

## FINANCIAL STRATEGY FOR EARTHQUAKE COSTS

### *Overview of Earthquake Response and Recovery Costs*

1. As a result of the earthquakes in September 2010 and February 2011, Council faces significant additional emergency response costs as well as costs the reinstatement of its infrastructure, other assets and maintenance of ongoing temporary works in place. These ongoing response and recovery costs are outlined further below.
2. In addition to these costs in future years, Council is forecasting an operating deficit of \$27.2 million for the 2010/11 year for the immediate impact of the earthquake. This deficit is a result of:
  - Immediate impact on 2010/11 Council revenue (largely parking and dividends) - \$19 million.
  - Reduced Council BAU operating costs – (\$5.3 million)
  - Rates remissions - \$3.7 million
  - Response & Recovery costs (including Emergency Operations Centre and staff time) - \$23.2 million
  - Council share of emergency works (eg. Shortfall in NZTA subsidies) - \$4.3 million
  - Welfare costs - \$0.6 million
  - These costs are partially offset by a 'BAU' Council operating surplus of \$9.0 million and a Council-approved transfer from the Earthquake Recovery Fund of \$9.3 million.
3. Staff recommend that Council borrow to fund the 2010/11 deficit and have built this assumption into the recommended Draft Annual Plan budget presented for Council approval. Although this increases Council's debt servicing costs in future, since 2006/07 Council has made accumulated operating surpluses of \$23.8 million of which, \$20.8 million has been applied to reducing Council debt.

### *Council Operating Cost and Revenues*

4. In the next three years, the Council will face similar challenges to those that will result in an operating deficit in 2010/11. The table below outlines the forecast impact of the earthquake on the Council's operating cost and revenues. Over three years, operating deficits are estimated to total \$73.9 million. Operating deficits are expected to decline over the next three years as revenues such as parking fees, lease revenue and dividends recover from the impact of the earthquake. The earthquake is also expected to impact negatively on the growth of the rating base, which has the consequential impact of increasing the rates required from the existing ratepayers.

<b>Council Cost and Revenue Impact</b>	<u>2011/12</u>	<u>2012/13</u>	<u>2013/14</u>
Rates Remissions	1.7	0.0	0.0
Rates growth impact (cumulative)	4.2	4.7	1.4
Fees & charges lost	8.7	7.2	5.2
Parking Infringements	1.5	1.1	0.8
Parking Fees	5.3	4.5	3.4
Other Revenues	1.9	1.6	1.0
Council operating costs	1.5	0.2	0.5
Cordon Management	1.3	0.0	0.0
CC Shuttle	-1.0	0.0	0.0
Facilities net savings	-3.4	-2.9	-2.0
Central City Plan	1.3	0.0	0.0
Insurance	3.0	2.8	2.2
Other Costs	0.3	0.3	0.3
Dividends	13.6	14.2	10.8
Council Operating Deficit (Pre-Interest Costs)	29.7	26.3	17.9

5. Staff have developed five options for Council to consider to fund these deficits. The ratepayer impact of the rating options are included in the table attached:

- (a) **Earthquake levy of \$106 per ratepayer for five years.** This option raises \$78.5 million in revenue over five years and covers the repayment of the operating deficits plus \$4.6 million in interest costs incurred.

Pros:

- Simple to understand and levies the same dollar charge on all ratepayers.
- Ability to easily remove the charge after five years (once the operating deficits have been paid back).
- Repays three years of operating deficits plus interest costs in five years.
- Minimises interest costs of funding the deficits.

Cons:

- Removal of the levy after five years would result in an overall rates decrease and removes the flexibility for Council to decide to use these funds to repay debt or put back into the renewals programme.
- Average rates increase in 2011/12 of 11.2%.
- Levy is regressive in that it results in total rate increases of 8.8% for \$1,000,000 capital value compared with 12.7% for the average capital value (see attached tables).

- (b) **Earthquake rates premium of 2.21% for three years.** This option raises \$80.6 million in revenue over five years and covers the repayment of the operating deficits plus \$6.7 million in interest costs incurred.

Pros:

- Simple to understand and levies the same percentage increase on all ratepayers.
- Repays three years of operating deficits plus interest costs in five years.
- Increases the rates base permanently which then allows Council to decide after five years to decrease rates, increase debt repayments or increase capital spending on renewals or other projects.

- The premium is progressive in its incidence – it results in a higher cost to a higher capital value asset in a similar way to the general rate.

Cons:

- Increases the rates increase by 2.21% each year in addition to the normal rates rise.

- (c) **Borrow for the entire deficit in the year incurred and repay over 30 years.** This option raises \$142 million in rates revenue over 33 years and covers the repayment of the operating deficits plus \$68.1 million in interest costs incurred.

Pros:

- Lowest immediate impact on rates.

Cons:

- Results in intergenerational inequity in that future ratepayers for 33 years pay off the Council's operating deficits for the next three years.
- No ongoing benefit enjoyed by future ratepayers who are required to service the debt.
- Incurs interest costs of \$68.1 million over 33 years therefore nearly doubles the amount of rates required to be collected to service the operating deficit.

- (d) **Rate for deficit in the year it is incurred.** This option raises \$75.6 million in rates revenue in 3 years and ensures the deficit is repaid in the year it is incurred. Only \$1.6 million in interest costs are incurred because the deficits are paid off quickly in the year they are incurred.

Pros:

- Consistent with Council's existing financial policies and results in a balanced budget.
- Up front impact on rates is then offset by lower rates rises as other Council revenues recover from the impact of the earthquake.

Cons:

- Very large impact on rates in 2011/12 – estimated at a total rates rise of 16.6%.
- No additional rates remain in the rating base if Council decide to reduce rates to balance future year budgets.

- (e) **Reduce Council levels of service to lower operating costs.** This option would reduce Council activities or the levels of service provided to the community to allow cost savings sufficient to cover the operating deficits.

Pros:

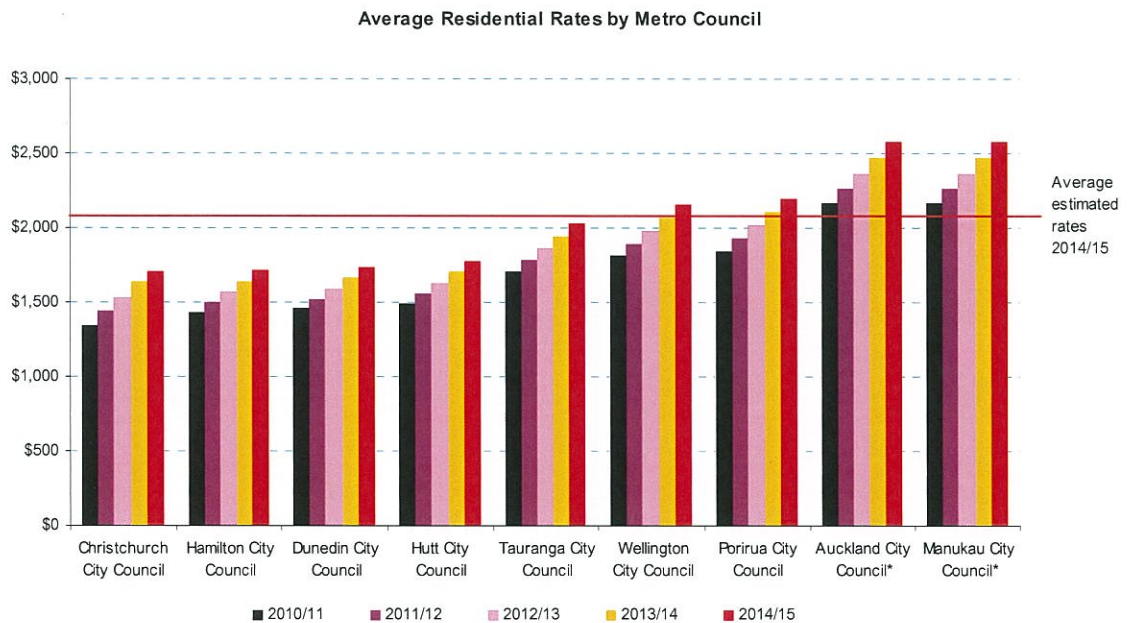
- Council operating costs reduced sufficiently to avoid the operating deficit.

Cons:

- Difficult to achieve in the timeframe due to the need for consultation on services to be removed.
- Would have severe impact on the levels of service provided to the community.
- Council would need to decide which services should not be provided.



- Likely to have significant up-front costs to restructure Council operations (thereby increasing the immediate deficit).
6. On balance, it is recommended that Council adopt option (b) above. This option is simple to understand and in five years will repay the operating deficits Council will incur over the next three years. The rates premium is also consistent with Christchurch City Council's general rates in that it is levied on the basis of capital value.
  7. Staff have made a high-level assessment of how Christchurch City Council's rates compared to other metropolitan Council rates before and after the premium is applied. The chart below provides this comparison from 2010/11 – 2014/15 for the average residential ratepayer. It assumes that the earthquake rates premium is applied for three years in Christchurch while other metropolitan rates increase by an average of 4.5% per annum.



8. In 2010/11, average Christchurch City Council rates were 22% below the average of these other metropolitan Councils' rates. After three years of rates premiums, Christchurch City Council's rates would remain 17% below the average and would remain the lowest metropolitan rates in New Zealand.

### **Response and Recovery Costs**

9. The table below provides an estimate of the response and recovery costs faced by the Council over the next five years. Total costs of \$2,457.6 billion are estimated over the five years of the infrastructure rebuild. Costs incurred in 2010/11 are largely as a result of the immediate emergency costs. These costs include the maintenance of temporary works and decline as permanent infrastructure is put in place.

	2010/11	2011/12	2012/13	2013/14	2014/15	2015/16	Total
Infrastructure (LAPP & Government)	36.3	288.5	309.6	387.5	368.3	249.1	1,639.3
Other Assets	8.8	61.3	117.9	125.2	124.4	74.0	511.6
Emergency & Response Costs	130.3	115.2	35.7	16.0	8.5	1.1	306.7
<b>Response and Recovery Costs</b>	<b>175.4</b>	<b>465.0</b>	<b>463.2</b>	<b>528.6</b>	<b>501.2</b>	<b>324.2</b>	<b>2,457.6</b>

10. The most obvious impact on Council is the overall cost of the infrastructure rebuild programme. Estimation for the infrastructure rebuild programme is well underway

and will be funded through a combination of insurance, government subsidies (NZTA and other), deferral of the renewals programme.

11. Infrastructure assets consist of roads (which are eligible for NZTA subsidies) and underground assets (eg. Water reticulation and wastewater), which are insured with the Local Authority Protection Programme (LAPP)
12. Council's above-ground assets are insured with Civic Assurance, which has adequate reinsurance to cover the estimated damage to these assets of \$363 million. Council has also made an estimate for betterment, increased costs of working (covered by insurance), uninsured assets (largely parks and stormwater) and insurance excesses of \$148 million over five years.
13. The immediate emergency management costs are funded jointly by Council, Ministry of Civil Defence and Emergency Management (MCDEM), NZTA and insurance. These costs are estimated to be in the order of \$306 million. Discussions are underway with all these parties to ensure maximum subsidies are available.
14. Following the September 2010 earthquake, Council took immediate action to curtail its renewals programme by \$56 million. Net of NZTA subsidies, this exercise provided funds of \$50 million to be set aside in an Earthquake Recovery Fund to be subsequently put towards the Council's recovery costs. In January 2011 Council resolved to apply \$9.3 million of these funds towards the immediate costs of the earthquake leaving \$40.7 million still available in the fund.
15. This recommended Draft Annual Plan proposes further reduction in the renewals programme for 2011/12. Net of NZTA subsidies, a further \$50 million reduction is recommended to be set aside in an Earthquake Recovery Fund to be used to fund the gap between the overall response and recovery costs and the likely subsidies Council will receive from insurers, MCDEM, NZTA and Government. The funding gap for 2011/12 is estimated to be \$11.7 million, which will be covered by Earthquake Recovery Fund.

## RATEPAYER IMPACT OF RATING OPTIONS PROVIDED

		Option 2 - Rates Premium				Option 1 - \$106 earthquake Levy		Option 3 - Borrow		Option 4 - Rate	
Rates Payable Capital Values	2010/11 Rates (incl. GST 15%)	2011/12 Draft AP Rates (incl. GST 15%)				\$	% change	\$	% change	\$	% change
		Base Change	Earthquake Costs	TOTAL							
	\$			\$	% change						
<b>Residential</b>											
200,000	925	3.8%	1.7%	976	5.5%	1,068	15.5%	963	4.1%	1,058	14.5%
300,000	1,261	4.5%	1.9%	1,342	6.4%	1,426	13.1%	1,322	4.8%	1,465	16.2%
322,000	1,335	4.6%	1.9%	1,422	6.5%	1,505	12.7%	1,401	4.9%	1,555	16.4%
383,000	1,541	4.8%	2.0%	1,645	6.8%	1,724	11.9%	1,620	5.1%	1,803	17.0%
400,000	1,598	4.8%	2.0%	1,707	6.8%	1,785	11.7%	1,681	5.2%	1,872	17.2%
500,000	1,935	5.1%	2.1%	2,073	7.1%	2,143	10.8%	2,040	5.4%	2,279	17.8%
600,000	2,271	5.2%	2.1%	2,438	7.4%	2,502	10.2%	2,399	5.6%	2,686	18.3%
700,000	2,608	5.4%	2.1%	2,804	7.5%	2,860	9.7%	2,758	5.8%	3,093	18.6%
800,000	2,945	5.5%	2.2%	3,170	7.6%	3,219	9.3%	3,117	5.9%	3,500	18.9%
900,000	3,281	5.5%	2.2%	3,535	7.7%	3,578	9.0%	3,476	5.9%	3,907	19.1%
1,000,000	3,618	5.6%	2.2%	3,901	7.8%	3,936	8.8%	3,835	6.0%	4,314	19.2%
<b>Business</b>											
200,000	1,218	5.8%	1.3%	1,305	7.1%	1,397	14.7%	1,292	6.1%	1,387	13.8%
300,000	1,702	6.5%	1.4%	1,836	7.9%	1,921	12.9%	1,816	6.7%	1,958	15.0%
400,000	2,185	6.8%	1.4%	2,366	8.3%	2,444	11.8%	2,340	7.1%	2,529	15.7%
500,000	2,669	7.0%	1.5%	2,897	8.5%	2,967	11.2%	2,864	7.3%	3,100	16.2%
600,000	3,153	7.2%	1.5%	3,427	8.7%	3,491	10.7%	3,388	7.5%	3,671	16.5%
700,000	3,636	7.3%	1.5%	3,957	8.8%	4,014	10.4%	3,912	7.6%	4,243	16.7%
800,000	4,120	7.4%	1.5%	4,488	8.9%	4,538	10.1%	4,436	7.7%	4,814	16.8%
900,000	4,603	7.5%	1.5%	5,018	9.0%	5,061	9.9%	4,959	7.7%	5,385	17.0%
1,000,000	5,087	7.5%	1.6%	5,548	9.1%	5,584	9.8%	5,483	7.8%	5,956	17.1%
2,000,000	9,922	7.8%	1.6%	10,852	9.4%	10,818	9.0%	10,722	8.1%	11,667	17.6%
5,000,000	24,429	7.9%	1.6%	26,764	9.6%	26,519	8.6%	26,438	8.2%	28,801	17.9%
<b>Rural</b>											
(not water, sewerage, or drainage rates, but includes part waste minimisation rate)											
200,000	552	4.2%	2.2%	587	6.4%	683	23.7%	577	4.6%	649	17.6%
300,000	719	5.2%	2.5%	774	7.7%	865	20.2%	760	5.7%	867	20.6%
400,000	886	5.8%	2.7%	962	8.5%	1,046	18.1%	942	6.3%	1,086	22.5%
500,000	1,053	6.3%	2.9%	1,149	9.1%	1,228	16.6%	1,124	6.8%	1,304	23.8%
600,000	1,220	6.6%	3.0%	1,336	9.5%	1,410	15.6%	1,306	7.1%	1,522	24.7%
700,000	1,387	6.8%	3.0%	1,523	9.8%	1,592	14.8%	1,489	7.3%	1,740	25.4%
800,000	1,554	7.0%	3.1%	1,711	10.1%	1,774	14.1%	1,671	7.5%	1,958	26.0%
900,000	1,721	7.1%	3.1%	1,898	10.3%	1,956	13.6%	1,853	7.7%	2,176	26.4%
1,000,000	1,888	7.2%	3.2%	2,085	10.4%	2,138	13.2%	2,036	7.8%	2,395	26.8%