Attachment C: Financial modelling of revenue & debt scenarios

- Financial modelling has been undertaken to illustrate the implications of trade-offs between various settings for investment levels, revenue and debt
- The examples are illustrative only, many other variants and combinations are possible.

Revenue settings

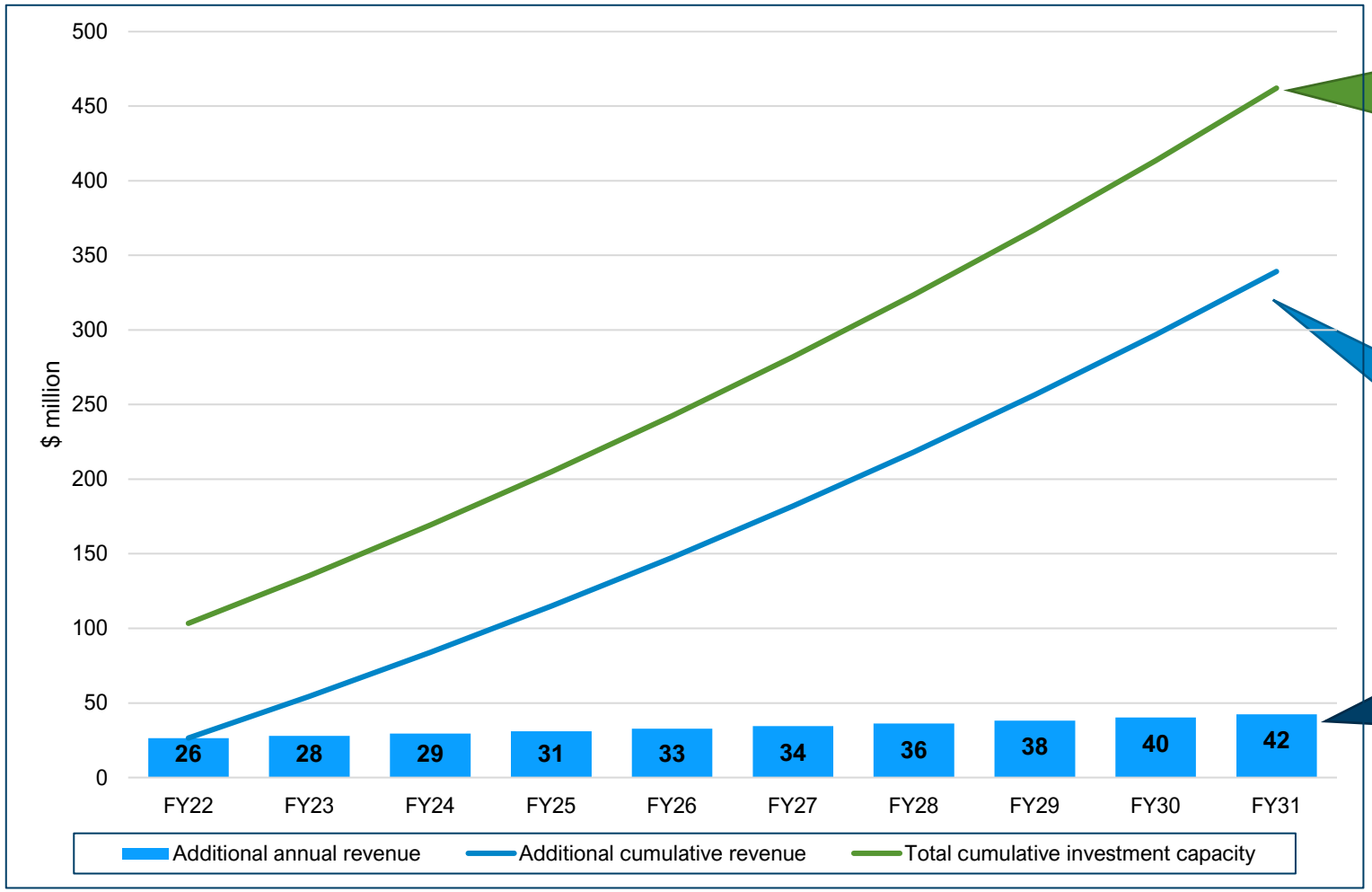
- Revenue growth will help address operating balance over the long-term and better support elevated debt levels
- Current budgets expect average general rates increases of 3.5% per annum.
- A higher rates increase, for one year only, will provide additional revenue and borrowing capacity that grows slowly over time.
- A small, one-off lift in general rates increase would not fund everything and would come on top of targeted rates and water charge increases - need to consider overall impact on businesses and households
- Higher levels of annual rates increases, maintained over time, will create strong, and enduring revenue growth and provide significant additional capacity.

General rates scenarios: one-off rates increases*

Average general rates increase	Revenue change		Borrowing Capacity (Year 1)	Additional cost for $1m residential property
	1-year	10-years		
5%	$26m	$339m	$77m	$36
7%	$62m	$791m	$180m	$84
9%	$97m	$1,244m	$282m	$132
12%	$150m	$1,922m	$436m	$203

* Returning to 3.5% from year two

5% general rates increase in Year One only*



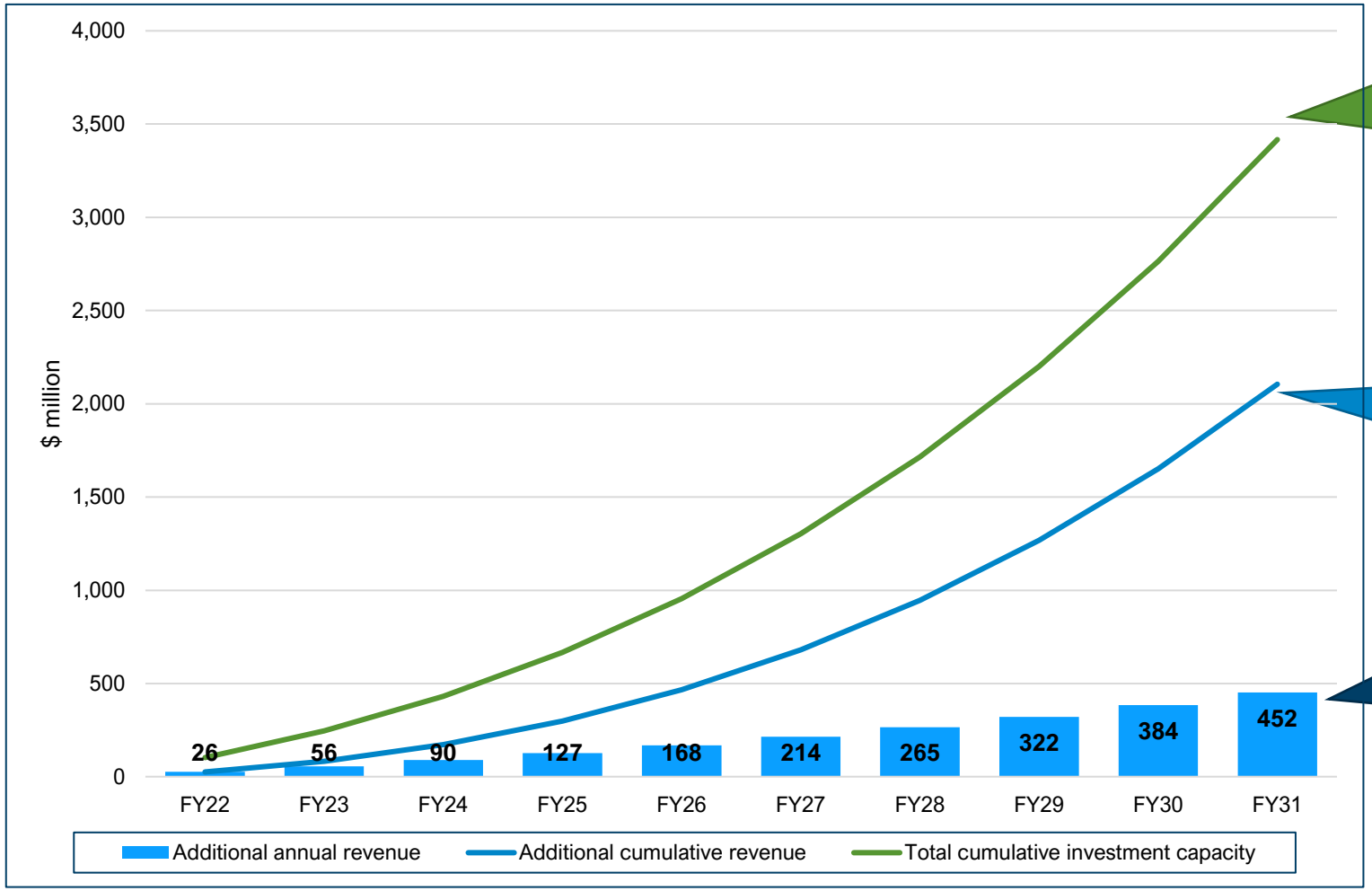
3. The revenue can also be leveraged at our debt limit allowing a total of over $450M additional investment

2. Over the 10-years this adds together to a total of $339M of revenue

1. Generates an additional $26M of revenue per annum, growing over time

* Returning to 3.5% from year two

5% general rates increase in every year of LTP



3. The revenue can also be leveraged at our debt limit allowing a total of over $3.4 billion additional investment

2. Over the 10-years this adds together to a total of over $2 billion of revenue

1. Generates an additional $26M of revenue per annum, growing strongly over time

Debt settings

- What is the opportunity
  - Better balance between supply and demand, more progress on important things over the next three years
  - Reduced operational risk profile
  - Fair approach given investment is in long-life assets
- What are the risks and trade-offs?
  - Higher financial risk, less able to deal with new shocks, increased chance that external factors impact on our AA/Aa2 credit ratings
  - Needs to be repaid, may put greater pressure on rates requirements in the future
  - May need to pay more attention to annual cashflows, operating budget performance, capital deficit and level of interest costs
  - May need to maintain greater capital flexibility, so reduced ability to make long-term commitments and more staged approach to some infrastructure

Debt settings

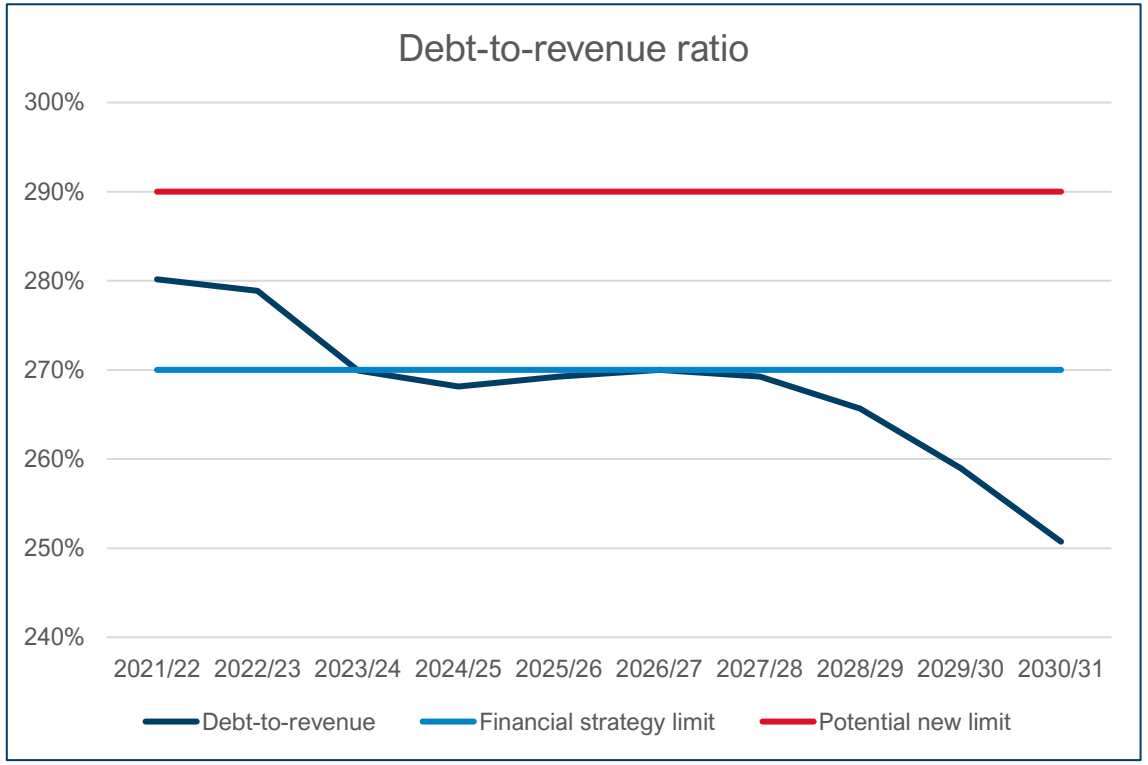
- Three possible scenarios for how we could use debt:

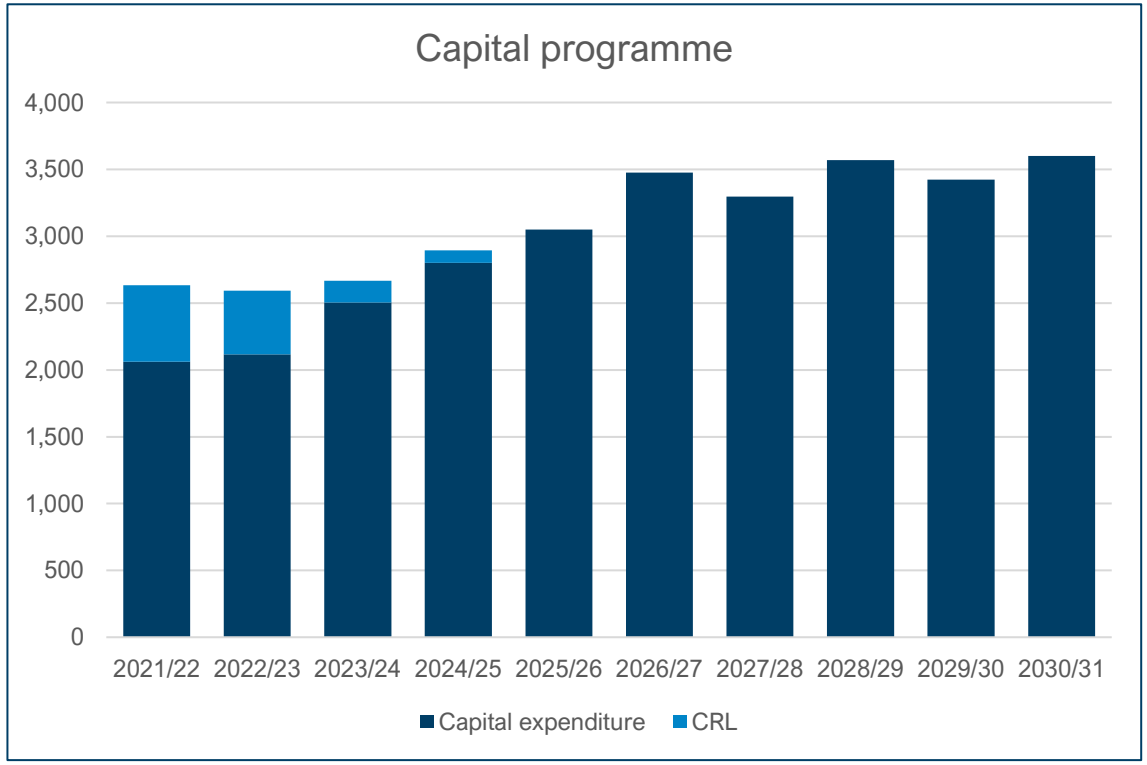
Name	Description
Highly constrained scenario	What we can afford based on current rates and debt settings (not withstanding a temporary departure from policy limits)
Maximum debt scenario	What we can afford by permanently going to the limits of what we can borrow based on the latest information from our credit rating agency (290%)
Accelerated investment scenario	What our investment profile would be if we used the new information from our credit rating agencies to invest more in the short-term but seek to create a prudent level of spare debt headroom by the end of the 10-year LTP period to enable us to deal with any future shocks

Highly constrained scenario

- This shows what could be achieved with temporarily elevated debt level but a prompt return to the current debt limit of 270%
- This could fund $31 billion of capital investment over 10 years
- Investment in the first three years would be constrained to around $2.6b per annum for the first three years
- This would enable committed and critical investment to proceed within the next three years, including Watercare's AMP 3b scenario, Healthy Water's recommended AMP and Auckland Transport purchase of EMUs to support CRL
- Most discretionary investments (both capex and opex) will not be able to be funded within those three years
- Outer year settings sustainable, but achievement of 100% depreciation funding delayed by three years until 2028

Highly constrained scenario





S&P Budgetary performance measure:
(out of five, one high)

- 4 for first six years of plan
- Drops to 3 for years 7-9 and 2 for year 10

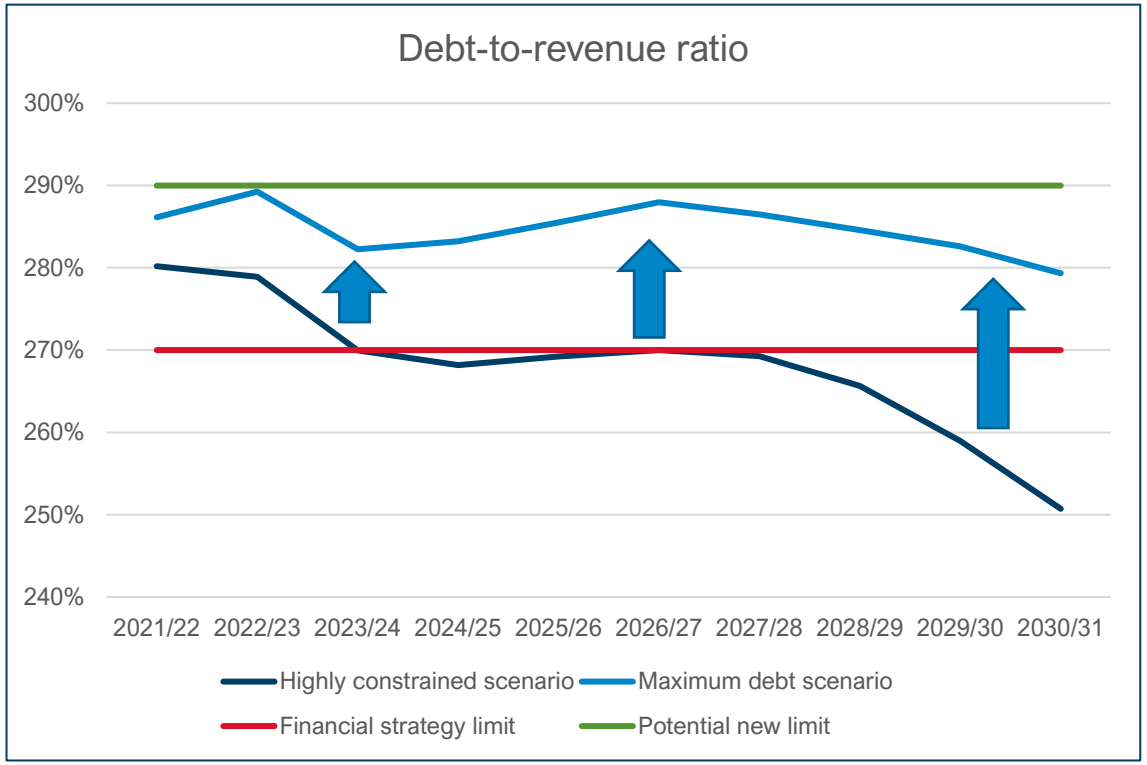
Balanced budget / funded depreciation:

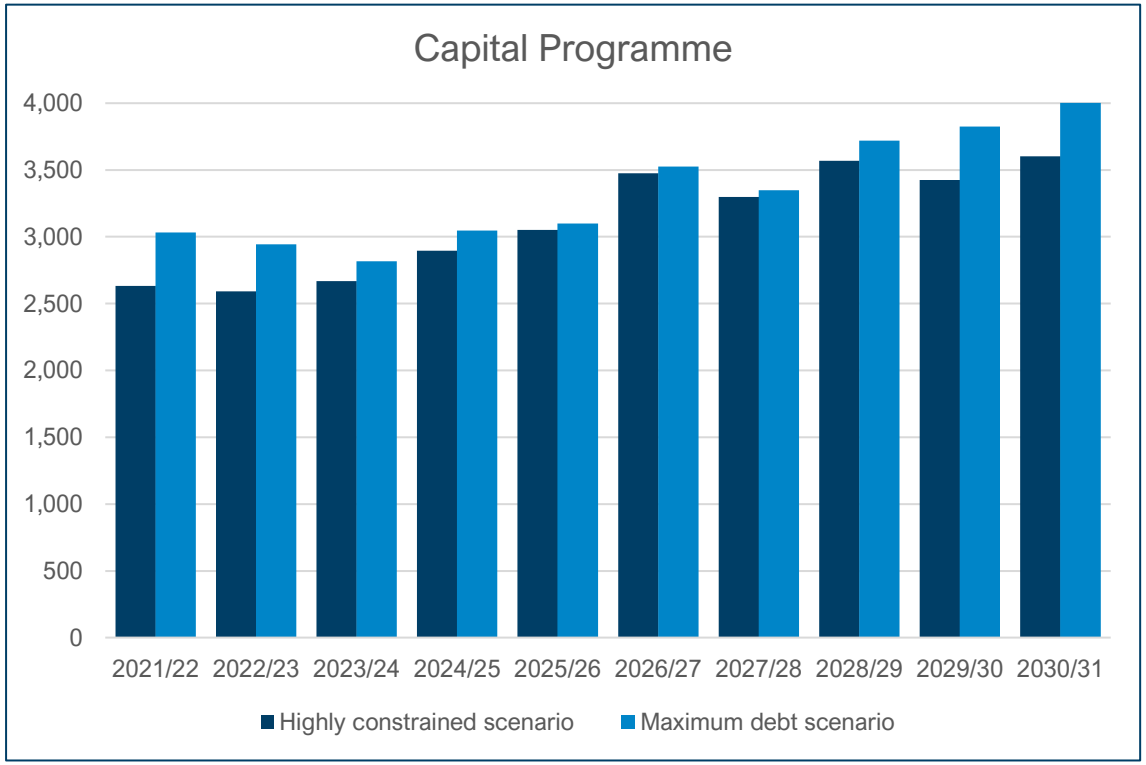
- Three-year delay in moving to fully funded depreciation

Maximum debt scenario

- Credit rating agencies have indicated debt to revenue limit could be lifted to 290% as the “new normal”
- Modelling suggests this could support $33b over ten years and $2.9-3 billion per annum in first three years
- Less than the $3.5 billion of demand – still need to prioritise
- Some important caveats:
  - After capital deficit, capex flexibility, budgetary performance, level of interest costs
- Further delays with funding 100% of depreciation
- Overall cash outflows of $700-800m per annum (10% to 15% of revenue) need to be debt funded on ongoing basis
- No headroom to respond to future shocks or new priorities

Maximum debt scenario





S&P Budgetary performance measure:
(out of five, one high)

- 4 for first nine years of plan
- Only drops to 3 for year 10

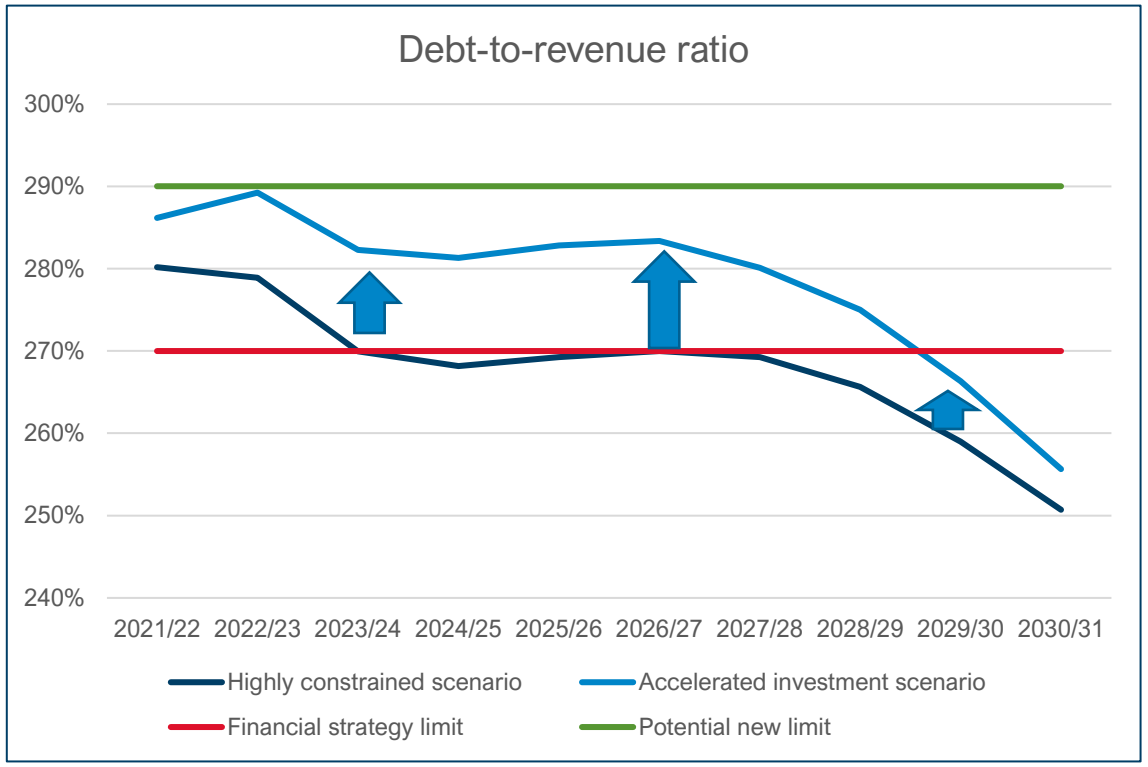
Balanced budget / funded depreciation:

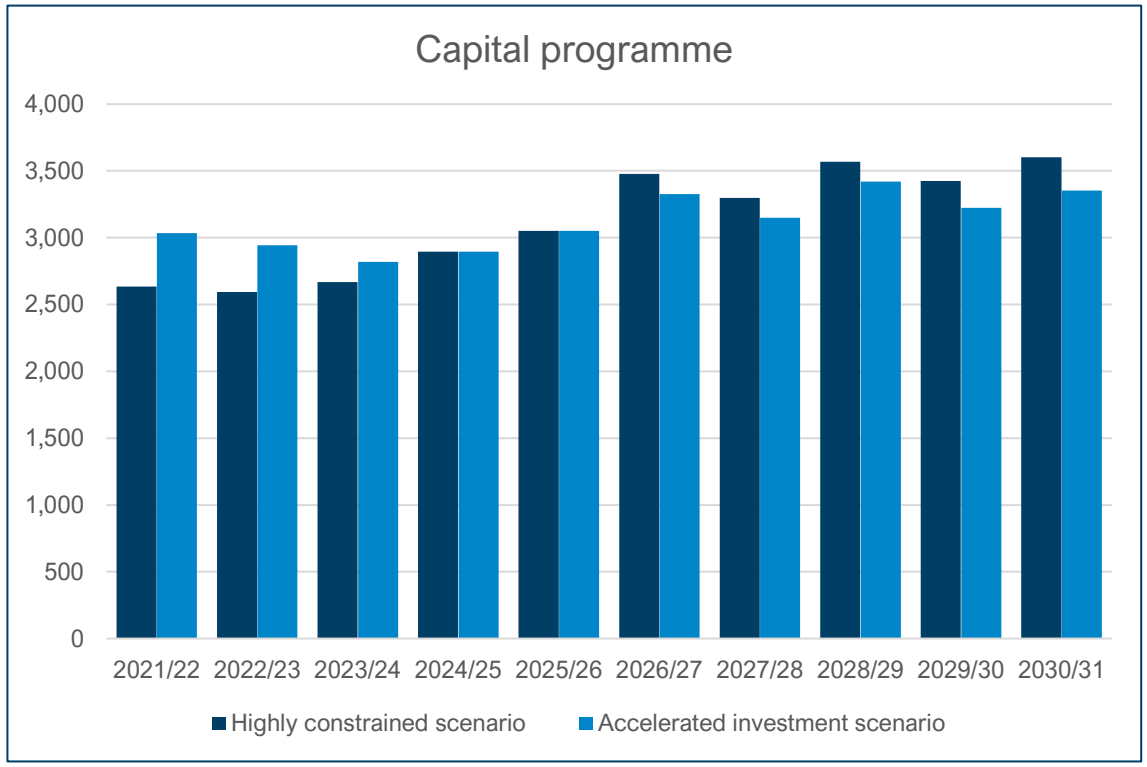
- Four-year delay in moving to fully funded depreciation

Accelerated investment scenario

- A more prudent approach would be to use the additional debt headroom associated with the new information in the short to medium term, but move back towards more prudent settings over time to leave greater headroom for future shocks
- A sensible profile might be limiting debt to 290% for first three years and then gradually reducing this to close to 250% by the end of the 10-year LTP period
- This could support $31 billion over ten years, and $2.9-3 billion per annum in first three years
- By the end of 10 years, operating cashflows are almost sufficient to fund net capital requirements without ongoing use of debt
- Limited headroom to deal with new shocks in short-term
- Alleviates key debt pinch point caused by the current COVID-19 situation while moving to a more prudent position over time.

Accelerated investment scenario





S&P Budgetary performance measure:
(out of five, one high)

- 4 for first six years of plan
- Drops to 3 for years 7 & 8 and 2 for years 9 &10

Balanced budget / funded depreciation:

- Four-year delay in moving to fully funded depreciation

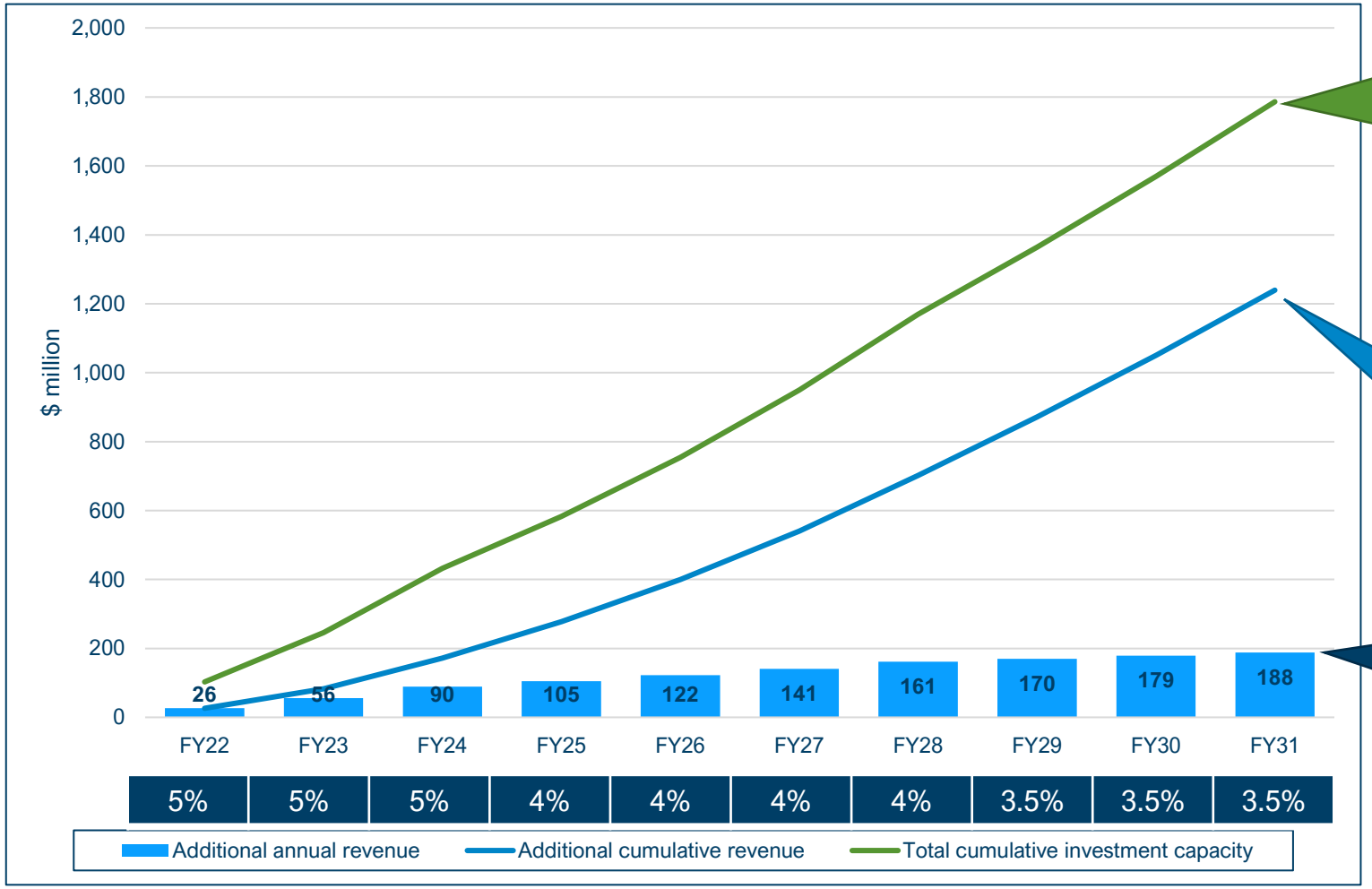
What could be achieved under this new debt scenario?

- Would not fund everything, still need to prioritise and make trade-offs
- Could make significantly more progress in first three years on items of high strategic priority and reduce operational risk profile
- Would better support Auckland's economic recovery
- Ongoing work on risk-based capex prioritisation should provide better information to inform decision-making

Revenue supported scenario

- Could choose to pull revenue lever rather than debt
- Higher rates increases could reduce asset risk while providing debt headroom to address shocks or take advantage of opportunities.
- Average general rates increases of:
  - Years 1-3 5% per annum
  - Years 4-7 4% per annum
  - Years 8-10 3.5% per annum
- This could support the same $33 billion of investment as the maximum debt scenario while returning debt-to-revenue to close to the current 270% policy limit

Revenue supported scenario

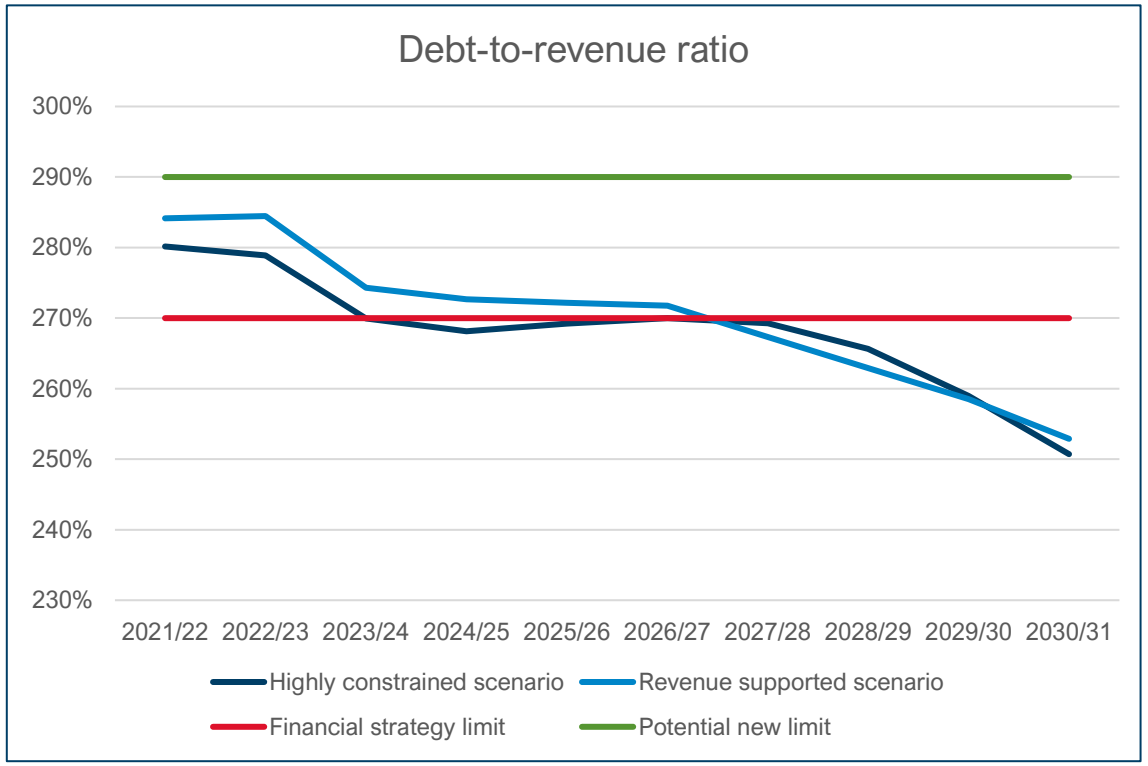


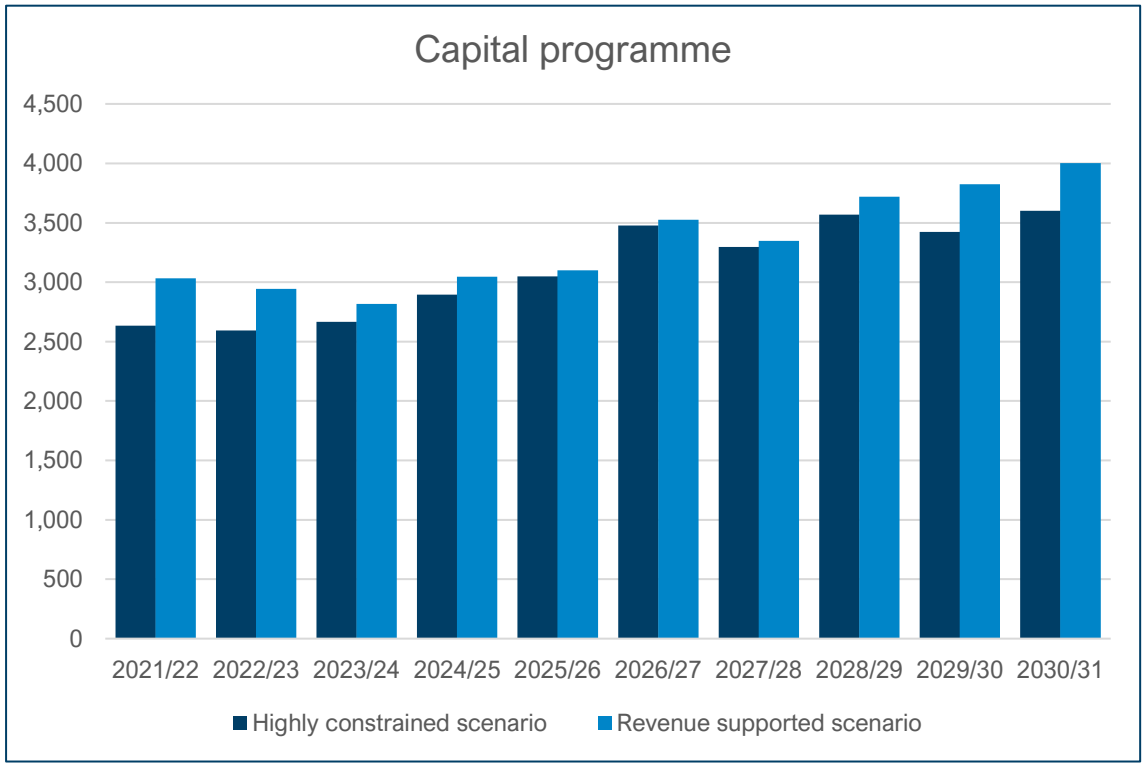
3. The revenue can also be leveraged at our debt limit allowing a total of almost $1.8 billion additional investment

2. Over the 10-years this adds together to a total of over $1.2 billion of revenue

1. Generates an additional $26M of revenue per annum, growing over time

Revenue supported scenario





S&P Budgetary performance measure:
(out of five, one high)

- 4 for first six years of plan
- Drops to 3 for remainder

Balanced budget / funded depreciation:

- Two-year delay in moving to fully funded depreciation