Revenue and financing policy

Revenue and Financing Policy

Introduction

The Local Government Act 2002 requires the Council to adopt a Revenue and Financing Policy which ensures that operating revenue is set at a sufficient level to meet the projected operating expenses, and that sources of funding are sufficient to meet capital expenditure. This policy will ensure the Council's community plan is financially sustainable and that debt is maintained at a manageable level. Included within the policy is a requirement to produce a balanced budget as defined in section 100 of the Act.

The Revenue and Financing Policy sets the context for rates, revenue charges, and capital expenditure funding, all of which are disclosed in the Funding Impact Statement. It has been developed within the context of the other financial policies of Council, and will apply for the next three years.

Inclusion of Banks Peninsula

With a few major exceptions, a uniform policy applies to the total area of the two merged councils, and it is based on that of the previous Christchurch City Council. There is a significant change to the user charges and rates for the former Banks Peninsula District Council community. The major exceptions are that the uniform targeted loan servicing rates for Church Bay and Governors Bay will continue, and the land drainage area of benefit has been extended to include developed areas of the Peninsula. As a result of the amalgamation all other rates and user charges will be brought into line with the City Council policies.

Funding of expenditure

The Local Government Act 2002 prescribes a series of issues to be considered. Section 101(3) requires each activity to be analysed, and decisions made about the most appropriate method of funding the operating and capital expenditure.

The following matters were considered for each activity when deciding how to fund the Council's operational expenditure:

- The Community Outcomes to which the activities contribute;
- 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 or inactions 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
- 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.

The policy has two discrete areas; the financing of capital expenditure and of operating expenses.

Financing of capital expenditure

The Council's capital expenditure covers:

- Purchase of assets, and
- New investments in Council companies.

The capital expenditure to be financed is developed on the city wide priority basis for all assets and the need for efficient city-wide funding basis. It is corporately funded, rather than by Council activity or group of activities, however there is some use of reserve funds specific to certain asset purchases. With the exception of the debt repayment term which has been extended from 20 to a maximum of 30 years, this is a continuation of the current policy. The amounts are disclosed on the Financial overview table on page 65.

The sources of funding include:

- Revenues received for capital expenditures, such as Transfund subsidies – these are included in the operating surplus;

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- Depreciation funds, being revenue received to cover the cost of depreciation;
- Financial contributions and development contributions (see the Development Contributions Policy in Volume 2);
- Sale of assets;
- Draw-down of special funds set aside for capital expenditure; and
- Borrowing.

The Council's financial management principles, as disclosed on page 59, provide that:

- Rating for depreciation will be applied to capital expenditure annually;
- Debt will be repaid within 30 years of raising to ensure inter-generational equity;
- The balance of capital expenditure will be funded from reserves, sale of assets and loans;
- Operating expenditure will be funded from operating revenue;
- The Council will budget for an operating surplus each year;
- Financial management will be based on maintaining projections within the four financial ratios; and
- The Council has the objective of maintaining at least an AA credit rating from Standard and Poor's.

New targeted rates are introduced in this LTCCP for recovering loan servicing charges, interest and principal, for:

- Central City mall redevelopment
- Church Bay and Governors Bay

The principal recovered will offset the specific loan repayments.

Financing Operational Expenditure

Activity funding – some underlying assumptions

The full description of each Activity, its service description and objectives is contained in the Activity Management Plans.

The activities are included within each Group of Activity page in this LTCCP. The Group pages outline the costs of each Activity, revenue sources for each and the rationale. The table at the end of this policy is a summary of the Activity analysis and revenue source with emphasis on rate revenue.

Further information is available on the nature and outcome of the activity analysis if required.

General versus direct benefits, and the impact on the community:

The Council services are divided into 46 activities. These in turn are summarised into 12 groups of activities. (See the Council's Activities section in this LTCCP).

The services produced can be analysed as being either for public good or private good. Public goods provide general benefits to the community as a whole, while private goods yield direct benefits to consumers. The majority of services provided by the Council have some public good characteristics and lie on a continuum between the two. For example, the Parks activities provide direct benefits to the users, both citizens and ratepayers and general benefits to the community, who have, for instance, an open space in their neighbourhood.

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

The benefits for each activity have been identified within the Group of Activities, which include a description of the activity and its contribution to Community Outcomes. The funding decisions follow this description.

Benefit analysis:

The funding analysis of activities is based on the following assumptions:

- The gross cost of an activity is assumed to equal the benefits delivered by the activity;
- An allocation of benefits is made between general benefits and direct customer benefits. This is a subjective choice of the Council;
- General benefits are funded by rates, generally on a straight capital value basis, as the benefit applies to the community as a whole. The community is represented by the capital values of rating units and therefore capital values are the rating base, because:
    - Capital value reflects relative value of utilisation of Council services;
    - Conceptually it reflects relative ability to pay in that ownership of property 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; and
    - 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 are those where there is a consuming "customer", either a person or entity, and the service provided by the council is wholly or substantially consumed by them.

User charges:

The direct benefits are the result of Council analysis of each activity as required by Local Government Act 2002 Section 101.3. That analysis concluded that some activities produce direct benefits, namely the portion of the cost of the service accruing to the direct customers. This does not mean that a user charge will follow, but merely that if a charge was to be made (or in fact could be made given the nature of the service and the ability of Council to charge) this would be the maximum.

Charges can be made to customers of the service if the Council policies for user charges allow or if there is an appropriate charging mechanism for the service. Where a charge is made, the

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price decision will take into account the relevant service delivery policy, access to services and affordability issues. These decisions of Council are made after taking into account the social, economic, environmental, and cultural wellbeing of the community (as required by the Act and the interests of the community).

Where, in the opinion of the Council, there is no practical means of charging the users or there is a Council policy constraint such as promoting open access to a service the charge revenue is less than the direct benefit costs. In those circumstances no charge is made or the charge is less than a full charge.

Often, at an activity level, user charges for a Council service activity will not cover the direct costs to users (the direct benefits). In that case a user charge shortfall occurs. Funding of direct benefit shortfalls is by rates by relative capital values (predominantly General rates but also some targeted rate) because: shortfalls of direct benefits after user charges occur as a result of Council policy decisions, as expressed in pricing policies, where Council has decided not to charge the customers a full cost recovery, and the stakeholders are represented by those who pay rates, expressed as relative capital values.

Where the activity is wholly funded by targeted rates, the shortfall is charged to the targeted rate payers.

Fees are set by Council and the revenue is reflected in the LTCCP Group of Activity pages. On the Group page disclosing the financial budget are notes giving further explanation of the level of fees and subsidies and the rationale of their selection. The table on page 268 shows how effect is given to this policy.

Rates distribution, some underlying assumptions:

The major outcome of this Revenue and Financing Policy is the basis of allocation of rates.

Most general benefits (and direct benefit shortfalls) apply equally to all rate paying sectors and therefore relative capital values or rating units (the properties) is the appropriate primary driver of allocation of the net rate requirement.

All rating is based on relative capital value without differentiating between rating sectors, with the exceptions as noted below where benefits do not apply equally.

The capital values for each sector are estimated to be in the following proportions:

- Business sector 19.32%
- Residential and Base sector 76.37%
- Rural Sector 4.30%

Where there is an unequal allocation of rates to rating units, the allocation of rates must use differential sectors. This means that 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 and the application for this Council is defined in the Funding Impact Statement on page 237.

The results of this Revenue and Financing Policy define the rate requirement which is then allocated to each sector, resulting in different rate decimals for each sector for the rate type.

Differential rating is used for general rates only and uses the three sectors listed above.

Revenue and Finance Policy: Conclusions for funding of operating expenditure

General conclusions:

The analysis conclusions for each activity is shown on the Group of Activity pages in this LTCCP. The following is a summary of the conclusions. This summary is reflected in the table on page 267.

The activities of the Council have been reviewed and the following conclusions reached:

- General benefits will be recovered by rates based on capital values;
- Direct benefits may be recovered by fees and charges;
- In many activities, there is no practical charging mechanism and therefore fee charging for direct benefits is not possible;
- There is a shortfall of direct benefits and rates are the best funding source;

- The rate funded shortfall of direct benefits accrues to rating units, assumed to be in proportion to capital value;
- Corporate revenues, made up of interest on funds, dividends and petroleum tax are raised to the maximum possible amount and are assumed to accrue to ratepayers who pay General rates on the basis of straight capital value. They do not offset activity costs, but reduce the total rates.

The basis of the exception to straight capital value rating

The total net operating cost of the Council is recovered by rates on a straight capital value basis to general rates except for those listed below.

The exceptions that have been identified by the Council are:

- The activity 'streets', in the group 'Streets and Transport';
- Land classed as 'rural' for differential rating purposes;
- Uniform Annual General charges:
- Targeted rates – charges by capital values, but to serviced properties for water, sewerage, and land drainage; and
- Targeted rates for loan servicing for the Central City mall redevelopment, charged to Central City business ratepayers;
- Targeted rates for some water and sewerage services – Church Bay and Governors Bay schemes and Excess Water Charges.

Streets activity loading on the Business Sector

There is an exceptional demand on city streets by the business sector. A study has identified that one heavy vehicle is equal to over 10,000 cars in terms of wear and tear to the road system.

The study concludes that after taking into account:

- The class of vehicles using the roads;
- The distance travelled by 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.

there is justification for a rate loading applied to the business (differential) sector for general rates. This loading is to the advantage of the residential and rural (differential) sectors.

The Council has concluded that an allocation of 55% to the business sector is appropriate based on the City Streets unit's funding model.

It is the business sector as a group which necessitates considerable extra expenditure to provide the strength of roads for heavy traffic. Its use of land and the traffic movements from it, and the potential land use as a result of Business zoning, means the business sector contributes significantly to the need to undertake the service.

The standard of construction necessary and supplied by Council for Streets is sufficient to meet forecast use. Where that use includes significant heavy vehicles, the standard of construction and the quantum of maintenance is substantially higher than would be necessary if there was no heavy traffic. If Council chose not to provide extra maintenance the road structure would breakdown resulting in a subsequent increase in 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.

Within the Streets Activity costs, the allocation to the business sector can be broken down into the expenditure type:

- Depreciation on streets is allocated at 61.48% to the business sector 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.

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- Capital expenditure, which is the basis of depreciation, is focused significantly on provision and expansion of capacity both for heavy trade vehicles and volume;
- Maintenance expenditure is allocated 46% 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;
- 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 streets activity is 55%.

Rural sector rate differential

Rating units in the rural sector will continue to have a lower general rate. The rural sector will have a fixed relationship of 75% of the general rate decimal (the multiplier) applying to the residential and base sector. This maintains the current relationship.

This lower general rate (as compared to residential) is justified on the following basis:

- A lower standard of services generally is provided to outlying rural properties, (no footpaths or street lighting);
- There is a greater distance from Council provided services and therefore reduced use of those amenities by ratepayers (lack of adjacent parks etc);
- The impact of the level of services provided by the Council on 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 will continue to be set for the following reasons:

- The activities and targeted rates of water and sewerage continue on straight capital values, with the rates applied to the serviced properties only, and in the case of water, half rates to those not connected.
- Land drainage rates will apply to the serviced area, adjusted annually, but to recover the direct benefits of the utility portion only.
- The underlying allocation assumptions are the same as for the general rate activities assumptions, except that the rate is restricted to the serviced area only and is not differentiated.
- The excess water targeted rate and the water supply fire connection targeted rate will continue as in the past, with the unit charge increase.
- A new targeted rate on the central city business ratepayers to recover the loan servicing costs to fund 70% of the city mall redevelopment capital costs of $10m (total):
  - The $7m loan will serviced on a table basis over 15 years estimated to be at 7%;
  - The rate will commence in the year following the completion of a stage of the project, the rate estimated to start 2007/08;
  - The liable ratepayers will be:
    - business ratepayers, as defined in the rate differential policy – see page 244 of the LTCCP; and
    - in the central city area zoned Central City and Central City – Edge, see zoning map attached on page 266.
  - The rate is estimated to recover $866,250 GST exclusive.
- The two special loan-servicing targeted rates for Church Bay and Governors Bay will continue as originally intended and agreed with the ratepayers concerned at the time the schemes were commissioned:
  - The estimated balance of the loans as at 1 July 2006 is:

- Church Bay water and sewerage scheme – $163,175 with three years to run;
- Governors Bay water and sewerage scheme - $255,518 with 10 years to run.

- The uniform targeted rate in each case will be set to recover interest and principal on a table basis with the interest rate being 7%.
- Any ratepayer may make an advanced payment of the balance of their liability for these uniform targeted rates on the basis of:
  - For rating years other than the current year, the amount payable will be the Net Present Value of the uniform rates estimated to be payable, discounted at the current interest rate;
  - For the current year, the balance of the rates assessed.

Uniform Annual General Charge (UAGC):

A UAGC of $115 applies to rating units. The Council has concluded that $115 is appropriate because:

- It is a fair modification of rates after considering the overall impact of rates allocated; and
- It is a fair allocation within each differential sector because the UAGC impacts on rates incidence, not on rate sector allocation. The charge recognises a common service to all properties.

The UAGC is 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. This means that a rating unit with multiple occupancies may have to pay several UAGC's.

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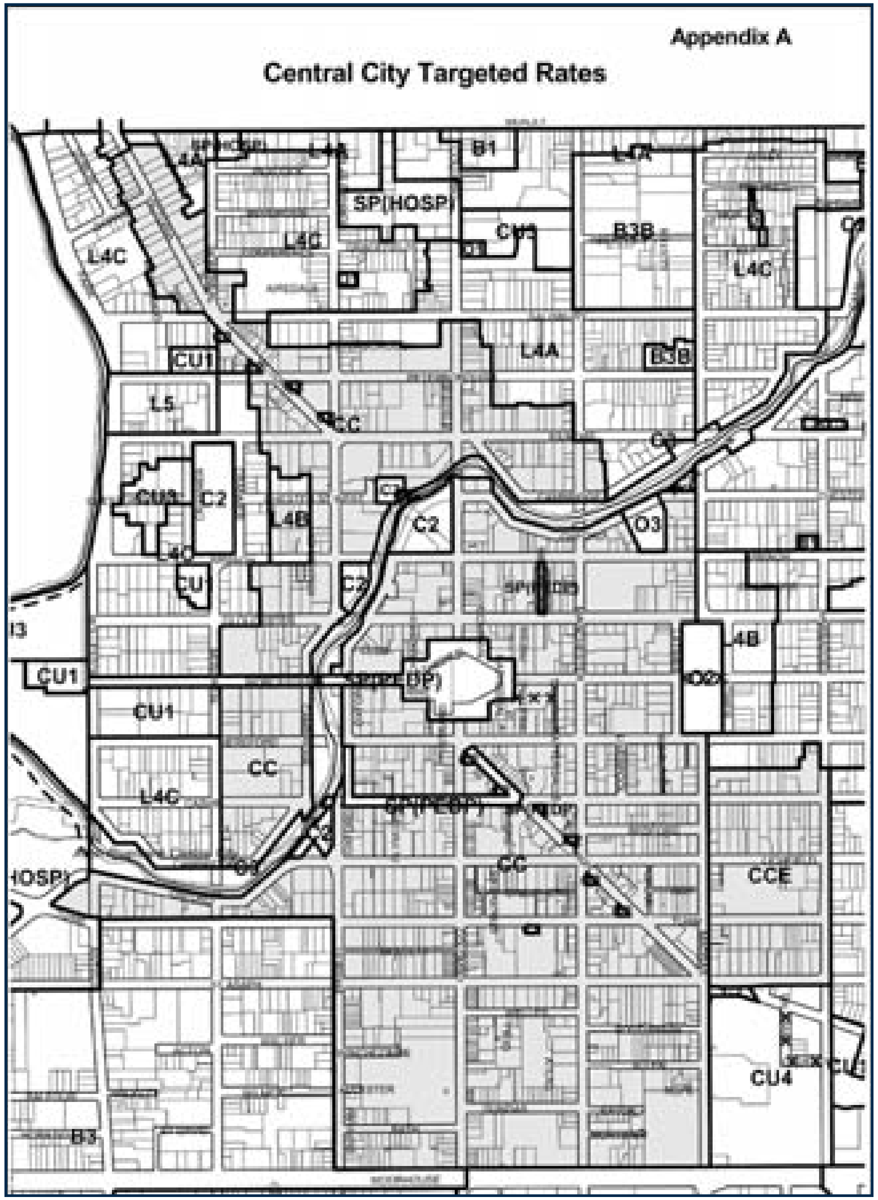
Summary of the rates system to be used

Rates fund the net operational costs of the Council, expressed on an activity basis:

- Differentials will apply for General Rates only;
- Capital Value is the rating base;
- All activities other than those specified for targeted rates below, will be funded by General Rates and assessed to rating units by:
    - Capital Values,
    - Differentiated to rate sectors of Residential, Business and Rural, and
    - Uniform Annual General Charge of $115 on each separately used part of a rating unit.
- Targeted rates will be set for:
    - Water supply activities,
    - Sewerage activities,
    - Land Drainage utility activities,
    - Water fire connection and excess water supply,
    - Central City Mall redevelopment,
    - Church Bay and Governors Bay water and sewerage rates.

Funding Impact Statement and the rating policies

The financial results of this policy are expressed in the tables contained in the Funding Impact Statement on page 237.



Revenue and Financing Policy - Summary table

Funding of operating expenses for 2006/07

	Total Cost Net GST	Direct Benefits	Activity Revenue	Direct Benefits Shortfall	General Benefits	Total Rates Net GST	Total Rates GST Inc	Residential Rates	Business Rates	Rural Rates	Non rateable Rates	Total Rates GST Inc
General Rate Funded Activities												
All activities other than Streets	299,400	156,804	173,480	-16,676	142,596	125,920	141,660					
Allocation - General rates by capital values		52.37%			47.63%			76.37%	19.32%	4.30%		
Streets activity - carriageway portion	29,348	14,674	3,664	11,010	14,674	25,684	28,894					
Allocation - with a loading on Business		50.00%			50.00%			42.99%	54.59%	2.42%		
Total General Rates	328,748	171,478	177,144	-5,666	157,270	151,604	170,554					
Rates by Capital Value								107,636	39,498	4,550		**151,684**
Uniform Annual General Charge - $115								16,508	1,918	444		**18,870**
Total General Rates								124,144	41,416	4,994		170,554
Targeted Rates:												
Water Supply Targeted Rate	18,813	15,050	2,630	12,421	3,763	16,184	18,206	14,219	3,227	138	622	**18,206**
Allocation		80.00%			20.00%			78.10%	17.73%	0.76%	3.42%	
Sewerage	32,031	25,625	3,862	21,763	6,406	28,169	31,690	24,842	5,631	110	1,107	**31,690**
Allocation		80.00%			20.00%			78.39%	17.77%	0.35%	3.49%	
Land Drainage	6,855	3,428	43	3,384	3,428	6,812	7,664	6,114	1,428	122		**7,664**
Allocation		50.00%			50.00%			79.77%	18.63%	1.59%	0.00%	
Church Bay and Governors Bay Loan rates	96	96		96		96	109	109				**109**
Allocation		100.00%						100.00%				
	386,543	215,677	183,679	31,998	170,867	202,865	228,223	169,428	51,702	5,364	1,729	228,223

Notes:
The total cost is the sum of all activities of the Council.
The direct benefits are the portion of the total cost accruing to direct customers of the activities.
Activity revenue is the total of fees, grants and subsidies.
General benefits are the total costs less the cost of direct benefits.
Total rates is the sum of all direct benefit shortfalls plus general benefit costs.
Rates are allocated to the rate types and sectors as shown.
The General rates allocation percentage is the share of Capital Value. It does not include the rural sector adjustment.
Rates are shown GST inclusive.

Revenue and Financing Policy

2006 /07 schedule of Activities within Groups

Activity	Direct Benefits	General Benefits	User Charge %	Subsidies	Targeted rates	General rate (including UAGC)
Central City Revitalisation	50.00%	50.00%	10.80%	0.00%		89.20%
City and Community Forward Planning and Urban Renewal	75.00%	25.00%	0.00%	0.00%		100.00%
Heritage Protection	50.00%	50.00%	14.03%	3.89%		82.07%
Civil Defence and Rural Fire	50.00%	50.00%	11.23%	0.00%		88.77%
Community Grants	50.00%	50.00%	0.24%	0.00%		99.76%
Community Support	20.00%	80.00%	1.47%	0.90%		97.63%
Early Learning Centres	80.00%	20.00%	24.28%	50.92%		24.80%
Halls and Conveniences	50.00%	50.00%	6.10%	0.00%		93.90%
Housing	80.00%	20.00%	82.27%	0.00%		Not funded from General rates
Art Gallery	80.00%	20.00%	12.21%	2.72%		85.07%
Libraries	80.00%	20.00%	8.04%	0.28%		91.68%
Museums	0.00%	100.00%	1.24%	0.00%		98.76%
Our City O-Tautahi	50.00%	50.00%	5.73%	0.00%		94.27%
Democracy and Governance Support	0.00%	100.00%	0.00%	0.00%		100.00%
Elected Member Representation	0.00%	100.00%	0.00%	0.00%		100.00%
City Promotion and International Relations	61.31%	38.69%	1.55%	0.00%		98.45%
Economic Development	80.00%	20.00%	1.84%	0.37%		97.79%
Employment Development	80.00%	20.00%	0.00%	0.00%		100.00%
Visitor Promotions	80.00%	20.00%	1.94%	0.00%		98.06%
Cemeteries	80.00%	20.00%	53.17%	0.96%		45.88%
Regional Parks	40.00%	60.00%	8.70%	0.03%		91.27%
Regional Parks	40.00%	60.00%	11.43%	0.00%		88.57%
The Botanic Gardens	40.00%	60.00%	3.38%	0.00%		96.62%
Urban Parks	40.00%	60.00%	4.12%	0.00%		95.88%
Waterways and Land Drainage	50.00%	50.00%	0.48%	0.00%	63.08%	36.44%

Pools and Leisure Centres, Stadia and Sporting Facilities	60.00%	40.00%	40.86%	0.00%		59.14%
Recreation and Leisure	80.00%	20.00%	3.06%	4.44%		92.50%
Recreation Programmes	80.00%	20.00%	14.28%	8.27%		77.45%
Sports Support and Promotion	80.00%	20.00%	0.17%	0.00%		99.83%
Black Bag Collection and Disposal	90.00%	10.00%	30.83%	0.00%		69.17%
Refuse Transfer and Disposal	50.00%	50.00%	42.90%	0.00%		57.10%
Waste Minimisation	50.00%	50.00%	43.31%	0.00%		56.69%
Enforcement and Inspection Activities	98.04%	1.96%	86.72%	0.00%		13.28%
Maintaining and Reviewing the City Plan	0.00%	100.00%	1.41%	0.00%		98.59%
Regulatory Approvals	100.00%	0.00%	72.47%	0.00%		27.53%
Cycle and Pedestrian Linkages - Off-Street	50.00%	50.00%	0.00%	10.12%		89.88%
Off-Street Parking	95.00%	5.00%	118.45%	0.00%		-18.45%
Pedestrian Malls - Off Street	50.00%	50.00%	0.00%	0.00%		100.00%
Public Passenger Transport	80.00%	20.00%	0.00%	12.65%		87.35%
Streets	50.00%	50.00%	12.37%	12.44%		75.19%
Wastewater Collection	80.00%	20.00%	-0.08%	0.00%	100.08%	
Wastewater Treatment and Disposal	80.00%	20.00%	29.58%	0.00%	70.42%	
Water Conservation	0.00%	100.00%	0.00%	0.00%	100.00%	
Water Supply	80.00%	20.00%	13.98%	0.00%	86.02%	
City Solutions	0.00%	100.00%	47.17%	0.00%		52.83%
Property	0.00%	100.00%	78.12%	0.00%		21.88%