate closure of its landfill and a reconfigured refuse transfer station.

4. Marlborough District Council (MDC) 2009-19 Draft LTCCP

A brief review was made of MDC's overall forecast financial position from its 2009-19 Draft LTCCP.
As expected MDC's finances are sound and very much shade the collective finances of HDC and KDC. The draft LTCCP has received an unqualified opinion from Audit NZ.

Highlights of the MDC forecast finances are;

- Total revenue rising from $89 million in 2009-10 to $129 million in 2018-19
- Forecast surpluses for every year, ranging from $5.8 million to $22.3 million
- Forecast financial assets increasing from $12.4 million in 2010 to $21.8 million in 2019.
- Forecast borrowings increasing from $21 million in 2010, peaking at $124 million in 2016 and reducing to $109 million by 2019.