Attachment B: Investment scenarios and funding levers

Executive summary

1. Through our Consultation Document Auckland Council proposed an investment programme for the 2021-2031 period of $31.4 billion. Despite the financial pressures of COVID-19 this included investment averaging $2.9 billion for the next three years. This proposed investment is enabled by additional cost savings, further asset recycling, temporarily higher borrowing, and a one-off 5 per cent average general rates increase in 2021/2022 and 3.5 per cent each of the remaining years.
2. Both public submissions and a representative survey showed a solid level of public support for this investment.
3. Following adoption of the consultation document staff have updated their revenue projections, forecasting assumptions and budget pressures.
4. Budgets have been updated for the unavoidable budget pressures to arrive at an Updated Base Scenario. This enables the delivery of the outcomes proposed in the Consultation Document, with the same revenue settings, without breaching our debt targets or further delaying our full funding of depreciation (Updated Base Scenario).
5. A number of the identified budget pressures constitute choices for the council around funding and service levels. These include, for example, additional public transport services, renewals of regional facilities, or the timing of capital investment.
6. Scenarios including all of these budget pressures (Fully Funded Scenario) and only some of them (Partially Funded Scenario) both fail to deliver full funding of depreciation by 2028 and therefore some form of response is recommended to ensure long-term financial sustainability.

Context

7. The key challenge for our budget is the large and growing gap between the demand for investment in our assets and services and our ability to finance and fund that investment.
8. Auckland is experiencing rapid growth, challenges from climate change and changing expectations from our community about the services they need. Like many other organisations, some services and facilities we provide were a response to circumstances that no longer exist.
9. In addition, we are facing some challenges with our aging assets, meaning there is a requirement to either replace them or invest in their upkeep to a greater extent than we have in the past.
10. Even before COVID-19, responding to these pressures was going to be hard as we were reaching the limits of what we can responsibly borrow. With significantly less revenue over the next three years, there is now even less money available to meet these needs in the near term. The uncertainty we face means this challenge could get even harder.

Consultation

Our proposal

11. For the 10-year period 2021-2031 we proposed a capital investment programme of around $31 billion. This compared with the $26 billion programme included in the 10-year Budget 2018-2028.
12. The timing of this investment is important given the urgency of the challenges we face. The proposal would enable capital investment averaging $2.9 billion for the next three years. This would enable us to make greater progress with delivering priority transport investment and renewals of community facilities. It will also create jobs and enable us to start to tackle the challenges of climate change, which will pose serious economic and environmental problems for the city long after COVID-19 ceases to be a problem.
13. To enable this level of investment we proposed:
    - That we continue and intensify our search for savings and value for money and proposed locking in at least $90 million as permanent ongoing annual savings.
    - Further sale or lease of surplus properties to generate $70 million a year over the next three years.
    - To increase our borrowing to a temporarily higher debt-to-revenue ratio of up to 290 per cent for the first three years, gradually returning to 270 per cent thereafter.
    - To retain our long-term commitment to a 3.5 per cent average general rates increase each year, but increase the average general rates for 2021/2022 by 5 per cent before returning to 3.5 per cent from the following year onwards.

Alternative options considered

Greater investment

14. With even greater use of rates and debt we could achieve a 10-year investment programme higher than the proposed $31 billion and achieve further improvements to service levels sooner.
15. We have considered investment scenarios of up to $35 billion. This would enable more provision for Auckland's growth and greater ability to achieve the strategic outcomes of the Auckland Plan 2050 sooner. However, we consider that the higher rates and debt required would not be prudent or affordable and this option was not proposed in our consultation document.

Lower rates and debt settings

16. Without higher rates and debt, the capital programme would need to be reduced to a highly constrained level averaging $2.6 billion over the next three years. This would mean 3.5 per cent average rates increases in all years and the debt-to-revenue ratio returning to 270 per cent within three years. However, up to $900 million could not be accelerated to the first three years and this would result in severe consequences for council services and service levels from delaying that investment. As a result, this option was not proposed in our consultation document.

Public feedback

17. The first question in the feedback form for the 10-year Budget 2021-2031 asked Aucklanders if they supported the proposed investment package and the associated funding levers.
18. Overall, 16,857 responses to this question were received. These included 3,177 pro forma responses where a template response had been prepared by a community group or other external organisation. With these pro forma responses we cannot be sure that respondents have been presented with or directed to our full consultation document and supporting information.
19. Looking at all the responses 34 per cent supported and 53 per cent did not support the proposal. If the pro forma responses are excluded 42 per cent supported and 43 per cent did not support.
20. The most common themes from those who supported the proposal included:
    - The need to invest in infrastructure – water infrastructure was commonly highlighted
    - The investment is needed to support a response on climate change
    - Stimulating the economy and keeping people in jobs.
21. Key reasons provided for not supporting the proposal related to:
    - Financial hardship that many are facing due to COVID-19
    - Finding revenue sources and savings from elsewhere e.g. internal savings
    - A lack of trust or generally dissatisfied with council.
22. For those who selected ‘Other’ and ‘Don’t know’, the main themes included:
    - Generally supporting investment in Auckland and our aging infrastructure
    - Finding revenue sources and savings from elsewhere e.g. internal savings
    - Supporting a different level of rates – some supporting higher, while others supporting a lower rates increase than proposed or a rates freeze.
23. An independent survey of a cross-section of 4,056 Aucklanders was also conducted where participants were given an explanation of the proposal including what would be delivered and the funding responses to enable the investment. 46 per cent of those surveyed supported the proposal while 37 per cent did not support.

Key considerations

24. The consultation document for this 10-year Budget identified some key considerations to guide us when we make decisions. These included:

- Protecting critical infrastructure

  When making decisions around levels of investment and timing of investment we need to consider the impact on the condition of our critical assets. We should ensure short-term changes do not lead to severe and irreversible long-term decline of our assets.

- Managing growth and keeping Auckland moving

  Two of the key drivers of the demand for capital investment are our rapidly growing population and the needs of our transport network. Decision-making needs to consider the impact on our efforts to support housing and development, and to enable Aucklanders to get where they want to go more easily, safely and sustainably.

- Ensuring long-term financial prudence and sustainability

  Maintaining a strong commitment to long-term financial prudence is critical to ensuring the council can maintain ongoing and cost-effective access to the capital it needs to fund its investments and to be able to respond to any future shocks. There are also specific requirements under the Local Government Act 2002 (LGA) that seek to ensure that New Zealand local authorities conduct their business in a financially prudent manner.

  In setting the Emergency Budget 2020/2021, the council resolved that it was prudent to temporarily depart from its existing policies related to debt limits and to not balance the budget for the 2020/2021 financial year, having had regard to the matters set out in section 100(2)(a) to (d) of the LGA. The intent of the council's policies relating to debt limits and the financial prudence requirements set out in legislation is to promote long-term financial sustainability, not to require rigid adherence to fixed policy settings in time of crisis.

  The LGA permits a council to depart from the requirement to set each year's operating revenues at a level sufficient to meet that year's projected operating costs (the balanced budget requirement), provided that the council formally resolves that it is financially prudent to do so, having considered the matters in section 100(2)(a) to (d) of the LGA. Further, the council can make decisions that are significantly inconsistent with its adopted policies, where appropriate, as long as when making the decision, the council clearly identifies the inconsistency, the reasons for it, and any intention to amend the policy to accommodate the decision.

  Due to the ongoing financial impacts of COVID-19 disruption the proposed budgets included in the consultation document included a three-year delay to the council achieving a long-term balanced budget position where all operating costs, including depreciation, are covered by operating revenues. Additionally, the proposed budgets included debt-to-revenue ratio levels of up to 290 per cent for the first three years before gradually returning to our long-term target of 270 per cent.

  In considering long-term prudence and sustainability the council should consider both these measures. Staff advised that these temporary departures from long-term targets could be justified in light of the COVID-19 challenges however it is not recommended that there is any extension to these measures. To ensure best practice financial management it is recommended the council seeks to return to below its target debt-to-revenue level of 270 per cent, and to achieve full funding of depreciation as soon as possible.

- Reducing emissions and adapting to climate change

  The council will need to consider the impacts of different choices on both mitigating and adapting to the effects of climate change. Budget changes that slow or reverse our progress in this critical area should be avoided wherever possible. Consideration of this principle is consistent with section 5ZN of the Climate Change Response Act 2002 which enables the council to take the 2050 target for emissions reduction into account in its decision-making.

- Delivering on Te Tiriti based partnerships with Māori

  In making decisions the council should consider our commitments to Māori and ensure it continues to act in accordance with our statutory provisions relating to Te Tiriti o Waitangi. We should also consider whether decisions ensure sufficient progress against the ten priority Māori outcome areas using the Kia Ora Tāmaki Makaurau performance framework.

- Valuing Auckland's natural environment

  The council should consider how decisions support progress towards the Auckland Plan outcome to preserve, protect and care for the natural environment as our shared cultural heritage, for its intrinsic value and for the benefit of present and future generations.

- Valuing inclusivity, equity and diversity

  Auckland is rich with diversity and decision-making need to consider how we ensure our services remain relevant to the different and changing demands of our community.

- Tailoring services to communities of greatest needs

  Some choices will have material impacts on the most vulnerable people within our community. The council should consider these impacts as decisions are made.

- Supporting the local economy, jobs and employment

  Different changes have different impacts on the economy and employment outcomes.

  Where possible, preferences should be given to budget changes with the least impact on employment outcomes for Auckland, whether or not the council group is the employer.

  The advice provided by the council's Chief Economist when developing the Emergency Budget 2020/2021 was that it is critically important to continue to invest in quality capital projects to stimulate the Auckland economy, both in terms of maintaining business confidence, and the flow-on impact of this spending through the economy. This advice remains valid.

  Investment in infrastructure will generally support direct employment, stimulate business confidence and enable significant further downstream employment. Investment in infrastructure such as pipes and roads will often enable more house-building activity. Town centre upgrades bring people back into those town centres. Some transport upgrades can do both of these two things. Infrastructure investment will have much more stimulatory power than adding more staff or people-oriented programmes.

Overall, staff consider that there remains a compelling case for council to continue with as much capital investment as it is prudently able to do so.

25. In addition to these considerations a number of other criteria and principles have been used to support past budget decisions. These continue to be important and include:

- Honouring contractual commitments
- Protecting public health and safety
- Statutory obligations
- Ease of implementation

New information

26. Following the preparation of the consultation document and supporting materials, and in preparation for the final 10-year Budget 2021-2031 decisions staff reassessed the key forecasting assumptions, particularly those related to COVID-19 and the flow on impacts on travel and the economy. At the same time staff engaged in a comprehensive budget refresh programme where budgets across the group were reassessed using latest information to ensure that the proposed service levels and investments could be delivered. Details of these processes are included in Attachment B1.

27. As a result of the refresh processes a number of budget changes were identified. Some of these are unavoidable impacts of changes to assumptions, market movements, or contracted costs. Others will require decisions by councillors around investment and service levels.

Budget changes and updated base scenario

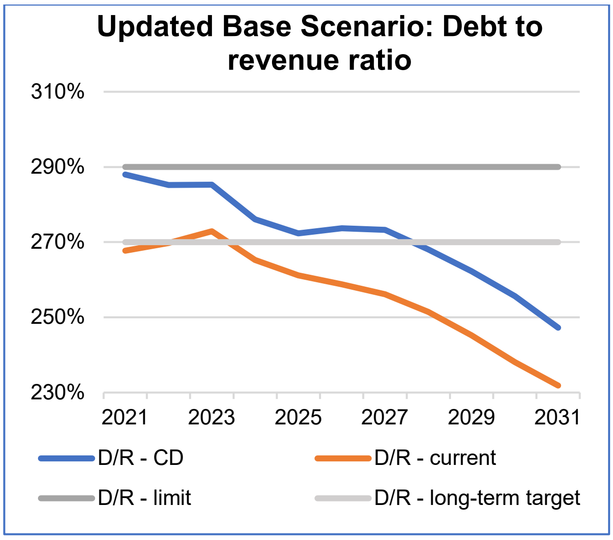
28. Identified changes that are a result of factors such as updated assumptions, market changes, or contracts have been incorporated into the proposed budget to establish an Updated Base Scenario. More detail of these changes can be found in Attachment B1.

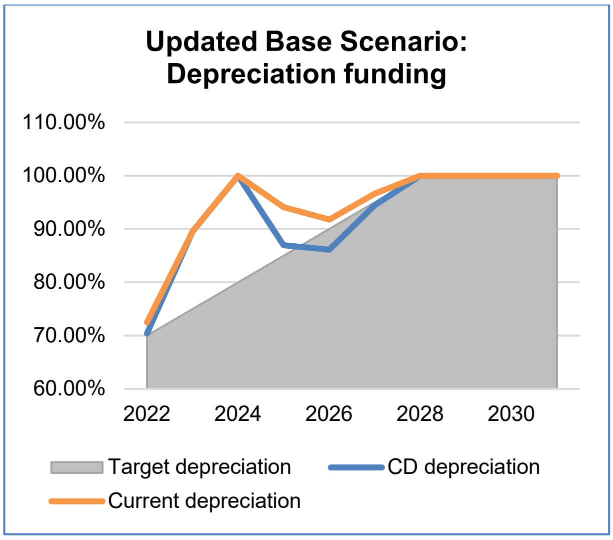
29. This scenario includes the investment lines included in the proposed budget (some slightly reduced due to the reapplication of inflation assumptions) and therefore would see us avoid unacceptable risks to our assets and keep investing in infrastructure to help the city recover from recession.

30. To enable this the scenario maintains the commitment to $90 million of permanent savings and cost reductions, and to the rates increase path of a one-off average 5 per cent increase followed by 3.5 per cent each year thereafter.

31. The increased asset recycling budget of $70 million per annum for three years has been pushed out around two years to accommodate asset sales not achieved in the current year and deferred into the first two years of the plan.

32. As the charts below illustrate, the Updated Base Scenario includes a lower debt position than in the consultation document (only exceeding 270 per cent in one year) and delivers an operating position where depreciation is fully funded by 2028 (in line with the proposed budget).





33. The lower debt-to-revenue position is primarily driven by a lower opening debt position (from favourable results in the current year) and from a lower forecast of the present value of public transport lease obligations (which we and rating agencies see as a commitment akin to debt).

34. The lower opening debt reduces our projected interest cost, which would help our balanced budget position but this impact is offset by other updates such as:

- Higher interest rates,
- Higher interest costs related to weathertightness claims,
- A reduced portion of interest costs funded by development contributions, and
- Higher projected depreciation of transport assets.

35. Our depreciation funding policy is focused on achieving a position where operating costs (including the annual "consumption" of our assets) are consistently covered by operating revenues. To get to this long-term position we have a steady revenue growth path but there are stepped changes in our operating cost base. In particular, the impact of the CRL opening in 2025 and the move to a different way of delivering community services. These result in a decreased depreciation funding percentage in 2025.

Budget choices

36. A number of the budget pressures identified through the budget refresh process will require key choices to be made for the final 10-year Budget 2021-2031. These are outlined below with more detail included in Attachment B1.

Public transport service levels

37. The transport budgets specified in the Consultation Document and Supporting Information are projected to deliver a growth in annual public transport patronage to 145 million by 2031.

38. The draft Regional Land Transport Plan (RLTP) has identified that additional operating spending on public transport would enable additional bus services to be added and ferry services to be improved and that these would support further patronage growth.

39. Auckland Transport has requested additional operating funding of $239m over the next ten years and has projected that that would deliver annual public transport patronage of 174 million by 2031.

40. Cognisant of the budgetary pressures faced by the council group Auckland Transport have noted that if the full funding were not available an increase in operating funding of $10m per annum ($100m over ten years) would allow some of the additional services to be delivered. This is projected to deliver annual patronage of 154 million by 2031.

Auckland Council operating cost pressures

41. Council staff have been working through the current year to identify the $120 million of operating savings required from the Emergency Budget 2020/2021. Additionally, work is well progressed on identifying programmes of work that would deliver the $90 million of ongoing annual cost reductions and savings included in the proposed 10-year Budget.
42. Given this context the executive team have identified a number of cost pressures that cannot be absorbed within existing budgets at this time. These are primarily driven by central government and council policy changes, and to manage operational risk.
43. These pressures are projected to require additional operating budget of $6 million in 2022/2023 (year two of the plan) and average $11 million per annum from 2023/2024 onwards.

Climate change response package

44. As discussed in the separate report work to date on the planting programme has identified challenges achieving desired outcomes using current approaches. To achieve the acreage of new plantings identified in the consultation document additional budget of $8 million would need to be funded across the ten years or a combination of private investment and other initiatives within the package being rescoped.

Regional facility renewals

45. The third phase of the capital prioritisation framework assessment identified that the proposed budget for renewal of Auckland Unlimited cultural venues was not sufficient to manage all risks.
46. An additional budget of $182 million would be required to avoid decline in these venues and the risk of closure.

Panuku regeneration programme

47. Refreshed planning of the Transform and Unlock programme delivered by Panuku indicates that spending will need to occur earlier and that the expected asset sales that fund the programme will occur later. The overall programme will remain cash-positive at all times but not to the extent included in current budgets.

Capital programme reprofiling

48. As the council invests in new and improved assets for the city the ongoing operating costs of these assets, and the interest on the borrowing to fund them, adds pressure to the council’s operating position.
49. One option available to the council to offset the impacts of the budget pressures identified would be to reprofile the capital programme. By moving investment out of the middle period of the plan and into the last few years the consequential operating costs would also be delayed until when revenues have grown.

50. This exercise should be informed by the Capital Prioritisation Framework to ensure that the most critical risks are still addressed, and the correct projects are deferred. More information on the framework and how it could be applied to different scenarios is included in Attachment B2.

51. The key impacts of any reprofiling would be on more discretionary projects and programmes, in areas such as parks and community, in order to retain those focused on asset risk.

Budget impacts

52. The overall impact of the above cost pressures is dependent on the choices made and any associated responses. The following two scenarios demonstrate the impacts of two example sets of choices.

Scenario summary

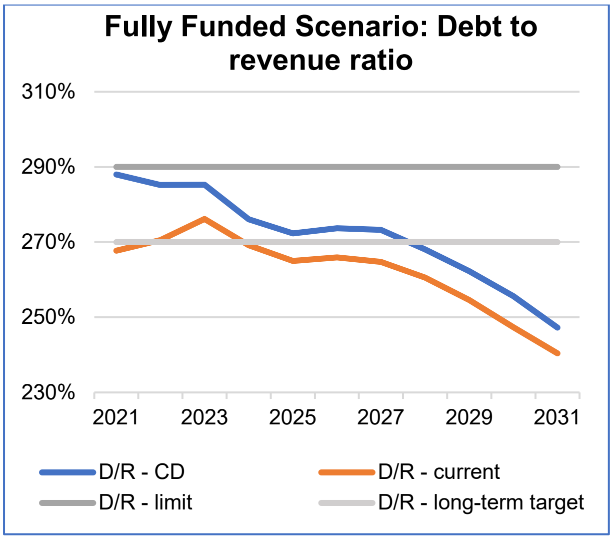
	Updated base scenario	Partially funded scenario	Fully funded scenario
Operating			
Public transport service levels – $239m extra	●	●	✓
Public transport service levels - $100m extra	●	✓	●
Auckland Council operating pressures	●	✓	✓
Climate change response package – $8m extra	●	●	✓
Capital			
Regional facility renewals	●	✓	✓
Panuku regeneration programme	●	✓	✓
Capital programme reprofiling	●	✓	●

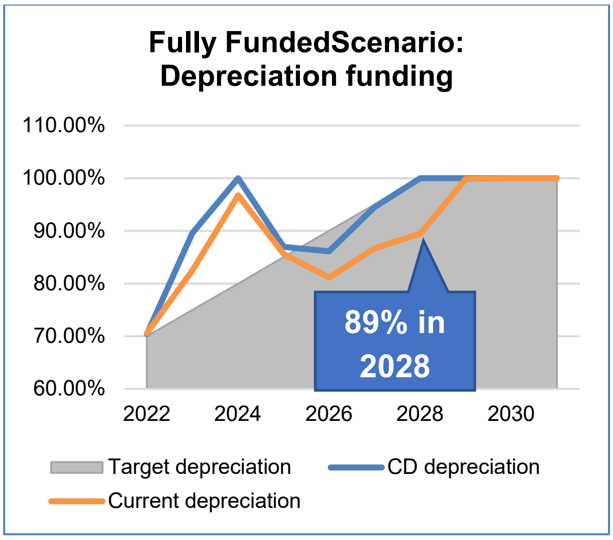
Fully funded scenario

53. If all pressures were incorporated to their full extent, then a significant funding response would be required.

54. To accommodate this with higher rates increases would require further increases of up to one per cent for years two to six.

55. If the proposed revenue settings were maintained, then the financial impact would be as shown in the charts below. This would include a further delay to achieving the full funding of depreciation (currently proposed to be achieved in 2028).





Partially funded scenario

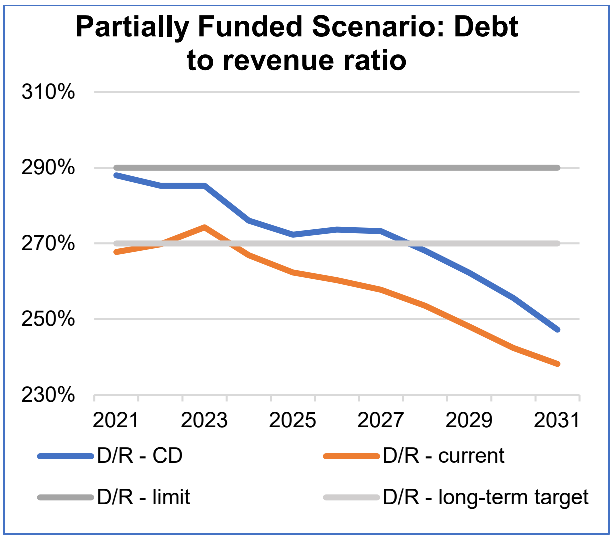
56. Alternatively, the council could choose to only partially fund some of these pressures.

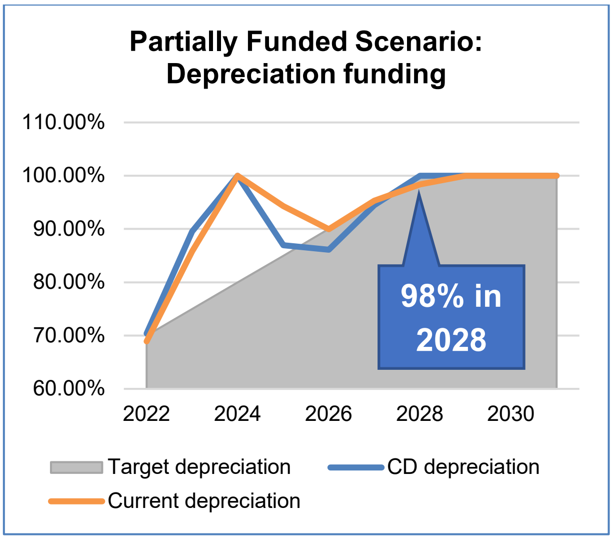
57. As an example, the below charts show a scenario incorporating the lower level of additional public transport spend, the rescoping option to address the challenge in the Climate Change package, and a reprofiling of the capital investment programme to defer $200 million of investment into the last three years.

58. The projects delayed from years 4-7 into years 8-10 with a reprofiling of $200 million (as informed by the Capital Reprioritisation Framework) are described in Attachment B2 and would primarily be:

- Parks and Community budgets that are yet to be allocated to specific projects, including for parks acquisition, parks development and OLIs
- Lower risk AUL renewals,
- Panuku investment in Onehunga Wharf and the Waterfront,
- A small number of lower risk stormwater projects, and
- Spending on information technology within Auckland Council.

59. This example scenario would also require an additional response as depreciation funding in 2028 is projected to be at 98 per cent.





Response choices

60. As the council has consulted with Aucklanders on its draft 10-year Budget, we are limited by what decisions may be taken. However, we have considered what options and financial levers may be available to respond to the budget pressures outlined.

Rates

61. The consultation document proposed maintaining a long-term commitment to a 3.5 per cent average general rate increase each year, but a one-off higher increase of 5 per cent for 2021/2022.

62. The consultation document did note that higher investment scenarios had been considered that would have required higher rates and debt but that the council considered that these would not be prudent or affordable.

63. If the council were to consider further increases to general rates, beyond 3.5 per cent, in year two and/or a later year then this would improve the operating position and mitigate impacts on when the council achieves a balanced budget.

64. Due to the compounding nature of rates increases it is difficult to specify the impact a further increase would have but as a rule of thumb 1 per cent of general rates is approximately $18 million of revenue.

Depreciation funding

65. In 2012 the council established a policy of moving toward full funding of depreciation from operating revenue sources and planned to achieve this by 2025. Due to the impact of COVID-19 our proposed budget included a deferral of this target by three years to 2028.

66. The council believes that achieving full funding of depreciation (and a balanced budget) is important in supporting financial sustainability and intergenerational equity. This position is supported by lenders and rating agencies.

67. The council could choose to further extend this target due to the many challenges it currently faces.
68. Staff advice is that it would not be prudent to further delay the full funding of depreciation as it does not represent good financial management and would not support long-term financial sustainability.

Cost reductions

69. The proposed budget included in the consultation document included locking in at least $90 million of permanent ongoing annual savings. This followed the one-off $120 million of savings in 2020/2021.
70. Achieving these cost reductions is requiring a relook at how the council delivers some services to the community. This will take time and will cause significant disruption for staff. Therefore, additional cost reductions in the early part of the plan would be challenging to achieve and could impact on some key service levels.
71. Further cost reduction targets beyond the first three years would allow time for options to be prepared and any service level adjustments to be considered.
72. In addition, Auckland Transport could look to find some cost reductions to help fund the additional public transport services identified.

Asset sales

73. Asset recycling targets have been set in both the Emergency Budget 2020/2021 ($244 million) and in the proposed budget for this 10-year Budget ($210 million over three years).
74. These targets are supported by analysis of surplus, non-service properties that are available for disposal. This analysis was included in the supporting information to the consultation document. Council staff believe that these targets are still achievable, although with cashflows spread over a slightly longer period as noted above.
75. The council could choose to increase, or accelerate, these targets but this would mean a higher share of the potential sales or leases would need to be converted into cash flow benefits. This is not recommended.

Attachments

B1	Group budget overview and analysis of changes
B2	Capital Prioritisation Framework