I hereby give notice that a confidential extraordinary meeting of the Audit and Risk Committee will be held on:

Date:	**Tuesday, 14 April 2020**
Time:	**2.00pm**
Meeting Room:	**This meeting will be held remotely**
Venue:	

Komiti Tātari me te Mātai Raru Tūpono / Audit and Risk Committee

CONFIDENTIAL ADDENDUM AGENDA

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Note: The reports contained within this agenda are for consideration and should not be construed as Council policy unless and until adopted. Should Members require further information relating to any reports, please contact the relevant manager, Chairperson or Deputy Chairperson.

Financial risk update - approach to identification and management of risks arising from COVID-19 pandemic

File No.: CP2020/04377

Matataputanga
Confidentiality

Reason:	The public conduct of the part of the meeting would be likely to result in the disclosure of information for which good reason for withholding exists under section 7.
Interests:	s7(2)(h) - The withholding of the information is necessary to enable the local authority to carry out, without prejudice or disadvantage, commercial activities. s7(2)(i) - The withholding of the information is necessary to enable the local authority to carry on, without prejudice or disadvantage, negotiations (including commercial and industrial negotiations). In particular, the report contains information around potential financial implications and emerging financial risks of COVID-19 in a highly uncertain environment. The release of this information could prejudice the position of the council and its council-controlled organisations in sensitive commercial arrangements and negotiations.
Grounds:	s48(1)(a) The public conduct of the part of the meeting would be likely to result in the disclosure of information for which good reason for withholding exists under section 7.

Te take mō te pūrongo
Purpose of the report

1. To provide oversight of the approach to providing advice on the potential financial implications and the management of emerging financial risks arising from COVID-19 on the council group's financial position.

Whakarāpopototanga matua
Executive summary

2. Disruption from the COVID-19 situation is adversely impacting many revenue streams for the council group as well as affecting the delivery of capital projects. Because there is not yet clarity on the severity, duration or longer-term impacts of this disruption, the quantum of the financial implications for the council group remains highly uncertain.
3. The council's finance team have undertaken financial scenario modelling across the council group to understand the potential implications and to inform elected members of the possible decisions and trade-offs that they may need to make because of the disruption.
4. The immediate key financial decisions relate to the process for preparing and adopting the Annual Budget 2020/2021 and any adjustments to rates.
5. The key trade-offs that the council will need to make in response to this situation involve balancing the cost imposed on ratepayers now and in the future against the need to continue to deliver critical council services and investments to support economic recovery, while at the same time maintaining the council group's sound financial position.
6. The Audit and Risk Committee delegations include oversight and advice to the Governing Body on risk management including financial risks. It also has a key role to play in ensuring that the council follows robust processes so as to be in a position to make sound decisions based on robust information and analysis.

7. To support the committee in this role, staff have prepared a document setting out the methodology and key assumptions used to undertake the financial scenario modelling.

8. Throughout this process finance staff have worked closely with our legal advisers on matters of compliance, including compliance with the Local Government Act 2002 and debt market disclosure requirements.

Ngā tūtohunga
Recommendation/s

That the Audit and Risk Committee:

a) note that the COVID-19 situation presents significant risks to the financial position of the Auckland Council group.

b) note that the severity, duration and longer-term implications of disruption from the COVID-19 situation remain highly uncertain and therefore the financial implications for the council group are also highly uncertain.

c) agree to advise Governing Body members (via the Emergency Committee) that the methodology and assumptions underpinning the financial scenario modelling are reasonable given the circumstances.

Restatement

d) confirm that there be no restatement of the confidential report or the resolutions at this time.

Horopaki
Context

9. The Audit and Risk Committee has several roles relevant to the financial implications of the COVID-19 situation on the council group. These include:
   - Monitoring and oversight of key high-level risks to council
   - Considering the validity of management processes and thinking in relation to these risks and the associated controls
   - Advising the Governing Body on key matters of compliance including compliance with the Local Government Act 2002, debt market listing rules and Local Government Funding Agency debt covenants.

10. The statutory process most immediately affected by these financial implications is the preparation and adoption of the council's Annual Budget 2020/2021. While this document is not itself subject to audit review, the Office of the Auditor General will be interested in this matter given its upcoming review of the 2019/2020 Annual Report and its general role in providing monitoring and oversight of the New Zealand local government sector.

11. Future engagements with the council's external auditors will therefore inevitably involve discussion on the financial implications of COVID-19.

Tātaritanga me ngā tohutohu
Analysis and advice

12. Disruption from the COVID-19 situation is adversely impacting many revenue streams for the council group as well as affecting the delivery of capital projects. Because there is not yet clarity on the severity, duration or longer-term impacts of this disruption, the quantum of the financial implications for the council group remains highly uncertain.

13. The longer the event continues the more significant and varied the impacts and consequences. The financial risks are also closely related to the wider COVID-19 related risks discussed in a separate paper to the Audit and Risk Committee.
14. The council's finance team have undertaken some financial scenario modelling across the council group to understand the potential implications and to inform elected members of the possible decisions and trade-offs that they may need to make because of the disruption. The immediate key financial decisions relate to the process for preparing and adopting the Annual Budget 2020/2021 and any adjustments to rates. The results of this analysis are set out in Attachment A.
15. The key financial constraints that the council faces in responding to shocks such as this are its ability to borrow and the willingness and ability of ratepayers to pay. The Local Government Funding Agency debt covenants set specific financial parameters, which if breached have specific consequences. On the other hand, the consequences of the council breaching the debt limits that are monitored by the credit rating agencies will depend on the judgement exercised by those agencies taking into account any actions by the council that may mitigate or limit the extent of the breach.
16. A credit rating downgrade would make it harder and more expensive to continue to access debt markets and may negatively impact on some of the investors in council's bonds. In addition, the council needs to think carefully about its debt policy settings to avoid overburdening future generations of ratepayers.
17. The key trade-offs that the council will need to make in response to this situation involve balancing the cost imposed on ratepayers now and in the future against the need to continue to deliver critical council services and investments to support economic recovery, while at the same time maintaining the council group's sound financial position.
18. The Audit and Risk Committee has a key role to play in ensuring that the council is in a position to make sound decisions based on robust information and analysis. To support the committee in this role, staff have prepared a document setting out the methodology and key assumptions used to undertake the financial scenario modelling. This document is included as Attachment B.
19. Some of the key controls employed in this work were:
    - Agreeing common group-wide assumptions at the commencement of the work
    - Seeking input widely across the council group
    - In the case of Auckland Transport which is facing the most significant impacts, input from external international experts and consideration of the modelling at board of directors level
    - Board-level reporting and engagement across the group
    - Review and validation by the council finance team, with a key focus on the consistent application of assumptions across the group
    - Seeking review and feedback where possible, for example from the council's Chief Economist on the potential impacts on rates and development contribution revenue.
20. Throughout this process finance staff have worked closely with the internal legal team on matters of compliance, including compliance with the Local Government Act 2002 (and related legislation) and debt market disclosure requirements. For the latter issue, external legal support has been included in the process.

21. The key issue in relation to compliance with the Local Government Act 2002 is balancing the requirement to adopt an annual plan by 30 June 2020 with the requirement to undertake adequate public consultation on key budget or rating changes (which is considered by the local government sector more generally to be the most critical compliance issue). The legal team are liaising with the broader local government sector and the Department of Internal Affairs on these compliance matters.

22. The key debt market listing compliance issues relate to the NZX disclosure requirements, with a particular focus on disclosure of information that may influence the price of the council's listed bonds. The key issues here are determining the factors that may influence bond pricing and at what point is the information sufficiently definite to warrant disclosure. There are also other related practical compliance matters such as managing confidentiality, the timing of disclosures and managing compliance with the requirements of exchanges other than the NZX on which council bonds are listed.

Tauākī whakaaweawe āhuarangi
Climate impact statement

23. There is no climate impact from the recommendations of this report.

Ngā whakaaweawe me ngā tirohanga a te rōpū Kaunihera
Council group impacts and views

24. This report considers the process by which information on the financial implications of COVID-19 have been pulled together from right across the council group.

Ngā whakaaweawe ā-rohe me ngā tirohanga a te poari ā-rohe
Local impacts and local board views

25. There are no local impacts associated with the recommendations of this report.

26. The impact of the financial implications for local boards will be considered as financial decision-making progresses.

Tauākī whakaaweawe Māori
Māori impact statement

27. There are no impacts for Māori associated with the recommendations of this report.

28. The impact of the financial implications on Māori outcomes will be considered as financial decision-making progresses.

Ngā ritenga ā-pūtea
Financial implications

29. Financial implications are discussed in Attachment A.

Ngā raru tūpono me ngā whakamaurutanga
Risks and mitigations

30. The financial risks of the COVID-19 situation for the council group are the subject of this report and its attachments. The Audit and Risk Committee plays a key role in maintaining oversight and advising the Governing Body on the management of these financial risks and the associated compliance matters, including whether or not a robust process has been followed.

Ngā koringa ā-muri
Next steps

31. The financial implications of the COVID-19 situation will be reported to the Emergency Committee meeting on 16 April 2020. That committee will be asked to provide direction on the process for finalising the Annual Budget 2020/2021 and to make some decisions relating to rates in light of the COVID-19 situation. The views of the Audit and Risk Committee will be formally communicated to the Emergency Committee by way of resolution.

Ngā tāpirihanga
Attachments

No.	Title	Page
A⇩	COVID-19 Financial Update	9
B⇩	Financial Modelling Methodology and Assumptions	21

Ngā kaihaina
Signatories

Author	Ross Tucker - General Manager, Financial Strategy and Planning
Authorisers	Kevin Ramsay - Acting Group Chief Financial Officer Phil Wilson - Governance Director

COVID-19 Financial Update

Purpose

1. The purpose of this document is to:
   a) Understand the potential financial impact of the COVID-19 situation including the short-term outlook to 30 June 2020 and under a range of scenarios for the financial year 2020/2021.
   b) Consider the approach to finalising the Annual Budget 2020/2021.
   c) Consider options for targeted rates relief for ratepayers experiencing financial difficulties.

Executive Summary

2. Prior to the COVID-19 situation the Auckland Council group was in a strong financial position, with over a billion dollars of standby facilities, debt at 245% of revenue and a credit rating of AA/Aa2.
3. Cash operating revenue for the group is forecast to be $250 million lower in the 2019/2020 financial year due to the effects of COVID-19. The cashflow consequences of this reduced revenue is forecast to be fully offset by reduced operating expenditure and capital investment cashflows. However, the lower revenue means that debt to revenue ratio is forecast to reach 262% by 30 June 2020 compared to a budget projection of 253%. This is still within the council's debt to revenue policy limit of 270%.
4. Financial scenario modelling indicates that if COVID-19 disruption lasts for six to twelve months then cash operating revenue for the group may be $450 to $650 million lower than currently budgeted for 2020/2021. While lower spending and slower capital investment may again mitigate the cashflow impact, the revenue impact may result in debt to revenue temporarily exceeding the 270% policy limit for one year.
5. In the case of **six months disruption**, it is likely that the group will be able to deliver around $2.3 billion of capital investment in each of the 2019/2020 and 2020/2021 years. While lower than planned prior to the COVID-19 situation, this is still a significant lift to compared to the $1.6 billion delivered on average for the previous five years. If the council wanted to further reduce capital investment in order to operate safely within debt limits in all years, then capital investment would need to be reduced to about $1 billion in 2020/2021.
6. In the case of **twelve months disruption**, it is likely that the group will only be able to deliver capital investment at the historical average rate of $1.6 billion in 2020/2021. In this scenario, it would not be possible to stay within the debt policy limit in all years by further reducing capital investment.
7. Possible responses to this situation could include:
   - working in partnership with central government to progress capital investment in a way that is not limited by the council's debt constraints
   - discussing with credit rating agencies capital investment scenarios at the projected levels of $1.6 to $2.3 billion in 2019/2020 with a debt to revenue ratio higher than 270% for one year
   - looking at key revenue settings, operating expenditure levels and asset disposals.

8. The council is required under the Local Government Act 2002 to adopt an annual plan by 30 June. However, significant budget changes and changes to rating policy require public consultation. Therefore, the council needs to balance the requirement to adopt its Annual Budget by 30 June with the requirement to undertake adequate public consultation on key budget or rating changes that are being considered as a result of COVID-19. Staff are therefore investigating options to consult on changes to budgets and rates postponement policy with adoption by 30 June or 31 July 2020.
9. The COVID-19 situation is causing disruption to many residents and businesses giving rise to both immediate cash challenges and medium to longer term uncertainty. Accommodation providers are amongst the hardest hit. However, any decisions around rates relief would need to be made with regard to the council's overall financial position and the long-term implications of that decision.
10. One approach to providing some rates relief is to reconsider the currently proposed 3.5% overall average general rates increase for 2020/2021. This approach would provide rates relief based on property value rather than need and would not help financially stressed ratepayers address immediate cashflow challenges. It could have significant long-term consequences, particularly if a lower rates increase in 2020/2021 was not "caught up" the following year.
11. Another approach is to provide different forms of rates relief that are targeted to those most in need. Staff are proposing a range of targeted options including:
    i. Suspending the Accommodation Provider Targeted Rate for a year.
    ii. Using existing policies to provide relief for the 2019/2020 fourth quarter rates instalment.
    iii. Considering options for extending rates postponement policies for the 2020/2021 rating year.

Analysis and advice

COVID-19 situation

12. Auckland Council group has a crisis management team focused on the COVID-19 situation and this team will report and advise on all operational issues related to the situation. The team is working collaboratively across all entities within the group and is following the lead of central government and the Ministry of Health to ensure a nationally coordinated approach. The operational implications of the situation are reported elsewhere, with this document focusing on purely the financial elements.

Financial starting point

13. Prior to the COVID-19 situation the council group had maintained a strong financial position. In the half year to December 2019 the group exceeded its direct revenue target by 7%, maintained control of operating expenditure and delivered a record level of capital investment. At the same time debt was kept at 245% of revenue and the group maintained an AA/Aa2 credit rating.
14. The council currently has access to between $1.2 billion and $1.3 billion of funds through committed standby facilities with 10 banks. These facilities are intended to provide liquidity in the event that the council is not able to access funding through the normal debt capital markets. The facilities have a range of maturity dates of between one and three years.

15. While the council has considerable financial flexibility in the near term to deal with unexpected shocks, the long-term projections were for the debt to revenue ratio to reach our 265% internal ceiling over the next few years as capital investment in the region progresses.
16. A number of unbudgeted pressures were identified as part of the annual budget process, including additional operating expenditure to support 2021 events, further funding for growth in public transport and an increase in net operating funding for RFA. It was anticipated that these pressures could be accommodated with only some modest adjustments to the pace of capital delivery in the short-term.

Current year forecast

Operating and capital cashflows

17. Cash operating revenue is forecast to be $250 million lower in the 2019/2020 financial year due to the effects of COVID-19. This is primarily driven by reductions in Auckland Transport revenue (including public transport impacts not fully covered by NZTA and the impact on parking and infringement revenues), non-receipt of the interim airport dividend, lower regional fuel tax collected and unpaid or deferred rates. Other notable revenue impacts include regulatory fees, event income and facilities revenue.
18. Cash operating expenditure may reduce by about $100 million. This is largely from a reduction in public transport services and pausing spending on non-essential service during the lockdown including reductions in temporary staff and contractors.
19. The net operating cashflow impact of about $150 million is forecast to be more than offset by reduced net capital funding requirements due to labour and supply chain disruptions impacting the timing of capital projects.

Borrowings and liquidity

20. Because of the offset impact of operating and capital cashflows, net debt is forecast to be close to the budget of $9.6 billion at 30 June 2020. However, the debt to revenue ratio is forecast to reach 262% compared to the Annual Budget 2019/2020 projection of 253%. This is not due to debt movements, but rather due to the forecast $250 million reduction in revenue impacting the revenue part of the debt to revenue ratio. This forecast assumes that the impact of unpaid or deferred rates is at the lower end of the potential range. This forecast remains within internal policy limits, credit agency guidance on ratios and Local Government Funding Agency (LGFA) debt covenants.
21. Because of the high level of uncertainty there is some risk that the 270% debt to revenue policy limit might be exceeded once the actual financial results for 2019/2020 are known. In particular, the debt to revenue ratio may be higher because of:
    i. Additional cash holdings resulting in gross debt being temporarily higher.
    ii. Accounting adjustments changing the reported fair value of our debt in an unfavourable manner.
    iii. More ratepayers than expected experiencing financial hardship and entering into payment plans to defer their May instalment until August.
22. An actual outcome slightly above 270% due to such factors is unlikely to be of great concern to rating agencies. For example, holding additional cash in uncertain times would be seen as a highly prudent thing to do in the current environment.
23. Access to debt markets has become challenging and volatile, but existing standby facilities provide a sufficient liquidity buffer including the ability to refinance maturing debt.

Scenario modelling methodology

24. Input was sought from departments within Auckland Council and each of the CCOs on the financial impacts of COVID-19.
25. The following scenarios were agreed to by all areas and the financial impacts for the next financial year were assessed under each of the scenarios.

Adjusted status quo	A rapid return to normal, minimal change to Annual Budget 2020/2021 aside from a few already known impacts (airport dividends, cancelled events)
6 months disruption	Disruption lasts from March to September 2020 with varying alert levels
12 months disruption	Disruption lasts from March 2020 to March 2021

26. Central finance staff have validated the inputs, ensured that a level of consistency was been applied across the different areas of the group and assessed the impact on group-level items. This included things such as airport dividends, regional fuel tax, rates and development contributions.
27. Where possible, reviews have been undertaken and advice sought to critique the assumptions. The Chief Economist for Auckland Council has reviewed different aspects including rates and development contribution modelling and provided advice and recommendations.

Potential financial impacts in financial year 2020/2021

Operating impacts

28. Long-term disruption would significantly impact many revenue lines. Auckland Transport would be the single largest affected area, with both parking and infringement, and public transport revenue being impacted. Other significantly affected areas include regulatory fees, rates, fuel tax, events and facilities, airport dividends, ports and Watercare.
29. The potential impacts of the three scenarios on operating budgets are estimated as follows:

	Adjusted status quo	6 months disruption	12 months disruption
Cash operating revenue	-$120M	-$450M	-$650M
Cash operating expenditure	-$30M	-$200M	-$300M
Net operating cashflow	-$90M	-$250M	-$350M

30. With this level of impact, the council would not be able to achieve a balanced budget in terms of the Local Government Act 2002 and its depreciation funding policy. However, when all relevant factors are considered it may well be prudent for the council to resolve to not run a balanced budget for 2020/2021 (as provided for the Local Government Act 2002) provided there is a clear commitment to returning to prudent long-term financial settings in the near future.

31. While the reductions in cash operating revenue are anticipated to be partially offset by reductions in cash operating expenditure, it is the gross revenue reductions that are the primary constraint on further borrowings because of the impact they have on the debt-to-revenue ratio calculation.

Capital impacts

32. Council investment and service delivery is highly reliant on imported goods and services. Changes to levels of business activity in other markets, constraints and barriers to global shipping, and limits on travel for expert staff will lead to procurement challenges.

33. In many cases this will directly lead to a slow-down in the delivery of capital investment. For example, the new electric trains ordered by Auckland Transport are assembled in Spain but with many components sourced from China. The combination of the hiatus in Chinese production in January and February and the current lockdown measures in Spain mean that these will be significantly delayed.

34. There will also likely be impacts on capital funding sources:
    i. A further slowdown of development contribution receipts.
    ii. A reduction in NZTA capital subsidies following any reduction in transport spend.
    iii. A reduction in regional fuel taxes collected as people travel less.

35. The potential impacts of the three scenarios on capital investment delivery are estimated as follows:

	Adjusted status quo	6 months disruption	12 months disruption
Capital delivery	-	-$300M	-$1,000M
External capital funding	-	-$200M	-$400M
Net capital funding requirement	-	-$100M	-$600M

36. In the case of the **six month disruption** scenario, the impacts on capital project timing is projected to result in capital delivery of around $2.3 billion in both the current year and 2020/2021. While lower than anticipated prior to the COVID-19 situation, this still represents a substantial lift in delivery from the average annual capex delivery for the group of $1.6 billion over the previous five years. If this lift can be maintained, it would represent a significant contribution to the economic recovery effort.

37. In the case of **twelve month disruption** scenario, this lift would not be able to be maintained and group capital delivery would drop back to the historic rate of about $1.6 billion in 2020/2021.

Debt management

38. The key trade-off in managing the council's debt in the COVID-19 situation is between:
    i. Maintaining the delivery of council services and investments to support the government's economic response; and
    ii. Ensuring long-term financial prudence for ratepayers.

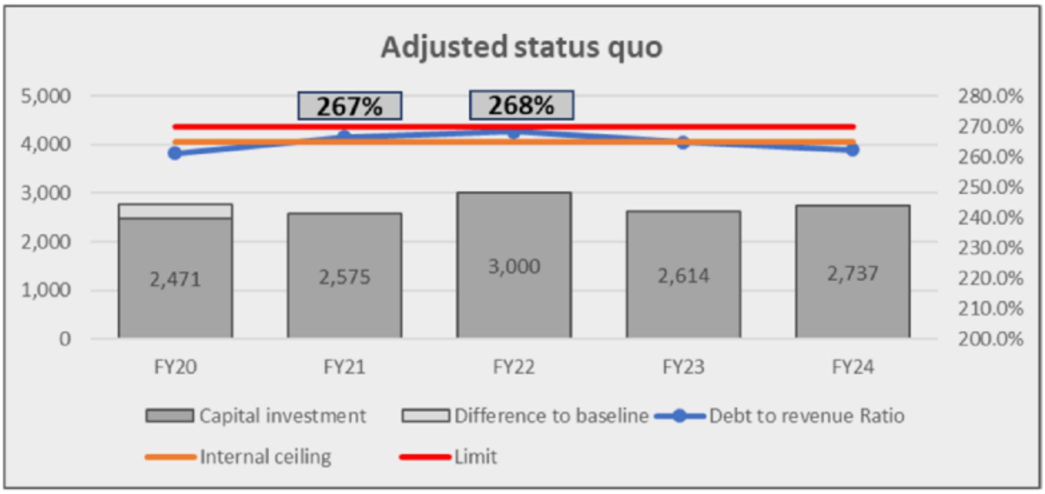
39. For the scenarios with significant ongoing disruption, the adverse operating cashflow impact is estimated to be offset by a lower capital funding requirement, meaning it is likely that debt levels will be broadly in line with what is currently planned for in 2020/2021. However, the reductions in revenue will put significant pressure on debt to revenue ratio for that one year.

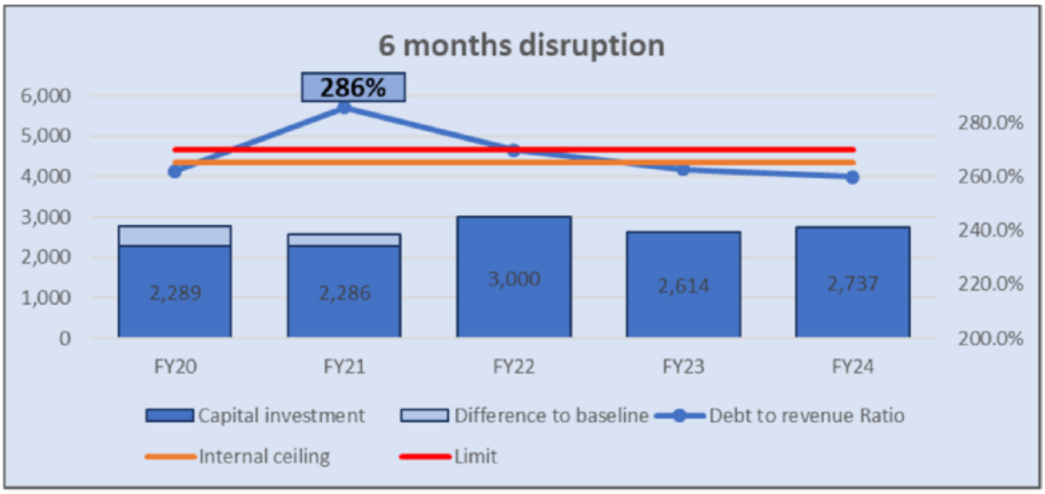
40. The projected debt to revenue ratio impacts are set out in the following table, along with the further reductions in capital expenditure in 2020/2021 that would be required (over and above the reductions directly caused by disruption) in order to stay safely below the policy limit at 265%. However, this is not possible in the 12 month disruption scenario.

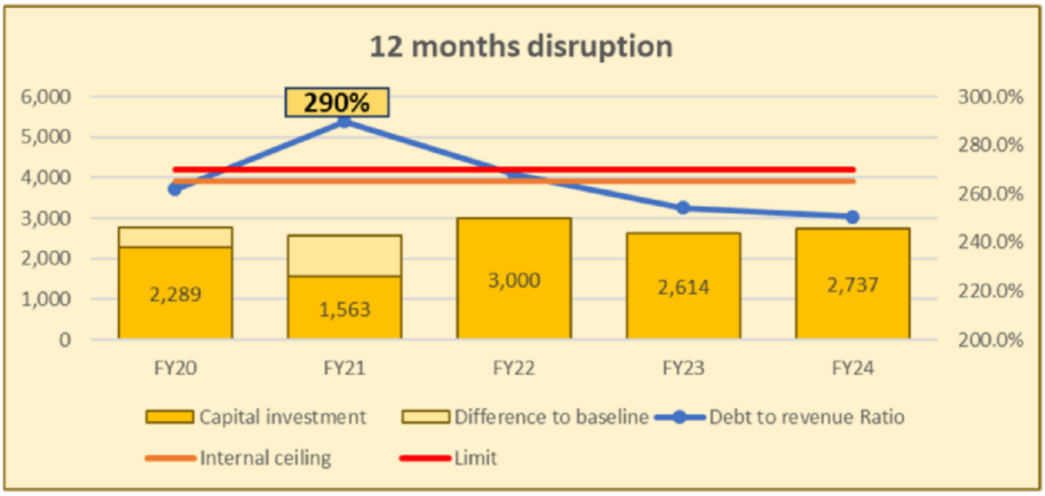
	Adjusted status quo	6 months disruption	12 months disruption
Debt to revenue in 2020/2021	267%	286%	290%
Debt to revenue policy limit	270%	270%	270%
Further required reduction in capex	$150M	$1,350M	N/A

41. While the adjustments required in the adjusted status quo represent only modest changes, the extent of capex reduction in the 6 month disruption scenario that would be required to maintain the debt to revenue ratio at 265% are substantial. It would mean reducing the group capital programme for 2020/2021 down to around $1 billion, requiring many construction contracts to be cancelled and probably mean only delivering the most critical projects to maintain essential services and protect public safety.

42. The following charts show that debt ratio impacts would be temporary, reflecting the projected temporary nature of the revenue impacts.







43. For the scenarios with significant ongoing disruption, the adverse operating cashflow impact is estimated to generally be offset by a lower capital funding requirement, meaning it is likely that debt levels will be broadly in line with what is currently planned for in 2020/2021. However, the reductions in revenue will put significant pressure on debt to revenue ratio for that one year.

44. One response to resolving the key trade-off question might be to further slowdown capital delivery as indicated in the analysis above. However, this could run counter to any government-led economic stimulus package and be detrimental to the long-term economic prospects of Aucklanders. Furthermore, the contractual situation for large capital projects is complex, and the short-term response of suspending contracts and accepting claims/variations to keep the workforce in place is unlikely to be viable long term.

45. Another response would be to work in partnership with central government to progress capital investment in a way that is not limited by the council's debt constraints. The current work underway in response to the government seeking out construction projects ready to start as soon as the construction industry returns to normal ("shovel ready" projects) is a key example of this.

46. The council could also discuss with credit rating agencies capital investment scenarios at these levels with debt to revenue higher than 270% for one year.

47. Other responses could be to look at key revenue settings, operating expenditure levels and asset disposals.

Annual Budget 2020/2021

48. Consultation for Annual Budget 2020/2021 was completed in March. Concurrently council departments and CCOs have refreshed their budgets, considering any changes to cost, revenue and timing projections. Political decision-making workshops and committees were scheduled to occur in April and May.

49. The subsequent COVID-19 situation will now have a significant impact on budget setting. Staff have identified the following three approaches the council could take from here:

Only revise budgets when there is a high degree of certainty	• Aligned to revised status quo scenario • Clearly disclose high level of uncertainty, and potential impacts of that uncertainty • Commit to revising budgets during the year if required
Take a "most likely" approach	• Take a position based on advice from economists and forecasters • Perhaps aligned to six-month disruption scenario • Signal both positive and negative impacts of uncertainty
Take a "worst case" approach	• Perhaps aligned to twelve-month disruption scenario • Be prepared to increase spending if revenue becomes more favourable

50. Council staff recommend taking a "most likely approach" on the basis that the other approaches may be beyond what can be considered a reasonable reflection of likely outcomes and are more likely to lead to further budget planning rounds which could cause further disruption and uncertainty.

51. The council is required under the Local Government Act 2002 to adopt an annual plan by 30 June. However, significant budget changes and changes to rating policy require public consultation. Therefore, the council needs to balance the requirement to adopt its Annual Budget by 30 June with the requirement to undertake adequate public consultation on key budget or rating changes that are being considered as a result of COVID-19.

52. Current advice from the wider local government sector suggest that the need for adequate public consultation is the most critical Local Government Act 2002 compliance issue.

53. Staff are investigating options to consult on changes to budgets and rates postponement policy with adoption by 30 June or 31 July 2020. Staff are also liaising with the broader local government sector and the Department of Internal Affairs on the issues of statutory compliance.

Rates relief

54. The COVID-19 situation is causing disruption to many residents and businesses giving rise to both immediate cash challenges and medium to longer term uncertainty. Accommodation providers are amongst the hardest hit.

55. While rates are usually a small portion of overall costs for both residents and businesses, these costs are a fixed cost while most business and household income is falling.

56. We currently offer a number of options to ratepayers experiencing difficulties paying their rates including:
    i. Advice on access to the government rates rebate scheme administered by the council.
    ii. Development of a payment plan (which usually requires full payment of the rates for the year by 30 June) with no penalty if ratepayer keeps to agreed plan.
    iii. Access to the council's rates postponement policy which is not means tested and is open to all residential ratepayers who:
        - live at the property; and
        - have owned it for more than two years; and
        - have postponed rates that are not more than 80% of their equity in the property.
57. One approach to providing some rates relief is to reconsider the currently proposed 3.5% overall average general rates increase for 2020/2021. Another option is to provide different forms of rates relief that are targeted to those most in need.
58. Council staff are proposing a range of targeted options to providing rates relief including:
    i. Suspending the Accommodation Provider Targeted Rate for a year.
    ii. Using existing policies to provide relief for the 2019/2020 fourth quarter rates instalment.
    iii. Considering options for extending rates postponement policies for the 2020/2021 rating year.

Changes to rates increase

59. The average general rates increase included for 2020/2021 in our 10-year Budget and referred to in our Annual Budget Consultation Document was 3.5%. This equates to $59 million of additional ongoing annual revenue.
60. If the council were to reduce the level of increase this would put pressure on both our operating funding and on our debt to revenue ratio. The multiplier effects of the ratio mean that the impact on our borrowing capacity would effectively be 365% of the revenue foregone.
61. The impact of different levels of average general rates increase on revenue and therefore borrowing capacity are set out in the table below:

Level of average general rates increase	Revenue foregone	Borrowing capacity change
0%	$59m	-$214m
1.5%	$33m	-$122m
2.5%	$17m	-$61m
3.5%	$0m	$0m

62. The impact of a lower rates increase on the 2020/2021 annual budget would therefore result in both reduced funding for operational activities (from the cashflow impact) and reduced borrowing capacity for capital investment (from the debt to revenue ratio impact). Depending on decisions made through the annual budget process, this could materially impact some service levels and work against the government's efforts to support economic recovery.

63. Given that the increase in general rates each year creates a permanent increase in the council's annual revenue, a lower average rates increase in 2020/2021 would need to be "caught up" the following year (for example a 0% increase in 2020/2021 and a 7% increase in 2021/2022) in order to achieve the long-term revenue settings underpinning the council's $26 billion 10-year capital investment programme.
64. Not "catching up" on the average rates increase would therefore mean longer-term impacts on investments and service levels. Depending on the capital investment decisions for 2020/2021, it may also mean that the projected debt to revenue ratio remains elevated above the 270% policy limit for more than one year. For example, in the six-month disruption scenario outlined above with a $2.3 billion capital programme in 2020/2021, a 0% rates increase with no catch-up would result in it taking five years for the ratio to drop back below 270%. This would raise questions about the sustainability and prudence of the council's medium-term financial strategy and may cause significant concern for the council's credit rating agencies and bondholders.
65. From a ratepayer's perspective, just reducing next year's average rates increase will not address the immediate cashflow issues associated with paying the next quarter's rates instalment. It also means the benefits of this relief will be proportional to property value, with no regard to the revenue or cashflow impacts being experienced by that ratepayer.

Accommodation Provider Targeted Rate

66. The APTR seeks to recover from accommodation providers a fair proportion of visitor attraction and major events spending by ATEED. It appears likely that restrictions on travel and mass gatherings will remain in place for some time and so this type of expenditure is unlikely to be beneficial at this time.
67. The board of ATEED have therefore proposed that the APTR and the spending on these activities that the APTR funds both be suspended for one year from 1 April 2020 to 31 March 2021. Once travel restrictions are lifted investment in visitor attraction and major events will be key to revitalising the tourism sector, and the APTR would then resume to help fund this investment. If the disruption to this sector was to persist for much longer than anticipated, then there would be plenty of time to review the situation ahead of 31 March 2021.
68. Staff propose that the immediate suspension of the APTR be implemented by remitting the fourth quarter instalment of APTR for the current year (and refunding any prepayments) using the existing scheme for the remission of rates for miscellaneous purposes. The size of this remission is estimated to be $3.3 million. The ATEED board have confirmed that they will be able to balance the group cashflow impact of this by reducing their operating expenditure by this amount within the current financial year.
69. The process for confirming the APTR rate and changes to the associated spend for next year will be through the annual budget process discussed above. Based on the above proposal, staff recommend that further public consultation for the Annual Budget 2020/2021 include a proposal to reduce the revenue to be collected by the APTR in 2020/2021 to one quarter of the currently planned amount, with this payable by the due date for the fourth quarter rates instalment for next year. This would have the effect of suspending the rate until 31 March 2021 and resuming it for the final quarter of the financial year. The estimated revenue reduction is $10.7 million and the ATEED board have confirmed that they would be able to reduce their spending by this same amount if that is the decision confirmed via the Annual Budget process following public consultation.

70. This approach would preserve the purpose and the intention of the rate and be cashflow neutral for the council group. It would still however have a revenue impact on the debt-to-revenue ratio.

Fourth quarter rates instalment

71. The fourth quarter rates instalment of $392.6 million (GST excl) is due by 28 May 2020. Meeting this obligation will be a challenge for ratepayers that are already financially stressed and who haven't paid in advance.

72. Staff consider that it is important for council to recognise the impact this challenge could have on the community and support the government's actions by proving some relief for those ratepayers who urgently need assistance with paying this bill. However, the council is constrained by its ability to raise debt and the need to maintain services and investment. Therefore, staff recommend the use of payment deferral and postponement options rather than remissions.

73. Because it is not practical to consult on and agree a new postponement policy before sending the fourth quarter rates notices, staff propose that the existing scheme for remission of rates penalties be used to allow ratepayers facing financial stress to defer the payment of their fourth quarter rates instalment until 31 August 2020 with no penalty. These ratepayers would have to agree to a payment plan and provide evidence confirming their financial stress.

74. We propose to update our internal guidelines to staff considering applications under our policies. Possible evidence that an applicant is facing financial stress may include:

    i. Business ratepayers who are in receipt of government support e.g. wage subsidy or guaranteed business loan.

    ii. Residential ratepayers with a mortgage and who have lost their jobs or can demonstrate a substantial reduction in income.

75. The deferral will enable financially stressed ratepayers to defer payment by three months (until the first instalment for the next rating year) with no penalties, interest or requirement to lodge a statutory land charge (as our longer-term postponement policy requires). The council will distribute material alerting ratepayers to how they can find information on financial assistance options along with rates notices. Ratepayers experiencing financial difficulty will have flexible payment options and be able to choose between lump sum options or smaller direct debits. Ratepayers may also be able to apply for rates postponement under a revised policy next year.

76. Under this proposal, it is estimated that between $30 to 125 million of rates payments might be deferred for 3 months.

77. The current year forecast shown above has allowed for a $30 million deferral, resulting in a projected debt-to-revenue ratio of 262%. If the deferral was $125 million debt-to-revenue would be projected to remain below 270% for the current year (assuming nothing else changed). If it became apparent that the uptake is likely to significantly exceed our forecast, we would reconsider this approach.

78. This deferral approach may not be a feasible option for some very small but important community groups that have a key role in supporting local communities, particularly in this period of uncertainty. Some small groups that operate community halls or sports club rooms may have no viable way of funding deferred rates. It is proposed that if necessary, grants are provided via the appropriate decision-making process where exceptional circumstances can be demonstrated and clear benefits to the community are evident. A preliminary analysis of the rates due for small and financially vulnerable community groups that may fit within this category estimates that grants of up to $1.2 million may be necessary.

2020/2021 rates postponement

79. For the 2020/2021 rating year, changes to the existing postponement policy can be considered as there is more time for consultation and decision making. In developing a proposal, council staff will consider the following matters:
    i. Linking the timeframe of postponement to the time of potential economic recovery.
    ii. Whether the policy should apply to all types of ratepayers except government and SOEs (i.e. business, residential and farming).
    iii. Targeting those most in need – primarily based on eligibility for government support, but also considering other aspects such as industry category and whether the property is mortgaged.
    iv. Medium-term considerations such as equity requirements, and an appropriate interest charge to avoid excessive impacts on council finances.
80. The estimated maximum take-up of such a policy, and therefore impact on the council, is about $90-100 million in year one and $25-30 million in year two. This is based on the sectors most likely to be severely affected in the medium term, such as tourism and hospitality. It also considers limited residential uptake due to lower home ownership rates being associated with people employed in the most affected industries, previous experience of ratepayer debt aversion and potential challenges with banks accepting statutory land charges being registered on the title of mortgaged properties.

Financial Modelling Assumptions and Methodology Document

1 *Methodology*

1.1 Key scenarios

Input was sought from departments within Auckland Council, each of the CCOs, Ports of Auckland and City Rail Link Limited on the financial impacts of the COVID-19 situation. A range of scenarios based on common group-wide assumptions were agreed and financial impacts for the next financial year were assessed for each scenario. Departments and CCOs also assessed the shorter-term impact on quarter 4 of the current financial year.

The key scenarios used for our reporting to elected members are outlined in the following table. Other scenarios with more severe disruption were also considered to stress test the analysis.

Adjusted status quo (Scenario 1)	A rapid return to normal, minimal change to Annual Budget 2020/2021 aside from a few already known impacts (airport dividends, cancelled events)
6 months disruption (Scenario 2)	Disruption lasts from March to September 2020 with varying alert levels
12 months disruption (Scenario 3)	Disruption instead lasts from March 2020 to March 2021

1.2 Desktop approach to Scenario 1 – rapid recovery

Scenario 1 was primarily undertaken as a desktop exercise that looked at a potential situation where the impact of COVID-19 was relatively brief and the return to "business as usual" came quickly. In this scenario we contemplated alert levels varying between 2 and 4 in the final quarter of the current financial year but with only border controls and some mass gathering limitations extending beyond July 2020.

Given the nature of this scenario it was generally not necessary to use impact estimates from departments and CCOs, beyond the impacts assessed for the current financial year. Rather the approach was to use existing draft budget information for 2020/2021 and only adjust for impacts that were already known or which had a very high degree of certainty.

The key adjustments used for 2020/2021 were the impacts on Auckland Airport dividends and Regional Facilities Auckland's commercial activity in line with Scenario 2, and an assumed lesser impact on public transport activity to reflect the likely hesitant nature of people's return to public transport use (as per overseas evidence following comparable events).

1.3 Methodology for Scenarios 2 and 3

Following discussion between CFOs, scenario guidance materials and templates were distributed to finance teams across the group. This exercise built on work that each organisation within the group had already progressed, with a key focus on achieving a consistent group-wide approach wherever possible.

The council's central finance team then consolidated and validated the scenario templates received and engaged with each area to correct errors, improve consistency and build an understanding of key drivers. Where information was incomplete or unavailable, the finance team extrapolated the data received with a guiding principle of maximising group-wide consistency of assumptions. The central finance team also reviewed group-level parameters such as rates, development contributions and regional fuel tax revenues.

Where possible reviews were undertaken, and advice was sought to critique key assumptions. The council's Chief Economist reviewed different aspects including rates and development contribution modelling and provided advice and recommendations on the range of likely impacts.

The information provided by Auckland Transport has been reviewed by their board. Expert advice obtained from external consultants McKinsey's about the international experience of COVID-19 distribution on public transport usage and revenues was incorporated in the scenario modelling.

Ports of Auckland and Panuku have also presented the financial information to their boards, while Regional Facilities Auckland sent the information to their board for their information following approval by their Chief Executive and Chief Financial Officer. Watercare have had the information reviewed by the Chair of their Audit and Risk Committee.

While ATEED's numbers are small in the group context, their board has played a key leadership role in relation to the Accommodation Provider Targeted Rate and the expenditure that it funds.

2 Summary of impacts

2.1 Impacts

It is acknowledged that there is still a lot of uncertainty and the financial information provided will be continually refined as more information becomes available. There is also some variability on the scale of the impact for different parts of the group depending on how much non-rates revenue was expected to be received.

The potential operating revenue and expenditure impacts for 2020/2021 were assessed as shown in the table below.

	Scenario 1	Scenario 2	Scenario 3
Cash operating revenue	**-$120**	**-$450m**	**-$650m**
Cash operating expenditure	**-$30**	**-$200m**	**-$300m**
Net operating cashflow	**-$90m**	**-$250m**	**-$350m**

For scenario one it was assumed that there would be no further disruption to capital expenditure delivery after 30 June 2020, the assessed capital expenditure impacts for 2020/2021 for the other two scenarios were as follows:

	Scenario 2	Scenario 3
Capital expenditure	-$300m	-$1,000m

2.2 Key risks

Given the high levels of uncertainty, there are some key risks associated with these assumptions and the analysis they underpin. These include:

- Longer or more severe disruption. This impact has been explored through the stress testing exercise, which showed similar patterns, just with larger magnitudes. The impact on the debt to revenue was quite similar to that for the key scenarios, indicating that the trend of operating and capital cashflows offsetting would continue with longer and more severe levels of disruption.
- Disconnect between revenue and capital project disruption. A key risk to the debt modelling would be a scenario where the group's revenue generating activities were significantly impacted but the construction sector was not. This would increase debt projections as the group would experience the revenue reductions but would not benefit from the favourable cashflow impacts of a slower rate of capital expenditure.
- Capital project contract complexity. Assessing the impact of disruption for large multi-year construction projects is challenging due to the complex contracting arrangements. Assumptions about the ability to put projects on hold may be more valid for a few month's disruption than for six to twelve months as contracts might then need to be cancelled and subsequently renegotiated.
- Broader economic aspects. There is a risk that disruption results in broader impacts on business confidence and viability with longer lasting consequences. The impact of this would include more severe and enduring reductions in the receipt of rates and development contributions revenue. The overall impact may be similar to that explored in the stress testing exercise.

3 Key assumptions

3.1 Cash Operating Revenue

- **Auckland Transport (AT) Public Transport Revenue** – the largest fall in Auckland Transport's revenue (up to 22% of total revenue) for scenarios 2 and 3 is from lower public transport fares due to reduced patronage. At the highest alert levels (alert 3 and 4) the shortfall in revenue will be fully covered by NZTA until 30 June 2020. The assumption is that this would continue to be the case next financial year as well. However, at lower alert levels it is assumed that this will only be partially covered. Patronage numbers are assumed to be between 9% - 37% of pre-COVID levels. AT have considered information from external consultants on international trends on the impacts on public transport use when assessing these impacts.

- **Parking and enforcement revenue (AT)** – at higher alert levels it is assumed that parking would be free and enforcement revenue from infringements would only be collected in some situations (health and safety breaches for example).
- **Regional Facilities Auckland** – severely impacted due to restrictions on public gatherings and closure of facilities, between 50% - 75% of operating revenue reduction under scenarios 2 and 3. Activities impacted include:
  - Auckland Zoo
  - Auckland Art Gallery
  - NZ Maritime Museum
  - Auckland Live
  - Stadiums / Concert revenue
- **Auckland Airport Dividend** – Assuming that no dividend will be paid in 2020/2021 for all three scenarios.
- **Regional Fuel Tax** – Assuming the same alert levels as AT. At alert level four we have taken a conservative assumption of a 90% reduction in regional fuel tax revenue (fuel companies are reporting 80% reductions in sales, and the NZTA is reporting a 76% reduction in Auckland traffic). At level three we assume a 60% reduction on the basis that many businesses and education facilities will be open, but many people may choose to stay home and travel less. At levels two and one we have assumed reductions of 20% and 10% respectively based on the continued emphasis on physical distancing, self-isolation of at-risk groups, and limits on non-essential travel around New Zealand.
- **Development Contributions** – Assuming that development contribution revenue drops proportionally (but not equivalently) to drops in regulatory activity. Also included in the forecast is pre-COVID-19 reductions. As mentioned earlier the modelling assumption related to development contributions revenue have been reviewed by the Chief Economist.
- **Rates Revenue Receipts** – For the final instalment of 2019/2020 rates, it has been assumed that between 10% and 30% may not be received by year end. This initial assumption has been developed by finance staff, working with our Chief Economist. The work involved looking at owner-occupier, landlord and business ratepayers and at market commentary around projected levels of unemployment and business stress. Assessments were made of the likely impact on different business sectors from the retail, hospitality and accommodation sectors to communications and mineral extraction.

  Additionally, this was overlaid with estimates of the numbers of ratepayers likely to take up opportunities to enter into payment or postponement arrangements.

  Continued refinement of these estimates will be necessary, informed by decisions made around the types of rate relief offered and updated projections around the impact of COVID-19 on both Aucklanders and Auckland businesses.

  For the 2020/2021 year it has been assumed that similar percentages seek relief with the key differences being for which instalments the payments are postponed. Scenario One assumes none, Scenario Two assumes the first instalment only and Scenario Three assumes both the first and second instalment.
- **Regulatory Revenue –** initial impact quite high (30% - 50% lower than budget) due to lower consenting volumes as well as reduced demand for other regulatory activities (licencing etc.). All scenarios assume a slow recovery progressively improving over time.

- **Customer and Community –** impact on revenue from closure of pools and leisure centres, libraries and holiday parks.
- **Ports of Auckland –** reduction in revenue from lower volumes flowing through the Port.
- **Watercare revenue** – some reduction in volumes and possible collectability issues have been factored in, impact overall is assumed to be less than 10% of total revenue budget for Watercare.
- s7(2)(b)(ii) Prejudice to commercial position, s7(2)(i) Prejudice to negotiations, s7(2)(h) prejudice local authority's commercial activities

3.2 Cash Operating Expenditure

The extent of the reduction in operating expenditure (7% - 10% reduction for the group for scenarios 2 and 3) is much less than the reduction in revenue with key essential services continuing.

Some lower costs will flow through from closure of facilities resulting in lower utilities, cleaning and other variable costs. Increased costs of cleaning offices and purchasing protective equipment has also been factored in.

AT have assumed they will continue to pay majority of public transport operating costs including PVR and driver wages.

Temporary staff and the cost of outsourced works have been assumed to reduce, for example in the regulatory area where permanent staff are assumed to be able to cope with lower consenting volumes. Permanent staff costs have generally not been adjusted under the scenarios as part of this exercise (other than AT who have assumed a small adjustment).

3.3 Capital Expenditure

The consistent assumption across the Group is that construction sites are not an essential service (unless there is a safety implication) so sites will be shut down when the city is in lockdown. Key considerations include labour and supply chain disruption especially where there is reliance on overseas products.

The most significant reductions assumed across the group were:

- Auckland Council: 30% - 50%
- Auckland Transport: 20% - 40%
- Watercare: 15% - 50%
- Panuku 30% - 86%

Auckland Transport did not consider multiple capital expenditure scenarios due to the high levels of uncertainty. Under scenario 3 an assumption by the central finance team has been made of an additional capital slowdown of up to 20% of the total AT programme to be consistent with other areas within the group.

Regional Facilities Auckland signaled an increase in capital expenditure in 2020/2021 for unfinished work relating to the Zoo and Aotea Centre that are currently on hold.

3.4 City Rail Link

Following discussions with City Rail Link Limited (CRLL) a lot of the planned investment in 2020/2021 is related to design work that can still occur, so expenditure levels remain as per budget. Under scenario 3 an assumption of a 20% reduction in investment has been made by the finance team for expected disruptions.

3.5 Americas Cup (AC36)

At this stage it is assumed that AC36 takes place as scheduled so under all scenarios no specific adjustments have been made to capital or operating expenditure. ATEED have advised that there are specific obligations that are required to be met under the Host Venue Agreements so they will continue to work to current timelines at this stage. The planning will continue with the lens that the event could be moved so greater flexibility will be sought on any new contracts to reduce possible penalties that may be incurred and also avoid potential sunk costs where practicable.

3.6 Capital funding sources

- NZTA capital subsidies will be dependent on the size of the capital investment – assumption being 40% - 50% of the investment will be funded via capital subsidies.
- Infrastructure Growth Charges – assumed lower number of connections under both scenarios ranging from 10% reduction under scenario 2 and up to 30% reduction under scenario 3.
- Asset sales – an allowance has been made for some delays within the Panuku and Corporate Strategy asset sales programme. Where sales are 80% probable or to be sold to the Crown the assumption is the sales would proceed, otherwise delayed.