revenue and financing policy

Introduction

The Local Government Act (2002) requires the Council to adopt a Revenue and Financing Policy which ensures operating revenue is set at a sufficient level to meet the projected operating expenses and that funding for capital expenditure is prudent recognising the service capability of assets throughout their useful life.

The policy will ensure the Council's long term programme is financially sustainable, that major projects, resulting operating costs, and debt are financed at manageable levels.

Included within the financial management policy is a requirement to generate surpluses thereby enabling the Council to reduce its dependence on borrowing to fund capital works. The policy statement will set the context for rates, other revenue charges, and capital funding, with the specific funding sources disclosed in the Funding Impact Statement.

The policy has two discrete areas. Firstly the funding of capital expenditure and secondly, financing operating revenue.

The policy has been developed within the context of the other financial management policies of Council and the rating policies and will apply for the next two years or until amend by a LTCCP, however the revenue structure and assumptions will continue for the next ten years.

The capital expenditure financing is detailed on the Financial Summary and the Funding Impact Statement, and will be corporately funded, not by activity or group of activities, except for specific reserve fund utilisation.

Capital Expenditure Financing

Capital expenditure, including 'term' investments and debt repayment, will continue to be financed as in the past and disclosed on the Financial Summary of the Annual Plan. The financing sources to be used are:

- Depreciation funds and retained surpluses including capital revenues
- Sale of assets
- Special funds set aside for capital expenditure, and finally
- Borrowing

The financial management principles of the Council mandate several key elements of capital expenditure financial management. They are a continuation of past policies, and include:

- Debt will be repaid within 20 years of raising to ensure inter-generational equity
- At least 59% of average annual capital expenditure will be funded from depreciation and operating surpluses
- The balance of capital expenditure will be funded from reserves, sale of assets and lastly, loans
- Operating expenditure will be funded from operating revenue
- The Council will budget for an operating surplus each year which will be used in part to repay debt
- Financial management will be based on maintaining projections within the five financial ratios, and on ensuring the Council continues to receive at least an AA credit rating from Standard and Poors

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Operational Expenditure Funding

The Local Government Act (2002) prescribes a series of issues to be considered. In particular Section 101.3 of the Act, requires each activity to be analysed, direct revenue, if applicable, identified, and the residual cost assigned to a rate revenue source.

Further, when considering the funding of operational expenditure, the following issues were considered (as required in the legislation):

- Each activity to be funded was considered, including for each
  - the community outcomes
  - the distribution of benefits between the community as a whole, any identifiable part of the community, and individuals
  - the period in or over which those benefits are expected to occur
  - the extent to which the actions of the community contribute to the need to undertake the activity
  - the costs and benefits, including consequences for transparency and accountability, of funding the activity
- And finally, the overall impact of any allocation of liability for revenue needs on the current and future social, economic, environmental, and cultural well-being of the community

Activity Funding – some underlying assumptions

The Council operations are divided into 77 activities. These in turn are summarised into 15 groups of activities. The funding analysis of activities uses the following assumptions:

- The gross cost of the activity is assumed to equal the benefits of the activity,
- The first allocation, and consequent funding of benefits is between general benefits and direct customer benefits:
  - General benefits are funded by rates on a straight capital value basis as the benefit applies to the community as a whole which is represented by capital values of rating units, because:
    - Capital value reflects relative value of utilisation of Council services,
    - It reflects relative ability to pay in that ownership of property at value reflects an acceptance of relative holding costs of a property,
    - Rates are a property based tax and sound taxation principles should be applied, such as transparency, neutrality, fairness of allocation,
    - There is an underlying assumption that all Council services add to the quality of life in the city and are therefore of value to all sectors of the community.
  - Direct customer benefits identified can, if Council policy chooses, or if there is an appropriate charging mechanism, be potentially recovered by user charges on customers. Often however, there is no practical means of charging the users or there is Council policy such as promoting open access to service. In these cases no charge is made or less than a full charge is made. Where a charge is made, the price decision will take into account relevant policy, access to services and affordability issues.

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- The second allocation of funding is to cover any shortfall in the funding of direct benefits after user charges and other direct revenues (if any) are applied. Shortfalls are funded, with one exception, by rating on the basis that the shortfall arises from deliberate Council decisions not to charge the customers of the service a full cost recovery. As the ratepayers are the residual funding source, they pick up the shortfall of direct benefits.
- This approach means there is an explicit policy decision not to regard ratepayers as defacto customers, recovering direct benefits as if the ratepayers were the consumers. Therefore ratepayers at large pay for the shortfall based on capital value.
- This approach also means that, with two exceptions, all rating will be based on capital value. There will be no differential between rating sectors.

The two exceptions to the above that have been identified by the Council are the activity Vehicle Ways in Streets and Transport, and the situation for land classed as Rural for rating purposes. These will be discussed in detail below.

General Benefits v Direct Benefits and the impact on the community:

Services supplied by the Council can be analysed into public goods or private goods. Private goods yield direct benefits to consumers, public goods provide benefits to the community as a whole. Most have some public good characteristics and lie on a continuum between public and private goods.

The distinction is largely based on the nature of the services, who they are produced for, and why Council provides the services.

The nature of the benefits for each activity have been identified and disclosed by the descriptive text statement for each activity and includes the description, outcome, beneficiary statement, and nature of the service. The funding decisions follow this analysis.

The major outcome of the Revenue & Financing Policy is the basis of allocation of rates:

Most general benefits apply equally to all rate paying sectors and therefore relative capital values is the appropriate primary driver of allocation of the net rate requirement. Some do not, in which case the allocation is more appropriate to one sector over others.

Rates distribution, some underlying assumptions:

If the allocation to all rating units is equal then the base is either by straight capital value or by uniform charge. This equal allocation does not need differential sectors.

The capital values for each sector as used for general rates funded activities are:

• Business sector,	20.64%
• Residential and Base sector, and	76.81%
• Rural Sector	2.55%

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Alternatively, an unequal allocation to rating units must use differential sectors.

For differentiation, the rating units are divided into rating sectors, using attributes of the property, primarily land use, as the deciding factor. The framework for differentiation is defined in the Local Government (Rating) Act 2002. The Revenue and Financing Policy defines the rate requirement which is then allocated to each sector. This results in different rate decimals for each sector for the rate type.

Differential rating is used for General Rates only and uses the following sectors:

- Business sector,
- Residential and Base sector, and
- Rural Sector

Please refer to the Rating policies for a description of each sector.

The Revenue & Finance Policy conclusions for operational expenditure funding

General conclusions:

- In many activities, there is no practical charging mechanism and therefore fee charging is not practical. Rates are the best funding source.
- The shortfall of direct benefits accrues to rating sectors (where rate funding is required) is assumed to be in proportion to Capital Value. This is appropriate as:
  - This is the chosen rating base and rates are a property tax.
  - The proportionate value reflects as closely as possible, given the rating system, the:
    - Relative impact on enhancing the value of property, for those services which are predominantly property based,
    - Ability to pay, in that one ratepayer can be compared to another.
    - Relative value or use of services, especially the availability of services factor,
- Within any differential sector, capital values reflect an appropriate allocation:
  - Relative impact of services to the value of property,
  - Ability to pay in that high value ratepayers can afford to pay more for Council services.
- There are significant benefits to all properties and ratepayers from the services of Council. The community has an expectation of a well serviced city. This is implicit in the Outcome statements of Council under the LTCCP. The benefits from all services apply to all ratepayers.
- Corporate revenues are assumed to accrued to ratepayers on the basis of straight capital value.

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Exception to straight capital value rating

Vehicle Ways

This activity has been allocated to rate sectors as if the sectors were the consumer of benefits.

There is an exceptional demand on city streets by the Business Sector especially in the activity "Vehicle Ways". The Council have concluded that an allocation of 54% to the Business Sector is appropriate and is based on the City Streets funding model.

Firstly, Vehicle Ways activity is the largest net cost activity.

Secondly, it is the Business ratepayers as a group who necessitate considerable extra expenditure to provide the strength of roads for heavy traffic and therefore contribute significantly to the need to undertake the service, both, by their use of land and the traffic movements from it, and the potential use as a result of Business Zoning of land.

The standard of construction necessary and supplied by Council for Vehicle ways is sufficient to meet forecasted use. Where that use includes significant heavy vehicles, the standard of construction and the quantum of maintenance is substantially higher than would necessary if there was no heavy traffic. If Council chose not to provide extra maintenance then the road structure would breakdown with heavy traffic use. There would be a consequent increase vehicle maintenance and running costs and a reduction in utility from the road network. There is therefore a justification to fund this activity separately from other activities of Council.

The analysis has identified that one heavy vehicle is equal to over 10,000 cars in terms of wear and tear damage to the road system.

The study concludes that after taking into account:

- The class of vehicle,
- The distance travelled for each class,
- Adjustments to equivalent distance by class,
- Allocating the class of vehicles to sectors, and,
- Adjusting the allocation by the number of rating units

An overall allocation results in a weighted share of 99% to the Business sector. This was the allocation base used in the last Annual Plan, however on review, this is considered extreme and a more moderate approach is warranted based on expenditure components.

The selected allocation to the Business Sector is now broken down into the expenditure type:

- Depreciation to be allocated at 60.81%, and is made up of two components:
  - A full allocation to the Business sector of depreciation on major arterial, minor arterial, and collector roads due to the heavy vehicle predominant use of those roads, and
  - An allocation to the Business sector of 50% of the balance of depreciation on all other roads.
  - Capital expenditure, which is the basis of depreciation, is focussed on provision and expansion of capacity both for heavy trade vehicles and volume.
- Maintenance expenditure is allocated 45% to the Business sector on the basis that significant maintenance of the road network is caused by the volume and weight of heavy trade vehicles. The quantum is determined at 45% although a range between 21%, (the minimum based on the capital value share) and 99%, (the upper limit based on the model used in the previous Funding Policy and still appropriate).

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- Maintenance expenditure is a reactive response to road surface failure. The cause is age, high use, changed use, or road structure breakdown. Much of this is exacerbated by heavy trade vehicles. Predominant light vehicle use does not on its own cause road surface failure.
- The resulting weighted average allocation to the Business Sector for Vehicle Ways activity is 54.255%.

Rural Sector Rate Differentials

There is currently a lower General Rate decimal applying to rating units in the rural sector. This will continue but will in future be based on a fixed relationship of 75% of the General Rate Decimal applying to the Residential and Base Sector. This approximately preserves the current relationship.

This lower general rate (as compared to Residential) is based on the following assumptions:

- A lower standard of services generally is provided to outlying rural properties,
- The greater distance from Council provided services and therefore reduced use of those amenities by ratepayers (no footpaths, lack of adjacent parks etc),
- The value and impact of services provided by the Council to the property values (farm land may not be enhanced by community services).

Note - there is no difference between sectors for Water, Sewerage, and Land Drainage rate decimals.

Targeted Rates

Targeted Rates continue:

- The activities and targeted rates of Water, Sewerage and Land Drainage continue but have straight capital value applied, with the rates applied to the serviced properties, and in the case of Water, half rates to those not connected. There was some minor differentiation in the past for Water and Sewerage.
- The allocation assumptions are the same as the General Rate activities assumptions except that the rate is restricted to the serviced area only.
- Water Rate on serviced but unconnected properties will be half that of connected.
- The Excess Water Targeted rate and the Water Supply Fire Connection Targeted Rate will continue as in the past, with the unit charge increase (see Rating policies and the price change schedule)

Continue with a Uniform Annual General Charge:

A Uniform Annual General Charge of $115.00 will apply to rating units, an increase from $105.00.

- As a modification of rates after considering the overall impact of rates allocated.
- As an allocation within each differential sector because the UAGC is impacts on rates incidence, not primarily about rate sector allocation. The charge recognises to a degree the extent of common service to properties.
- Continue to be applied to each separately occupied part of a rating unit as defined in the rating policies because this better represents the ratepayer consumption of services, better than a single charge for a rating unit.

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The rates system to be used

The current system of rate types will continue.

- All activities other than those specified for targeted rates below, will be funded by General Rates and assessed as:
  - A valuation based rate, assessed on Capital Values, plus
  - Uniform Annual General Charge, of $115 on each separately used part of a Rating Unit

- Targeted rates will be set for:
  - Water
  - Sewerage
  - Land Drainage functions, and
  - Water fire connection and excess water supply

- Capital Value is the rating base
- Differentials will apply for General Rates only
- The makeup and definition of the differentials has been amended to restrict the makeup of the Rural Sector
- The Rural Sector General Rate Decimals will be set at 75% of those applying to the Residential and Base Sector

Funding Impact Statement and the Rating Policies

The financial results of this policy are expressed in the tables contained in the Funding impact Statement. In addition, the rate decimals and rating policies are detailed in rating policies this LTCCP.

"The Strip" - Oxford Terrace

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Revenue and Financing Policy - Table 1

	Total Cost	Direct Benefits	Revenue	Shortfall	General Benefits	Total Rates Net Gst	Total Rates Gst Inc	Residential	Business	Rural	Non rateable	Total Rates
General Rate Funded Activities												
Other then 'Vehicle Ways' Activity	245,950,723	100,619,335	-148,856,377	-48,237,040	145,331,386	97,094,346	109,231,139					
Allocation - general		*40.91%*			*59.09%*			*76.81%*	*20.64%*	*2.55%*		
Vehicle Ways	25,176,586	12,588,293	-2,604,693	9,983,600	12,588,293	22,571,893	25,393,380					
Allocation		*50.00%*			*50.00%*			*43.20%*	*54.26%*	*2.55%*		
Total General Rates	271,127,310	113,207,629	-151,461,070	-38,253,440	157,919,680	119,666,240	134,624,519					
Rates by Capital Value								80,625,889	34,623,590	2,011,190		117,260,669
Uniform Annual General Charge - $115								15,453,585	1,698,895	211,370		17,363,850
Total General Rates								**96,079,474**	**36,322,485**	**2,222,560**		**134,624,519**
Targeted Rates:												
Water Supply Targeted Rate	15,066,809	12,053,447	-1,793,000	10,260,447	3,013,362	13,273,809	14,933,036					
Allocation		*80.00%*			*20.00%*			*74.69%*	*18.48%*	*0.78%*	*6.05%*	
Water supply - Full								10,983,479	2,640,126	101,847	875,007	14,600,460
Water supply - Half								117,005	106,751	14,529	23,992	262,276
Water supply Fire Connection - $100								15,000	49,600		5,700	70,300
Sewerage	24,606,373	19,685,098	-3,636,330	16,048,768	4,921,275	20,970,043	23,591,298	17,591,054	4,468,487	78,414	1,453,344	23,591,298
Allocation		*80.00%*			*20.00%*			*74.57%*	*18.94%*	*0.33%*	*6.16%*	
Land Drainage	10,957,330	5,478,665	-37,000	5,441,665	5,478,665	10,920,330	12,285,372	9,629,584	2,458,838	196,950		12,285,372
Allocation		*50.00%*			*50.00%*			*78.38%*	*20.01%*	*1.60%*		
Total Rates	**321,757,822**	**150,424,841**	**-156,927,400**	**-6,502,559**	**171,332,981**	**164,830,422**	**185,434,225**	**134,415,598**	**46,046,287**	**2,614,300**	**2,358,044**	**185,434,225**