

Draft LTCCP 2009-19

Submission to the Christchurch City Council

By Geoff Barnes

I wish to make my presentation in person to the Council.

Summary of recommendations:

The draft policies are not in the interests of the ratepayers in that there are too many opportunities for the Council not to disclose the nature of significant transactions, cost increases are in excess of reasonable inflation provisions and the long term financial strategy unreasonably benefits current ratepayers to the detriment of future ratepayers by failing to fund all operating costs. Also there are some unexplained discrepancies and fatal rate setting drafting errors.

Specifically:

- The Investment Policy should be amended to ensure Council authorisation (in public session) and full disclosure of all 'internal borrowing', and of equity or property investments.
- The Liability Management Policy should be amended to protect the ratepayers against excessive unplanned borrowing. The policy should be amended to require Council to publicly justify all new borrowing.
- Changes to the Financial Ratios are not explained. The LTCCP text implies they are a continuation of the past practice, yet they are not.
- Disclosure of 2008/09 budget figures should be provided in the financial summary and all tables within the LTCCP, not just some tables.
- Explanation should be provided for the additional \$5m capital expenditure under the heading 'Corporate' on Vol page 49
- Operating Expense increase for activities should be constrained to inflation.
- Depreciation should be fully funded, not just limited to renewal expenditure.
- All references to the operating surplus of \$36m in 2009-10 etc should be accompanied with the explanation that the Council is planning for a deficit of \$13m.
- There are fatal errors in the 'Excess water supply targeted rate' charge as defined in the draft LTCCP. The rate setting process for the charge should be recommenced under a new Special Consultative Procedure.

Specific recommendations

1. **The Investment Policy should be amended to include public disclosure of use of reserve funds for internal borrowing and for sale and purchase of investments in equities and real estate.**

My recommendation:

- **Where internal borrowing exists (or is estimated to exist) at the 30 June in any year, the Annual Plan should include a summary of the Reserve and Trust Funds used for internal borrowing and a statement of how they will be replaced in the event the Reserve Funds or Trust Funds are needed for their intended purpose and the risks of such replacement.**
- **Internal borrowing should be disclosed on all balance sheets of Council as a contingent liability and reduction of invested funds.**
- **Internal Borrowing should only occur by specific resolution of Council, adopted in open session.**
- **All Council resolutions authorising the purchase and sale of Equity Investments and Property Investments should be made in open public session of Council including the rationale for the transaction as outlined in the Investment Policy under the headings of Equity Investments and Property Investments.**

Rationale for my recommendations:

- **Internal Borrowing –**
 - The current Liability Management Policy does not permit internal borrowing.
 - The current policy expects that reserve funds are invested in real financial assets, not to offset debt.
 - If Reserve Funds are invested in debt avoidance then liquid cash may not be available if and when the Reserve Funds are needed. Special disclosure is needed at the time the transaction is authorised and the ratepayers have a right to be informed. If replacement debt funds are not available, a decision to invest Reserve Funds this way is tantamount to a distribution of the Reserve Fund for purposes other than the original intent.
 - Special balance sheet disclosure is required as the level of internal borrowing may not otherwise be disclosed on the balance sheet. The community should be informed of the extent at any time.
- **Purchase and sale of Equity and Property Investments**
 - The resolution authorising the purchase should be conducted in open public session, not 'Public Excluded' given the potential impact on the ratepayers.
 - The resolution should include the purchase rationale demonstrating how each purchase meets the minimum standard of the objectives as set out in the Investment Policy under the headings Equity Investments and Property Investments.

2. **The proposed Liability Management Policy does not protect the ratepayers. It is too permissive and should be amended to require Council to justify all new borrowing.**

My recommendation:

- **The requirement that “*The Council must approve all new loans and borrowing facilities*” should be amended by adding “by resolution at a meeting open to the public”.**
- **The resolution should define the purpose of the loan in terms of what capital expenditure is being funded and the term of the loan.**
- **Borrowing internally should be treated, from a resolution and disclosure perspective, as if it were external borrowing.**
- **The Balance Sheet in all annual accounts and annual plans should disclose all internal borrowings either by specific entry in the liabilities or by notes to the accounts. The disclosure to include the Reserve Fund source.**

Rationale for my recommendations:

- **Council debt is a burden on future ratepayers. The ability to raise debt should be tempered with reasonable public accountability.**
- **The Council has recently undertaken unplanned debt raising without prior public knowledge or disclosure (the Henderson land purchase debt). There was no ability by the public to express concerns or even review compliance with policies. This is a disturbing precedent, unknown in the history of the Council. The powers granted under the Local Government Act were tempered by the requirement for a borrowing policy, and the current policy requires the Council to consider several issues before approval. For the Henderson Land Purchase Loan it is now not possible for the public to review compliance with the policy and as the sums are significant there is genuine public concern.**
- **All new loans should be authorised by specific resolution passed in open session of Council including why the loan is being raised, what capital expenditure is being funded, and the term of the loan. The draft policy refers to a portfolio basis yet it also refers to the term of the loan limited to the economic life of the asset being funded. This information should be included in the loan raising resolution.**
- **The loan servicing costs and annual repayment provisions should be included for internal loans as much as for externally funded loans.**

3. Financial Ratios – changes not highlighted - Vol 1 page 43

My recommendation:

The adopted LTCCP should highlight the changed financial ratios, the reason for the change and the outcome should the current ratios be continued.

Rationale my recommendations:

- The financial ratios are a key accountability tool for the ratepayers and credit rating agencies.
- Whilst the Council is free to determine the ratios used, changes should be made with care and only where the change is carefully explained within the LTCCP.
- The draft LTCCP includes new ratios yet the text implies these are a continuation of the existing ratios. "...is its five key financial ratios" when they are not.
- The Council should include the impact of the 10 year LTCCP outcome on the existing ratios and the new proposed so that compliance with both is disclosed.

4. Disclosure of 2008/09 budget figures should be provided in the financial summary and all tables within the LTCCP, not just some tables.

My recommendation:

The adopted LTCCP should include the comparative 2008/09 budget figures on all tables.

Rationale my recommendations:

- Comparative financials are essential to disclose trends.
- Good accountability requires full disclosure. The comparison with previous years should be apparent to all readers of the draft and adopted LTCCP and not require manual extraction from past LTCCPs and Annual Plans.
- Stakeholders have a right to the information.
- The content of the financial tables within the LTCCP change over time. Change limits the ability for the public to trace the trend of cost and revenue changes over time.
- The information is known to the Council and is a minor additional requirement.
- The information is included in the Forecasted Financial Statements etc. Therefore extending the requirement to all tables is a minor extension.
- The tables should include percentage change data with explanations of changes outside of acceptable inflation escalations.
- The tables should be available 'on line' as spreadsheets to allow stakeholders to download and execute analysis routines. The Council should support an informed society by making its information 'user friendly'.

5. Explanation should be provided for the additional \$5m capital expenditure under the heading 'Corporate' on Vol page 49.

My recommendation:

Disclosure required on inconsistent tables.

Rationale my recommendations:

Page 49 Vol 1 has Corporate 2009/10 capital expenditure at \$39.7m compared to \$34.8m Page 251. An explanation should be provided for the difference.

6. Operating expense escalation should be constrained to inflation. At most, inflation plus an allowance for growth could be allowed.

My recommendation:

Escalation in operating expenditure should be constrained to inflation.

Rationale my recommendations:

- The increase costs of many activities is significantly beyond inflation estimates.
- The outcome is worse when the compounding impact is considered over several years.
- All extraordinary increases should be identified and explained.

The following table demonstrates the activity cost escalations:

Increase in operating expenditure by Group of Activity:

		Plan 2009–10	Plan 2010–11	Plan 2011–12
City development		8.84%	8.31%	1.31%
Community support		9.21%	8.26%	7.95%
Cultural and learning services		-1.79%	5.82%	16.62%
Democracy and governance		2.88%	19.55%	-5.72%
Economic development	Note 9.64% incr 08/09	15.22%	-3.50%	2.82%
Parks, open spaces and waterways		10.74%	5.54%	5.22%
Recreation and leisure		0.22%	9.37%	3.87%
Refuse minimisation and disposal		36.72%	4.96%	3.24%
Regulatory services	Note 5.04% incr 08/09	-9.22%	10.36%	2.83%
Streets and transport	Note 31.35% incr 08/09	-2.40%	4.26%	5.99%
Wastewater		11.05%	14.71%	7.59%
Water supply	Note 17.53% incr 08/09	-2.13%	6.74%	5.59%
Corporate		15.68%	17.09%	-4.13%
Total Group of Activity expenditure	Note 13.27% incr 08/09	4.19%	7.64%	5.62%
Depreciation		5.04%	6.87%	8.14%
Interest		13.59%	25.15%	25.69%

7. Depreciation should be fully funded, not limited to renewal expenditure.

My recommendation:

- **The annual depreciation charge should be funded as it best represents the annual consumption of the asset base of the Council over the full life of the asset.**
- **Funding renewals only limits the funding obligations to the annual discretion of Council based on perceived affordability issues. The LTCCP should disclose the 'whole of asset life' implications.**
- **It should be made clear that the amount of capital funding for renewals will be limited to the actual renewal expenditure (or is it the budgeted amount - it is not clear). Not completing the budgeted program will materially impact the funding needs.**

Rationale my recommendations:

- Accrual accounting, reflecting full annual costs has been mandatory for Local Government since 1990.
- There is an expectation that the full annual operating costs will be disclosed and funded.
- To do otherwise ignores intergenerational equity. Intergenerational equity is ignored as the amount of the renewal program may not represent the annual use of assets as it is the product of a view of asset management. It may not be the appropriate amount in any year.
- Further, under the balance budget legislation (Sect 100), the requirement to provide revenue to meet all operating expenses is the dominant requirement. The balance budget is a contrived achievement rather than funding the known expenditure.
- The service potential of assets used to deliver services is measured in part by the economic life and annually by depreciation expense. The decision to under fund depreciation contradicts the depreciation calculation in an arbitrary manner.
- The rationale for underfunding refers to the LTCCP period 2009/19, however the justification requirements in the legislation (Sect 100.2 b & c) are for the whole of the useful life of the assets, not just 10 years. More proof is required to ensure that under funding depreciation will not impact the future service delivery potential of classes of assets.
- The Gross CCC debt is forecasted to rise to \$853m (and \$692 at June 2016). The current LTCCP has the Gross Debt after 10 years at \$251m (at June 2016), the difference is \$441m. The substantial increase in forecasted Gross Debt is a result of the deliberate underfunding of depreciation. This debt is a burden on future ratepayers, to the advantage of current ratepayers.
- Current rates are deliberately deduced by underfunding depreciation.
- I do not advocate rate increases, but the financial strategy in the draft LTCCP has a blatant rates subsidy to the detriment of future ratepayers. A preferred strategy is a more aggressive reduction in operating costs, particularly overhead costs, and with more dividends and user charges.

The funding shortfall is:

Plan year	Depreciation	Funded Renewal Exp	Shortfall
2008-09			3,600
2009-10	110,611	87,766	22,845
2010-11	118,205	89,355	28,850
2011-12	127,830	92,824	35,006
2012-13	135,980	96,473	39,507
2013-14	144,897	99,886	45,011
2014-15	153,151	103,526	49,625
2015-16	156,272	107,295	48,977
2016-17	164,711	111,101	53,610
2017-18	174,006	115,019	58,987
2018-19	179,458	119,184	60,274
Total over 11 years			446,292

8. All references to the operating surplus of \$36m in 2009-10 should be accompanied with the explanation that the Council is planning for a deficit of \$13m Vol 1 Page 222.

My recommendation:

- The LLCCP should include full disclosure that the Council is running an operating deficit rather than a surplus over the years of the LTCCP.
- The statements regarding the 'surplus' should be accompanied with a note that:
 - The Income account net surplus is \$36.231m
 - Made up of:
 - Operating deficit of \$13.024m
 - Development contributions received for capital expenditure \$18.672m
 - Capital grants and subsidies for capital expenditure \$14.334m
 - Vested capital assets received \$16.249m
- The Council should explain how it has met the 'balanced budget' requirements of Section 100 (revenue sufficient to meet the operating expenses) in the face of a \$13m deficit.

Rationale for my recommendations:

- The accounting standards require a comprehensive view of 'revenue', which includes revenue reserved for capital expenditure (2009-10 \$49.225m).
- Under the Local Government Act this capital revenue cannot be applied to finance operating expenditure.
- Therefore when discussing the 'surplus' the true nature of the operating surplus should be disclosed – that is, there is an operating deficit of \$13.024m (2009-10).
- The balanced budget requirements of Section 100 LGA 2002 require sufficient operating revenue to cover operating expenses. Planning for a deficit does not meet this requirement.

- The statement on page 41 Vol 1 that *“Throughout the period of the LTCCP 2009/19, the Council will continue to collect rates to cover the cost of asset depreciation.”* This is not correct as there is an operating deficit and capital funding is limited to renewal expenditure.

9. The Policy on Determining Significance should be amended to limit the commercial sensitivity exclusion.

My recommendation:

- **The exclusion on the grounds of commercial sensitivity should be strictly limited to those elements of the decision which are commercially sensitive, but not to the decision as a whole or to any funding decision part. Vol 2 page 219.**

Rationale for my recommendations:

- The commercial sensitivity exclusion from disclosure and Special Consultative Procedure (SCP) is too wide in the proposed Policy on Determining Significance.
- In all unplanned transactions, there will always be some elements which could, with a liberal interpretation, have some commercial sensitivity. Council should not be able to use this as an excuse to avoid public disclosure or a SCP for the whole decision.
- Full accountability to the community would entail a narrow limited interpretation of the components of a decision that absolutely require commercial sensitivity treatment. All other components should be in full public decision making and where required, be under the Policy on Determining Significance.
- The recent Henderson land purchase process shows the Council has a predisposition to excluding public disclosure and SCP. Where was the commercial sensitivity in the loan raising decision associated with the purchase? If anything, only the purchase price may need to be treated as commercially sensitive. It is noted that this was released to the public soon after the decision was made – it obviously wasn’t that sensitive.
- The text under the heading “Purpose” sets out objectives of “...open and transparent...”, yet the most important decisions could be hidden from the public under the guise of commercial sensitivity.
- There is no explanation in the policy statement on how the Council will deal with transaction approval where the Council determines some commercial sensitivity exists. Recent experience would indicate the Council will err on the side of non disclosure.

10. Water Supply Activity – The Council should not be seen as the main waster of water. To correct this the inspection program for leak detection should be given higher priority. Vol 1 Page 64.

My recommendation:

- **The leak detection and repair program should be advanced beyond the proposed 8 year cycle.**

Rationale for my recommendations:

- There is an assumption that at least 10% of water extracted from the aquifer is wasted from the CCC pipe network network.
- The current level of network leaks is assumed to be in line with industry standards but the facts are not known because the level of leaks is not measured. See Page 64.
- It is noted that the “Draft Water Supply Strategy” and supporting documents includes an assessment of loss from the network from leaks. The calculated 6 million cubic meters of water loss pa is expressed as an acceptable “economic level of loss”.
- This level of loss is unreasonable, especially as the community are urged to conserve.
- The level of network loss is assessed to be significantly greater than that estimated within the consumers pipe-work. Such losses would not be tolerated on private property, yet they are classed as acceptable for the CCC network.

11. There are fatal errors in the ‘Excess water supply targeted rate’ charge as defined in the draft LTCCP. The rate setting process for the charge should be recommenced under a new Special Consultative Procedure. Vol 2 Page 45.

My recommendation:

- **The proposed rate for 2009-10 should be defined at either 55 cents or 50 cents, not both.**
- **The proposed rate relies on the definition of “Extraordinary supply” in the Water Related Services Bylaw, however this is not defined, only the ‘ordinary supply’ is. The ‘ordinary supply’ is not referred to in the rate setting text.**
- **As a result of the draft LTCCP wording, the previous ‘3 or more residential units on one title’ are now exempt from the charge. This is a significant change and it is not clear that this was intended. The summary of rate changes on page 46 does not include this change.**
- **The fees schedule changes should not include the excess water charge as they are a ‘rate’ not a fee (either a Bylaw or ‘other’ legislation).**

Rationale for my recommendations:

- There are fatal errors in the draft LTCCP on this topic. There is longstanding judicial direction that Councils should set rates and fees in compliance with the relevant legislation. Errors in process negate the outcome. Council should start again on this issue.
- The revised 2008 Bylaw changed the definitions and revoked previous definitions. Rate setting cannot rely on revoked definitions.

- The 2008 Bylaw includes - *“ORDINARY SUPPLY means a category of metered water supply which is available on demand directly from the Point of Supply subject to an agreed level of service as set out in the Council’s Long-Term Council Community Plan.”* There is no definition of ‘extraordinary supply’.
- For tenanted residential property, rates are a landlord expense. They are a business expense, no different from any other business occupation of land. Excess water charges should be made where there is evidence of business occupation of land, and in the case of residential use, one or two units on one title could be legitimately used for owner occupation, whereas 3 or more are clearly commercially let. This has always been a simple test and should be continued. To remove all residential occupancy from the charge may accidentally include those outside the Residential Tenancies Act and include rents on which GST is charged (hotels, motels, etc). There is no explanation that this was an intended change.
- The fees schedule changes on Vol 2 page 167 should not include the excess water charge as they are a ‘rate’ not a (Bylaw or other legislation) fee. This is reinforced by the reference to the Restricted Water Supply Rate, the next item on the fees schedule. This error adds weight to the requirement to commence the rate setting process again.

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