Draft LTP Budget for Consultation

Te take mō te pūrongo
Purpose of the report

1. To support the Mayoral Proposal and council decision-making on draft budgets for consultation on the Auckland Council group's 10-year Budget 2021-2031. This 10-year Budget is also known as the council groups's Long-term Plan (LTP).

Whakarāpopototanga matua
Executive summary

2. The latest projections are that the COVID-19 situation and impacts on the Council's revenue will persist for longer than previously anticipated. Combined with the $450 million impact in the Emergency Budget, the total impact on council's cash revenue is around $1 billion over four years.
3. In addition, a bottom-up refresh of budgets across the group has identified a substantial increase in investment demand. This identified $8 billion of additional capital investment demand over ten years and operational expenditure cost pressures of around $100 million per annum over the next three years and growing over time.
4. Investment increases of this magnitude are not achievable given the council's current debt and revenue settings. Therefore, a range of options to mitigate this situation are considered in this report.
5. Discussions with our credit rating agencies have identified that we have some capacity for moderate increases in debt which may help us respond to these pressures. However, we need to ensure that we keep our borrowing prudent and maintain enough capacity to respond to future shocks.
6. For this 10-year Budget, the council needs to balance growing investment demand with limited investment supply, and reduced supply in the short-term due to the ongoing COVID-19 revenue impacts. We need to make practical decisions for the next three years based on what is most urgent but also remain cognisant of longer-term risks and trade-offs.
7. No single factor will be enough to resolve this situation and achieve an acceptable outcome. The solution will need to involve some combination of changes to key investment, revenue and debt settings. To help understand the key trade-offs, some financial scenario modelling has been undertaken which pull these levers to differing degrees.
8. The results of this analysis indicate that a highly constrained investment scenario is likely to be unacceptable because of the high risk to council assets and service and the lack of progress with strategic and growth objectives. A maximum debt scenario would go a long way to mitigating this, but at the cost of leaving minimal headroom to deal with future shocks.
9. This suggests that the council needs to make a choice about the right mix of debt and revenue settings to resolve this situation. Ultimately, greater use of the revenue lever will allow more investment to occur over time and lead to a more sustainable operating position for the council, but with potential trade-offs in terms of affordability for the community.
10. Staff have prepared a detailed set of 10-year financial projections for the high constrained scenario which represents what can be achieved within current revenue and debt settings. This provide a good benchmark to compare other proposals. Staff recommend using this data set as the cornerstone for draft prospective financial information to support public consultation on the 10-year Budget 2021-2031.
11. To address the limitations of the highly constrained budget scenario, staff also recommend that one or more alternative proposals are consulted on via the 10-year Budget 2021-2031.

12. Information is included in this report and its attachments to help the public understand the likely practical implications of an alternative scenario compared to the highly constrained baseline.

Ngā tūtohunga
Recommendation/s

That the Mayor:

a) agree that the draft budgets set out in Attachment D to this report form the basis of the detailed financial information required to support public consultation on Auckland Council's 10-year Budget 2021-2031, subject to any specific budget adjustments in the Mayoral Proposal not already reflected in Attachment D.

b) agree to consult via the 10-year Budget process on one or more, or some confirmation of the alternative budget scenarios set out in this report.

Horopaki
Context

13. In June 2018, Auckland Council adopted its current 10-year Budget 2018-2028 with a $26 billion capital investment programme over ten years supported by a regional fuel tax and a new water quality targeted rate. Budget projections have been subsequently updated through Annual Budget processes and to reflect a decision in April 2019 for Auckland Council to make budget provision of an additional $500 million of investment in the City Rail Link.

14. The most recent updates were agreed as part of adopting the Emergency Budget 2020/2021 in July 2020. This budget responded to the twin challenges of a $450 million revenue shortfall due to the impacts of COVID-19 and the need to fund $239 million of new water supply expenditure to respond to Auckland's drought.

15. To mitigate these challenges, the Emergency Budget included a mix of capital expenditure deferrals, operating expenditure reductions, property asset recycling targets and a temporarily elevated debt to revenue ratio. When this budget was set, the impacts of COVID-19 and therefore the set of mitigating actions, were expected to primarily affect the 2020/2021 year.

16. The latest projections are that the COVID-19 situation and impacts on the Council's revenue will persist for longer than previously anticipated. In particular, this includes revenue reductions for Ports of Auckland Limited, public transport, regulatory revenue, revenue from conventions and stadiums and dividends from Auckland International Airport Limited. This has been exacerbated by the current drought situation and associated water restrictions as well as some reductions in revenue from commercial contracts across the Council group.

17. While the outlook remains uncertain, the indicative magnitude of these impacts on the likely reductions in Council's cash operating revenue relative to pre-COVID-19 budget projections are as follows:

Financial year	Cash revenue impact
2021/2022	$260m
2022/2023	$170m
2023/2024	$110m

18. These projections were publicly released on 11 November 2020. Combined with the $450 million impact in the Emergency Budget, the total impact on council's cash revenue is around $1 billion over four years.

Tātaritanga me ngā tohutohu
Analysis and advice

Budget update process

19. The process to update budgets across the group has involved three phases:
    1) Top down direction on a common set of group-level forecasting assumptions
    2) Bottom-up refresh of budgets based on the forecasting assumptions
    3) Top down direction on mitigations to ensure proposed budgets are affordable.

20. The forecasting assumptions used for this process were informed by a range of internal and external inputs with the assistance of the council's Chief Economist.

21. A report on these assumptions was considered by the Audit and Risk Committee on 14 October 2020 which noted the high level of uncertainty surrounding these assumptions and resolved to advise the Finance and Performance Committee that:

    "the methodology used to develop the COVID-19 related significant forecasting assumptions for the LTP 2021-2031 is complete, reasonable and supportable given the uncertainty." (Resolution number AUD/2020/75)

22. In addition to the revenue impacts noted above, the bottom-up refresh of budgets by the group also identified a substantial increase in investment demand. This included:
    - a projected 10-year capital investment requirement across the council group of around $35 billion (compared to pre-COVID budget projections of $27 billion), and
    - operational expenditure cost pressures of around $100 million per annum over the next three years and growing over time.

23. Investment increases of this magnitude are not achievable given the council's current debt and revenue settings. The remainder of this report addresses the third and final stage of our budget update process which focuses on the range of options to mitigate this situation.

24. A detailed analysis of the results of the budget update process completed so far are set out in Attachment A.

Key principles

25. The following criteria and principles were used to develop the Emergency Budget 2020/2021, all of which are also important considerations for making decisions for the 10-year Budget 2021-2031:
    - ensuring long-term financial prudence and sustainability - ensuring the council can continue to access capital markets on favourable terms to finance the investments required to progress its long-term objectives, and avoid placing an unsustainable debt burden on future ratepayers
    - honouring contractual commitments – avoiding the cost and any other adverse consequences of cancelling in-flight projects or long-term operational contracts. The extent of change may require some contracts to be reviewed, varied or renegotiated, but unilateral cancellation of contracts should generally be avoided.
    - protecting public health and safety – ensuring changes do not result in unacceptable risks to the health and safety of our community
    - preserving asset integrity – ensuring short-term changes do not lead to severe and irreversible long-term declines in the condition of critical assets.

- statutory obligations – ensuring we are able to continue to comply with key legislative requirements for the provision of council services.
- Māori outcomes – ensuring that we continue to honour our commitments to Māori and that we continue to act in accordance with our statutory provisions relating to Te Tiriti o Waitangi.
- jobs and employment – minimising the impact of changes on jobs and businesses in Auckland. While a material impact is now unavoidable, different changes have different impacts on employment outcomes. Where possible, preferences should be given to budget changes with the least impact on employment outcomes for Auckland, regardless of whether or not the council group is the employer.
- ease of implementation - some changes can be implemented quickly and easily, while others will be long, complex and less certain. Where possible, preference should be given to the budget changes that are quick to implement and have less implementation risk.
- protecting the most vulnerable - some changes may have material impacts on the most vulnerable people within our community. Such changes should be avoided or minimised wherever possible.
- supporting our communities – the council plays a key role in supporting a number of community organisations. Some of these organisations are facing a greater increase in community need while their other funding sources are at risk. Wherever possible, changes should at least avoid making these community groups an worse off.
- climate change – different changes will have different implications for 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.

Strategic considerations

26. To ensure certain high priority strategic outcomes are adequately considered across all elements of the 10-year Budget 2021-2031 the council is utilising four strategic lenses. These lenses build on some of the considerations above and are defined as follows:
    - recovery lens – helping to rebuild economic activity, supporting sustainable employment and promoting cohesive, inclusive and resilient communities
    - Māori outcomes lens – ensuring sufficient progress against the ten priority Māori outcome areas using the Kia Ora Tāmaki Makaurau performance framework
    - climate lens – exploring all opportunities for mitigating and adapting to climate change
    - development lens – taking a spatial view to ensure better alignment of efforts to support housing and development.
27. These four lenses are built on and are entirely consistent with the council's long-term strategic direction as set out in the Auckland Plan 2050. They just seek to provide greater guidance and focus on the key priority areas at this point in time and in the current circumstances.

Economic considerations

28. 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.

29. 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.

30. 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.

Financial prudence considerations

31. 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.

32. 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.

33. 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, 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.

34. Further resolutions relating to financial prudence may be necessary as part of developing the 10-year Budget 2021-2031.

Risk-based prioritisation

35. The considerations above can be viewed as a set of risk factors that cover financial risk, operational risk and the risk of strategic misalignment.

36. Without quality information and advice presented in a consistent way across the council group, there is a risk that budget decisions could be made that lead to unacceptable or sub-optimal risks to council assets and services.

37. To mitigate this, a risk-based capital investment prioritisation exercise is underway based on consistent criteria across the group and with high levels of participation of subject matter experts from the different entities within the group. This work seeks to analyse the risk associated with various levels and timing of capital investment and ensure that elected members receive quality advice to inform their investment decision-making.

38. To date this has focussed on the prioritisation of capital investment across the group. Phase 1 of this work involved a rapid assessment of projects and programmes into broad categories with differing risk profiles to allow an initial assessment of capacity to deliver on critical capital requirements.

39. The details of the risk-based prioritisation framework being employed is set out in Attachment B. Further work is now underway to refine this prioritisation framework and provide more granular advice at a project and programme level.

The key challenge

40. In each 10-year budget the council needs to carefully balance the need for investment in our city with ensuring that the costs of that investment are acceptable, both now and into the future.

41. We now know that the council is vulnerable to shocks as evidenced by:

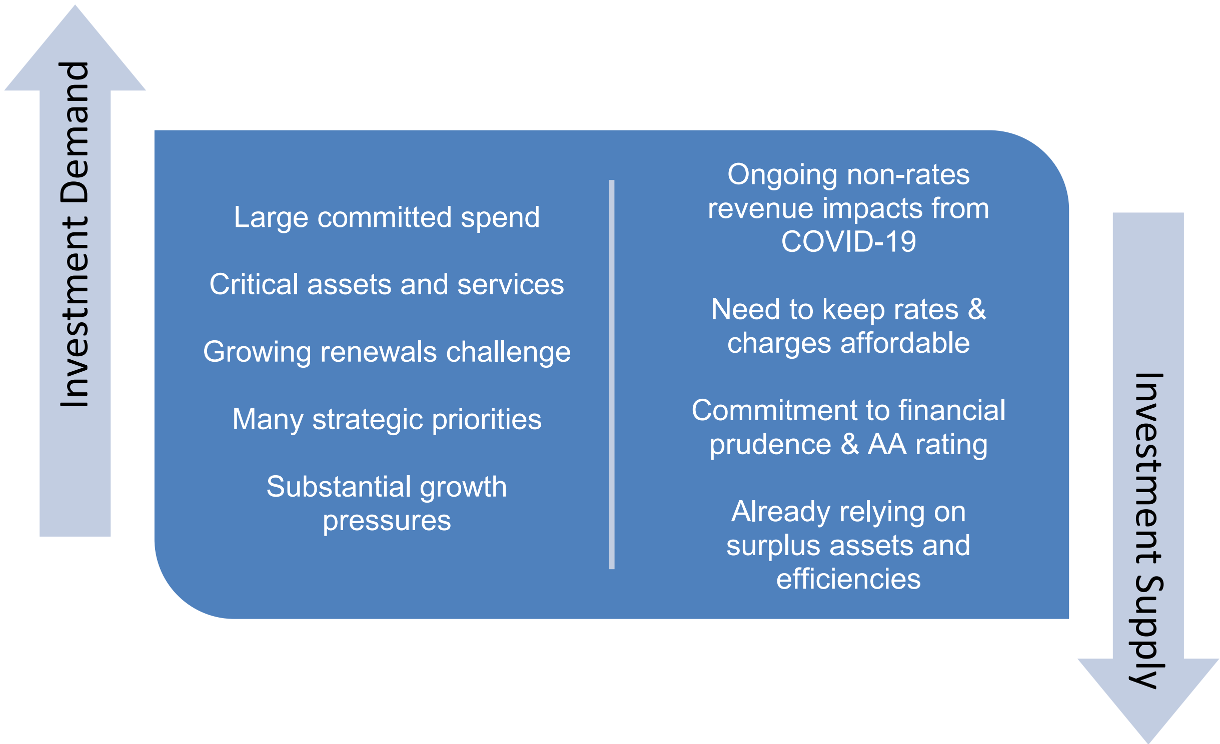
    1) The additional investment required in the City Rail Link project agreed to in 2019
    2) The ongoing COVID-19 disruption and revenue impacts
    3) The urgent need for investment to respond to Auckland's drought

42. Updates of asset management plans across the group have now also identified high levels of asset risk and significant additional investment levels to address growth and meet strategic objectives.

43. Discussions with our credit rating agencies have identified that we have some capacity for moderate increases in debt which may help us respond to these pressures. However, we need to ensure that we keep our borrowing prudent and maintain enough capacity to respond to future shocks.

44. For this 10-year Budget, the council needs to balance growing investment demand with limited investment supply, and reduced supply in the short-term due to the ongoing COVID-19 revenue impacts. We need to make practical decisions for the next three years based on what is most urgent but also remain cognisant of longer-term risks and trade-offs.

45. The key drivers of this growing gap between investment demand and supply are summarised in the following diagram:



46. The identified capital investment demand of $35 billion over 10-years and the operating cost pressures of around $100 million over the next three years are not affordable under our current revenue and debt settings.

47. Balancing this equation means considering key trade-offs between our settings for investment levels, revenue and debt.

48. Considering investment settings involves assessing the risks to key council assets and services, and the rate of progress we need to make in pursuing our strategic and growth objectives.

49. Considering revenue settings involves assessing the amount of income that is needed to sustainably balance our levels of expenditure and what pricing paths for rates, fees and

charges are affordable and acceptable to our community. In addition to supporting capital investment, revenue growth may help better address the council's operating budget position over the long-term and better support elevated debt levels.

50. Considering debt settings is about determining what is prudent and how much headroom we need to maintain the capacity to respond to future shocks. While our rating agencies have indicated that we have some capacity for higher debt levels, they have also indicated that if we moved to those higher setting we would need to keep a careful eye on our interest cost levels, annual cashflow position and the degree of flexibility in our capital programme.

51. Another consideration is that the principle of intergenerational equity suggests using debt is a fair way to spread the cost of long-life infrastructure assets over current and future ratepayers.

52. Financial modelling has indicated that if this situation was to be mitigated by pulling just one primary lever, then one of the following mitigations would be required:

- the council's key debt to revenue would need to rise to 330% which is significantly less prudent that the current 270% policy limit, or
- general rates would need to increase by 12.5% each year for the next three years which would likely create affordability issues for many ratepayers, or
- capital and operating expenditure would need to be highly constrained for the next three years, with some severe consequences for council's operations and strategic objectives.

53. Clearly, relying on a single one of these three levers will not lead to an acceptable outcome and so they need to be considered together.

Budget scenarios

54. To help understand the key trade-offs, some financial scenario modelling involving the three settings has been completed and is set out in Attachment C.

55. The four example scenarios considered in that attachment are described in the following table:

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 agencies
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
Revenue supported scenario	What our investment profile might be if we relied primarily on changes to revenue settings (rather than increasing the ratio of debt to revenue) to reduce our asset risks

56. The key parameters and outputs from this scenario modelling are set out in the following table:

	Scenario			
Parameter	Highly constrained	Maximum debt	Accelerated investment	Revenue supported
Revenue	3.5% rates increase p.a.	3.5% rates increase p.a.	3.5% rates increase p.a.	Higher increases, reducing over time

Debt policy	Return to within 270% by year 3	Limit to 290%	280% by year 8, <260% by year 10	<270 year 7 <260% year by 9
Capital investment next 3 years	$2.6 billion p.a.	$2.9 billion p.a	$2.9 billion p.a	$2.9 billion p.a
Capital investment 10-year total	$31 billion	$33 billion	$31 billion, but more frontloaded	$33 billion
Financial risk	Moderate	High	Moderate	Moderate
Operational / investment risk	High	Moderate	Moderate	Moderate

57. These results indicate that the highly constrained scenario is likely to be unacceptable because of the high risk to council assets and service and the lack of progress with strategic and growth objectives. The maximum debt scenario would go a long way to mitigating this, but at the cost of leaving minimal headroom to deal with future shocks.

58. This leaves the last two scenarios, which effectively provide choice about the right mix of debt and revenue settings to resolve this situation. Ultimately, greater use of the revenue lever will allow more investment to occur over time and lead to a more sustainable operating position for the council, but with potential trade-offs in terms of affordability for the community.

Baseline budgets: Highly constrained scenario

59. Staff have prepared a detailed set of 10-year financial projections for the high constrained scenario which represents what can be achieved within current revenue and debt settings.

60. While this may not be the preferred or even an acceptable scenario, it does provide a good base to work from and as a key benchmark to compare other proposals. Staff recommend using this data set as the cornerstone for draft prospective financial information to support public consultation on the 10-year Budget 2021-2031.

61. The key operating and capital budget lines under this scenario are set out in Attachment D. The attachment also sets out what key investments could be delivered over the next three years (with an average capital investment of $2.6 billion per annum) and what the key risks and trade-offs are of not being able to fully meet investment demand.

62. The key assumptions underpinning this scenario include:

- Average general rates increase of 3.5% each year
- A return to within the current 270% debt policy limit by year three of the plan
- Extending the Water Quality Targeted Rate and Natural Environment Targeted Rate to end in 2031 (aligned to the 10-year period of the 10-year Budget)
- Equivalent RFT amount in last three years
- $90 million of the $120 million costs savings for Auckland Council in the Emergency Budget could be maintained on an ongoing basis
- A Watercare investment profile and price increases that maintain their debt to revenue ratio below 340% for the first three years
- An increase in the target for asset recycling for each of the next three years from $20 million to $70 million per annum.

63. Attachment E sets out an overview of the council's asset recycling opportunities and demonstrates that there is a credible opportunity to realise the higher targets assumed in this scenario.

Proposals for alternative scenarios

64. To address the limitations of the highly constrained budget scenario, and to enable flexibility in decision-making following consultation given the uncertainty, staff recommend that one or more alternative proposals are consulted on via the 10-year Budget 2021-2031.

65. None of the scenarios discussed here would fund all of the investment demand outlined in the draft Asset Management Plans across the group, so the council would still need to prioritise and make trade-offs. The ongoing work on risk-based capital prioritisation should assist with this over the course of the 10-year Budget process.

66. In Attachment D, staff have also provided an indication of what more might be able to be achieved under a proposed alternative scenario that supported capital investment of $2.9 billion on average for the next three years rather than the $2.6 billion in the highly constrained scenario. This kind of information would help the public understand the likely practical implications of an alternative financial scenario.

Tauākī whakaaweawe āhuarangi
Climate impact statement

67. Options for increased investment to accelerate action in response to climate change are presented in a separate document. This is a key priority area and the climate strategic lens has been used through the 10-year Budget process to ensure adequate focus has been given to this matter across all council activities.

68. In the highly constrained scenario, a wide range of actions to mitigate and adapt to climate change would still be progressed across the council group, but the additional capacity provides under an alternative scenario would allow more progress to made in this key area.

Ngā whakaaweawe me ngā tirohanga a te rōpū Kaunihera

Council group impacts and views

69. The budget information set out in this report and its attachments is based on budget information submitted by organisation from across the council group. Each of the council's Council Controlled Organisations (CCOs) engaged with their board of directors on their initial budget submissions.

70. The Chairperson, Chief Executive and other key staff from each CCO have had the opportunity to directly participate in some key Finance and Performance Committee workshops on the 10-year Budget.

71. Further information and input will be sought from across the council group as the 10-year Budget progresses.

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

72. Information about the work on the 10-year Budget has been shared with local boards throughout this process. Local Board Chairs have been included in a series of Finance and Performance Committee workshops to discuss this work.

73. Local Boards have been invited to provide their specific views on the Mayoral Proposal for the 10-year Budget to the committee.

74. Part of the process for finalising the 10-year Budget (including 21 local board agreements) will include further engagement with local boards.

Tauākī whakaaweawe Māori

Māori impact statement

75. Māori are particularly vulnerable to the impacts of COVID-19. Opportunities are being considered to repurpose existing Māori Outcomes budget to support Māori-led responses to and recovery from COVID-19.

76. Māori Outcomes is a key priority area and the Māori Outcomes strategic lens has been used through the 10-year Budget process to ensure adequate focus has been given to this matter across all council activities.

77. In the highly constrained scenario, existing commitments to progressing Māori Outcomes will be progressed as a matter of high priority. With the additional capacity provided under an alternative scenario, it may be possible to make more progress to made in this key area and to mitigate any risks of delays to achieving the intended outcomes.

Ngā ritenga ā-pūtea

Financial implications

78. Financial implications are discussed in the body of this report, with further details set out in the attachments.

Ngā raru tūpono me ngā whakamaurutanga
Risks and mitigations

79. The high-level financial, operational and strategic risks associated with the 10-year Budget are discussed in the body of this report.

80. The Audit and Risk Committee plays a key role in maintaining oversight and advising the Governing Body on the management of significant financial risks and the associated compliance matters, including whether or not a robust process has been followed.

81. Staff reported to the Audit and Risk Committee on 14 October 2020 on the process, methodology and underlying assumptions used to assess the financial implications of the COVID-19 situation on the council group. The committee's oversight role of 10-year Budget process and key risks is ongoing. Consultation materials will be presented to the committee ahead of the Governing Body adopting these for public consultation in February 2021.

Ngā koringa ā-muri
Next steps

82. On 9 December 2020, the Finance and Performance Committee will consider the Mayoral Proposal for the 10-year Budget 2021-2031 along with other reports from staff and agree on the items for public consultation via the 10-year Budget process.

83. Staff will then prepare draft consultation materials based on the Mayoral Proposal and the decisions of the committee and submit these for audit review before Christmas. The Governing Body will be asked to adopt the consultation materials in February after the audit review is complete and the Audit and Risk Committee has met to consider the audit findings.

84. After public consultation is complete, the Finance and Performance Committee will consider the results of the public feedback, the views of local boards and the latest information from internal and external sources to develop final budgets. The Governing Body will then adopt the final 10-year Budget 2021-2031 by 30 June 2021.

Ngā tāpirihanga
Attachments

No.	Title	Page
A	Budget update process and results	
B	Risk-based prioritisation framework	
C	Scenario modelling	
D	Highly constrained scenario	
E	Asset recycling opportunities	

Ngā kaihaina
Signatories

Authors	Ross Tucker - General Manager, Financial Strategy and Planning
Authorisers	Kevin Ramsay – Acting Group Chief Financial Officer