Hawke's Bay Regional Council

Long Term Plan 2015-25

Part 2 | Financial Strategy

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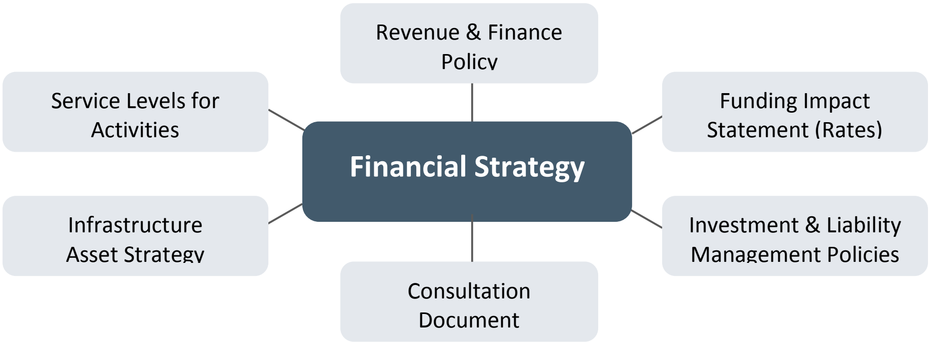
Section 1 - Introduction

1.1 Reason for Financial Strategy

The purpose of this financial strategy is to demonstrate prudent financial management by Hawke's Bay Regional Council (HBRC) when considering proposals for funding and expenditure as presented in this Long Term Plan (LTP). Furthermore, this strategy will endeavour to make transparent the overall effects of these strategies on HBRC's services, rates, debt and investments.

1.2 Importance of Financial Strategy to Other Sections of this Long Term Plan

The Financial Strategy informs and guides the assessment of funding and expenditure proposals outlined in the LTP. This Strategy links and drives the context of the other related sections included in the LTP. The diagram below best illustrates this.



1.3 Changes in Population

Since 2009 the Hawke's Bay population has increased by 2.8%, compared to the national increase at 4.8% (led by the Nelson, Auckland and Waikato regions). Hawke's Bay's growth rate over the period places it above the Gisborne, Manawatu-Wanganui, Marlborough, West Coast and Canterbury regions and on par with Southland region.

HBRC has not taken into account forecast changes in the population, economic activity or climate change. It is considered that the impact of any changes in these statistics will have a minimal or very low effect on the Plan's projections.

1.4 Change in Land Use/Economics

Hawke's Bay's economy is largely a rural economy dominated by export orientated primary production including value added processing and is therefore exposed to significant environmental (e.g. climatic) and international market fluctuations.

Primary production and related processing sectors account for approximately 30% of total regional employment compared to 12% nationally. The Hawke's Bay percentage increases further when all the different industries servicing the rural sector (e.g. specialised manufacturing, energy supply, building construction, wholesale and retailing of rural supplies, Napier Port and road/rail freight transport, communications and business/financial services) are also taken into account.

The Hawke's Bay economy is underpinned by the private business sectors many of which focus on commodity products for export. HBRC's strategies in this LTP are geared to providing economic stimulus by directing investment funds into those areas that support core competencies in our region and that will drive economic activity and their associated multiplier effects.

1.5 HBRC's Current Funding Position

The following table sets out the funding of HBRC's operating and capital requirements as detailed in the 2014/15 Annual Plan.

Funding of HBRC's Operating and Capital Requirements		
Funding	**$Million**	**% of Total**
General Rates	2.8	3.5%
Targeted Rates	12.9	16.3%
Investment Income	14.4	18.2%
Direct charges to customers	6.6	8.4%
Loans	8.2	10.4%
HBRC Reserves	31.3	39.6%
Contributions from Central Government	2.8	3.6%
Total Funding	**79.0**	**100%**

This $79m is required to fund HBRC's operating activities ($41m) and for HBRC's capital/investment programme ($38m).

The rating required to fund HBRC's operations can be kept to a minimum due to interest earned on Council's investments in term deposits and in dividends from Hawke's Bay Regional Investment Company Limited (HBRIC Ltd) through Napier Port.

The capital/investment proposed programme relates to HBRC's funding to cover HBRIC Ltd ($22m), investment in Napier/Gisborne Rail ($3.9m), community lending for Heatsmart programme ($2.6m) and other fixed assets and infrastructure ($5.3m). The funding of this capital/investment programme is proposed to be covered by increased borrowings of Council ($8.2m) and from HBRC reserves ($29.8m).

Section 2 – Council Operations – 10 Year Plan Surplus/Deficit Profile

2.1 Net Surplus/Deficit

The challenges for HBRC is to provide funding for its strategic agenda, specifically in the areas of sustaining natural resources – e.g. water, land use and regional scale infrastructure, as these investments underpin an efficient export based economy whilst maintaining returns from HBRC's investment portfolio at a level which sustains a healthy operating budget. A number of the proposed investments are predicted to provide HBRC with substantial returns in the medium to long term.

This effect of delayed returns on new investment has necessitated differing financial strategies during the term of the 10 years of this Plan.

Financial Strategy

- *Years 1-3 of the Plan*

  Due to the proposed investments in water storage schemes and Napier Gisborne Rail and also to the low interest earned on term deposits (amounts available for investment in term deposits in the first year of the Plan are assumed to be at a level of approximately $*66m*) the financial strategies around these initial years include the following:

  - The attainment of efficiencies of approximately $300k in HBRC's current operations.
  - Increased dividends from HBRIC Ltd (through Napier Port) to assist in providing a return to HBRC on the funds proposed to be invested in the Ruataniwha Water Storage Scheme (RWSS).
  - Use of Council reserves in year 1, specifically the dividend equalisation reserve, which has been set aside to offset fluctuations from HBRC's investment portfolio.

- *Years 4-7 of the Plan*

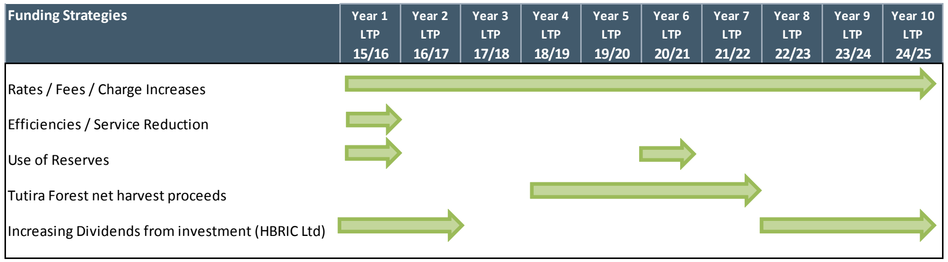
  HBRC currently has forestry assets totalling $4.6m (as at 30 June 2014). Of this forestry estate, 114 hectares in the Tutira country park, currently valued at $2.1m, will when harvested during the four years commencing 2018-19, have an expected yield of $2.8m for the Council during these four years. This is an example of HBRC's investment in growth assets that will reward HBRC in the medium to long term.

  Continued use of the dividend equalisation reserve to offset fluctuations in regional income in year 6.

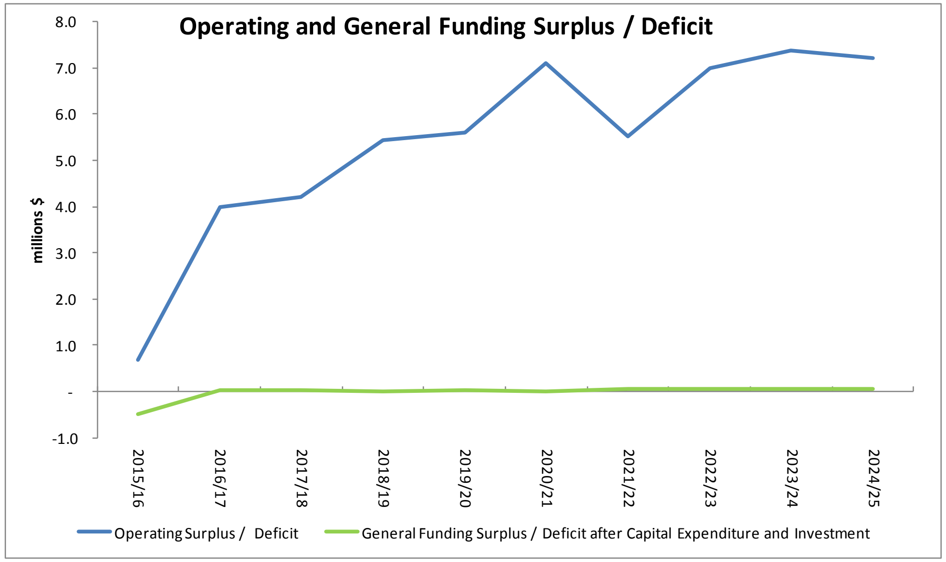
- *Years 8 - 10 of the Plan*

  This is a period where Council can expect an increase in dividend returns from Napier Port which will be derived from the increased tonnages achieved by Napier Port due to the capital expenditure on the continued development of the Port in the early years of the LTP.

The diagram below sets out from a pictorial perspective, the trends outlined above.



The graph below outlines the projected operating and general funded surplus/deficit for HBRC over the 10 year period covered by this Plan.



The operating surplus increases to provide funding for an increasing infrastructure capital programme both within the 10 Year Plan period and for the years subsequent to the Plan.

The net general funded surplus/deficit reflects the amount retained by HBRC after meeting its operating and capital commitments for the year.

2.2 Limits on Rates and Rate Increases

HBRC proposes to limit rate increases to the Local Government cost index (LCGI) plus a level of service adjustment of up to a 3.7%. These level of service adjustments vary from year to year depending on the need for such adjustments to fund increased services. HBRC has resolved to increase their commitment to tourism promotion by $300,000 in 2015-16, a further $300,000 in 2016-17 and a further $300,000 in 2017-18.

The table set out below provides for each year of the Plan, the LCGI, plus the level of service adjustments that it is proposed to make for each year of the Plan.

Year	LCGI	Adjustment for Levels of Service Increases	Total Proposed Increase in Rates
2015-16	2.25%	3.62%	5.87%
2016-17	2.45%	3.24%	5.69%
2017-18	2.53%	2.98%	5.51%
2018-19	2.61%	1.00%	3.61%
2019-20	2.75%	1.00%	3.75%
2020-21	2.90%	1.00%	3.90%
2021-22	3.04%	-	3.04%
2022-23	3.19%	-	3.19%
2023-24	3.36%	-	3.36%
2024-25	3.53%	(2.70%) 1	0.83%

[1] This decrease in the level of service reflects the cessation of the targeted rate on Napier and Hastings rateable properties within the airsheds. It is anticipated this programme will be completed by 2024/25.

There are three major adjustments proposed in HBRC rating for this 10 Year Plan and these are:

- The rates to fund TB Vector services previously collected on all rateable rural land containing 4.0469 hectares within the region will no longer be collected by HBRC.
- Sustainable land management activities that are currently 100% funded from general rates based on land. This Plan proposes that 25% of this activity will now be funded from a targeted rate on all rateable rural land containing 4.0469 hectares in the region.

  As both the TB Vector and Land Management rates are set on an area basis, the adjustments offset one another.
- Increase in the economic development rate to provide funding for further tourism promotion to be carried out by Hawke's Bay Tourism. Increase in rating in years 1 to 3 of the plan provide for an additional $300,000 in 2015-16, a further $300,000 in 2016-17 and a further $300,000 in 2017-18. This has the effect of increasing the tourism promotion funding by $900,000. This increased level is maintained for the remaining seven years of the plan.

The increase in general rates in 2015-16 is for the most part due to the proposed increased expenditure on projects covering environmental sustainability, specifically the development of regional planning policies.

2.3 Impact on Proposed HBRC Service Levels

The following rates levels are set to enable HBRC to maintain the current levels of service and also meet additional service level demand, specifically the implementation of Plan Change 6 in the Tukituki, increased plan and strategy development works and tourism promotion.

Rate Increases/(Decreases)										
Rates ($000's)	2015/16	2016/17	2017/18	2018/19	2019/20	2020/21	2021/22	2022/23	2023/24	2024/25
General Rates	10.25%	3.10%	4.71%	9.53%	7.35%	7.90%	4.04%	3.74%	4.17%	4.07%
Total Targeted Rates	4.90%	6.29%	5.68%	2.30%	2.89%	2.90%	2.79%	3.04%	3.14%	0.04%
Total Rates	5.87%	5.69%	5.51%	3.61%	3.75%	3.90%	3.04%	3.19%	3.36%	0.83%

Financial Measures: Rate Forecasts											
Rates ($000's)	2014/15	2015/16	2016/17	2017/18	2018/19	2019/20	2020/21	2021/22	2022/23	2023/24	2024/25
General Rates	2,839	3,130	3,227	3,379	3,701	3,973	4,287	4,460	4,627	4,820	5,016
Total Targeted Rates	12,826	13,454	14,300	15,112	15,459	15,905	16,366	16,822	17,333	17,878	17,870
Total Rates	15,665	16,584	17,527	18,491	19,160	19,878	20,653	21,282	21,960	22,698	22,886

Projected Number of Rating Units											
	2014/15	2015/16	2016/17	2017/18	2018/19	2019/20	2020/21	2021/22	2022/23	2023/24	2024/25
Rating Units	69,042	70,155	70,330	70,506	70,682	70,859	71,036	71,214	71,392	71,570	71,749

Section 3 – Investment Strategy

3.1 Financial Strategy for HBRC's Investment Portfolio

HBRC's strategic investment agenda is to improve the use of the investment portfolio by moving funding away from investments that either provide low to modest returns (e.g. Napier leasehold land) or do not facilitate regional economic development (e.g. Wellington leasehold properties) and use these funds for investments that promote regional economic development and provide improved returns in the medium to long term on the capital invested. Over the period of the Long Term Plan HBRC will also consider investments that offer opportunities for the diversification of the region's economy.

During 2011-12 HBRC set up an investment company (HBRIC Ltd) with the purpose of improving the diversification of investments and return on HBRC's investments. The brief was for this company to target potential investments in water (storage), land (improved land use/technology), infrastructure (commercial property) and logistics (Napier Port). Investment in any one of these categories has a multiplier effect on any of the other categories – e.g. investment in water storage enhances improved land use and additional tonnage is exported through Napier Port.

HBRC holds approximately $305m in investment assets as at 30 June 2014. The table below sets out the investment asset classes in which HBRC currently undertakes investment, and the proposed change in this allocation during the term of this LTP.

This reallocation of investment funding is geared to meet HBRC's strategic focus areas as shown in the following table.

Investment Asset Class as at 30 June 2014 and 2025

Investment Class	Meet HBRC's Focus Area	Allocation	
		2014	2025
Leasehold Land	-	8%	9%
Water Storage	Regional scale infrastructure	3%	28%
Land Use Change	Natural resource management	1%	2%
Logistics	Regional scale infrastructure	58%	56%
Cash [1]	-	30%	5%
Total		**100%**	**100%**

[1] The cash balances held at 2025 represents special purpose reserves – e.g. regional/scheme disaster reserves and asset replacement reserves.

3.2 Investment Strategies/Economic Drivers/Value of Investment

HBRC's proposed investment areas, subject to Council approval of a sound business case, are set out below.

Proposed Investment Areas			
Item	**HBRC's Investment Provided over the Long Term Plan**		
	Up to 2014-15	**10 Year Plan**	**Total**
Investments Managed Through Hawke's Bay Regional Investment Company (HBRIC Ltd)			
Water Harvesting: On the agricultural plains within the Hawke's Bay region, delivering secure and sustainable water for irrigation offers an opportunity to substantially increase economic performance as well as further diversifying the agricultural/ horticultural base. Given that primary production is dependent on secure and sustainable natural resources, winter water storage infrastructure offers the prospect of further growth in the economy and providing, in part, the region with more resilience with regard to drought and risk.			
• *Ruataniwha Plains Water Storage Scheme:* Dam building and related infrastructure programmed 2015 – 2017 Funding required by HBRIC Ltd for an equity stake in the proposed operating company	$12M	$59.5M	$71.5M
• *Ngaruroro Water Storage Scheme:* Dam building and related infrastructure programmed 2019 – 2021 Funding required by HBRIC Ltd for an equity stake in the proposed operating company	-	$30.0M	$30.0M
Investments Managed by HBRC			
Development of Forestry Estate: HBRC currently has 673 hectares of planting in a number of tree species, spread through the region for the purpose of providing returns from harvesting, carbon credit sales and manuka honey sales. Some of the areas of forestry are also available for the management of wastewater, whilst other areas have recreational potential. ** This figure includes the costs for establishment and maintenance of the forests and return on funds invested. It excludes land purchase.*	$4.5M*	$3.0M	$7.5M
Napier Gisborne Rail: HBRC is currently exploring the possibility of leasing from KiwiRail, the railway line between Napier and Gisborne. Provision has been made in this LTP to fund the cost of repairing the railway line. This Plan assumes that this line would then be leased to a private sector company who would operate rail services between Napier and Gisborne.	$0.2M	$5.3M	$5.5M
Total of Proposed Investment Programmes	**$16.7M**	**$97.8M**	**$114.5M**

3.3 Targeted Returns on Proposed Investments

The proposed investments will be made progressively during the 10 years of this LTP and set out below are the estimated returns on these projects that HBRC expects to receive from these investments.

Returns on funding provided for these new investments are assumed to be:

- Ruataniwha 6%
- Ngaruroro 6%
- Napier Gisborne Rail 6%
- Forestry 6%

HBRC will only approve funding of these investments after receiving a sound business case which will include a comprehensive risk analysis. Business cases will be subject to independent peer review.

3.4 Funding for the Above Strategic Investment Initiatives

HBRC will provide funding for the investment initiatives by drawing down on the cash reserves set aside for investment (at the commencement of this LTP a sum of $66m will be on deposit), sale of Wellington leasehold land (the sale is scheduled in the LTP for year 3) and borrowings.

3.5 Council Investment Risks

Council Investment Risks				
Investment	**Assumptions**	**Risk to Assumption**	**Level of Uncertainty**	**Reasons and Financial Effects of Uncertainty**
HBRIC Ltd	Dividends will be paid to HBRC as scheduled.	Napier Port financial performance falls short of its forecasts.	Low	A substantial part of HBRC's regional income comes from HBRIC as the majority of HBRC's investment assets are held by HBRIC. Any diminution of dividends paid by HBRIC to HBRC will have a direct negative effect on HBRC's operating position. HBRIC's ability to pay dividends relies in the first instance on the profitability and dividend payments of Napier Port, as RWSS is not likely to generate positive cash flows for HBRIC before the end of the LTP.
	Funds drawdowns for RWSS will not exceed $80M in total.	Calls for increased funding for new investments	Low	Delays in financial close and design and construction phases could lead to higher costs and consequently increased calls for funding by HBRIC potentially adversely impacting HBRC's cash flows for operations and other investments. This LTP provides funding for RWSS up to $71.5M as stated in the RWSS Statement of Proposal. Any increase on this figure would also need to meet HBRC's requirement for 6% return. HBRIC's funding structure can mitigate any risk in this regard.
Forestry Harvesting	Log prices are Ministry of Primary Industries (MPI) 5 year average CPI adjusted as at 30 June 2014.	Price for logs at harvesting is lower than forecast.	Low	Like all commodity markets timber is cyclical, however this risk can be managed by bringing forward or deferring harvesting.
	Stumpages as forecast by independent valuer as at 30 June 2014.	Stumpages fall short of forecast.	Low	Stumpage rates as forecast are considered to be conservative and actual performance of the forest should be better than forecast.
Forestry Carbon Investments	Carbon is sold at an average price of $3.80 per tonne.	Price falls below assumed average of $3.80/tonne.	Medium	Carbon prices are strongly influenced by global politics and economic performance. Prices have fallen considerably since 2012, however Council can hold carbon accumulated from forestry for long periods (i.e. 5-10 years), so can manage its selling strategy to maximise returns over the period of the plan.
Forestry Manuka Honey	Honey yield is specified by agreement with Comvita.	Honey yield per hectare is lower than forecast.	Low	Projected returns are based on MPI apiary data, which has been reliable to date. Manuka revenue in this LTP is relatively low and lower yields are unlikely to have a material impact on the LTP.

Council Investment Risks continued				
Investment	**Assumptions**	**Risk to Assumption**	**Level of Uncertainty**	**Reasons and Financial Effects of Uncertainty**
NGR	Costs of reinstatement of line is no more than $5.5M.	Costs exceed $5.5M.	Medium	Cost overruns may adversely impact HBRC's cashflows for operations and investment elsewhere.
	Establishment of viable operating business.	Operating business is unable to be formed or becomes unviable.	Medium	A viable operating business funded by stakeholders other than HBRC is required. If this cannot be achieved then either HBRC will have to operate the business or the proposal will not proceed. If the project does not proceed at this stage (i.e. subsequent to restoration of the track) then Council would be exposed to estimated losses of up to $920,000 per annum.
	Return to HBRC is not less than 6%.	Operating company is unable to pay lease payments to HBRC of 6%.	Medium	Lower returns may adversely impact HBRC's cashflows for operations or investment elsewhere.

3.6 Investment Company Risks

Table below summarises the principal investment risks in respect of the proposed projects of HBRIC Ltd.

Investment Company (HBRIC Ltd) Risks				
Investment	**Assumptions**	**Risk to Assumption**	**Level of Uncertainty**	**Reasons and Financial Effects of Uncertainty**
Water Storage and Harvesting (Ruataniwha Plains - RWSS)	Farmer uptake	Uptake is lower than planned	Medium	Farmer uptake of distributed water of at least 40M m3 in the first years of operations is critical for RWSS viability. Unless this threshold is met the project will not proceed. The HBRIC Ltd Board is proactively managing this risk through an extensive relationship building programme with the Central Hawke's Bay farming community and other stakeholders.
	Investment by co-investors	Low investment interest	Medium	Negotiations are ongoing with several parties. Unless investor commitment meets financial close requirements the project will not proceed.
	Project cost	Project cost rises	Low	Significant risk however is being mitigated against by strong project management by the HBRIC Ltd Board.
	Project proceeds	Project does not proceed	Low	Net after tax cost to HBRIC Ltd in this event estimated to be around $10M and funding previously earmarked for RWSS will be held for alternative investment yielding at least 6%pa. As HBRIC Ltd will be able to at least maintain dividends at a rate of 6% on the funds lost as a result of termination, there will be no impact on this LTPs regional income.
Water Storage (Ngaruroro – NWS)	Feasibility has yet to be established	Feasibility is not established	Medium	Feasibility will not be commissioned until 2015-16. If not feasible, then the project will be re-evaluated.
	HBRIC Ltd funding commitment is $30M	Funding requirement exceeds $30M	Medium	Co-investors may not be sufficient to fund project and/or costs may be higher than indicated.
Port of Napier	Dividends to HBRIC will be paid as scheduled	Port of Napier Dividends are higher or lower than forecast	Low	PONL financial performance has been improving for some years, and current dividend payments now only require around 51% of NPAT. This allows considerable reinvestment in the business to date and leaves room for a higher share of NPAT to be paid as dividends in the future.

3.7 Funding Risks

Funding Risks				
Funding Type	**Assumption**	**Risk to Assumption**	**Level of Uncertainty**	**Reasons and Financial Effects of Uncertainty**
Sale of Wellington leasehold properties	Net value of $13M will be received on the sale.	Demand by the market is insufficient to achieve a sale at a level acceptable to HBRC	Low	HBRC would lose around $60,000 pa in interest for every $1M of reduced sale realisation value.

3.8 Other Risks

Other Risks			
Assumption	**Risk to Assumption**	**Level of Uncertainty**	**Reasons and Financial Effects of Uncertainty**
Inflation	Inflation is higher or lower than forecast	Medium	Inflation is affected by external economic factors, most of which are outside of HBRC's control and influence. The estimate of the potential effects of the uncertainty is best illustrated by stating that for 2015-16 a move in the cost adjustors provided by BERL and used in this plan by plus or minus 0.5% would result in either an under or over provision for external expenditure of $108,000 and for employment costs of $65,000 .
Interest Rates on Borrowings	Interest rates are higher or lower than forecast	High – especially in later years of the plan	The majority of the borrowing programme proposed in this plan is to provide funding to cover loans to homeowners for clean heat installations and for the proposed activities of HBRIC. As the borrowing programme for HBRC is expected to increase in the later years of the plan, any movement in interest rates would have a greater effect on HBRC's interest expense towards the end of the plan. This plan assumes that, with the exception of RWSS, HBRIC will pay for advances at HBRC's borrowing rate. The effect of any interest rate movements on the borrowing programme can best be illustrated by stating that a 0.5% movement either up or down from the assumed levels of interest rates in this plan would result in an annual exposure of plus or minus $23,000 for 2015-16 (on borrowings of $4.7M) and for the peak year of borrowing $134,000 for 2019-20 (on borrowings of $26.8M.
Interest Rates on Deposits held for Investment	Interest rates are higher or lower than forecast	Medium	Short and long term HBRC cash deposits held for investment are estimated to be in the order of $66M at the start of this plan and will be reduced to nil by year 5 of the plan. Therefore a 0.5% movement either up or down from the assumed levels of interest rates in this plan would result in an annual exposure of plus or minus $217,000 for 2015-16 and $23,000 in 2018-19.
Occurrence of Natural Disaster	A natural disaster/flood event occurs which damages Council's property, plant and equipment	Medium	Call on commercial insurance, Local Authority Protection Programme and Government funding through the National Civil Defence Recovery Plan. The use of reserves is also available to HBRC as required.

Section 4 - Financial Strategies for HBRC's Major Operational Initiatives

The following programmes are included in the LTP 2012-22 for implementation and funding:

Clean Heat Financial Assistance

The purpose of this programme is to encourage the replacement of open fires or non-compliant wood burners with more efficient forms of heating. This programme applies to homes within the Napier and Hastings air shed boundaries. There are varying dates for different areas to comply with the National Air Quality Standards, however the final date for implementation is 2020. The financial assistance provided by HBRC covers the payment of grants and subsidised loans, (50% of interest payments subsidised), to home owners replacing their non-compliant burners with compliant heating.

Home Insulation – Financial Assistance

A further programme of HBRC is to promote healthy homes by providing loan assistance for insulation. This assistance is available to all home owners within the region and is being promoted by HBRC to ensure improved health outcomes and lower energy costs for home owners. There is no interest subsidy on the loans provided to home owners.

Solar Energy Efficiencies

HBRC has made provision for possible financial assistance to home owners for solar energy efficiencies. The details of any implementation may be developed following consultation on a regional Energy Strategy.

Financial Implications of Clean Heat, Home Insulation						
Number of Conversions	2015/16	2016/17	2017/18	2018/19	2019/20	**Total**
Total Clean Heat	**1,500**	**1,000**	**1,500**	**1,000**	**1,000**	**6,000**
Loans	500	333	500	333	334	**2,000**
Grants	1,000	667	1,000	667	666	**4,000**
Number of Insulation Loans	160	160	160	160	160	**800**

Funding of Clean Heat, Home Insulation						
Funding ($000's)	2015/16	2016/17	2017/18	2018/19	2019/20	**Total**
Clean Heat Loans	1,700	1,132	1,850	1,232	1,232	**7,146**
Clean Heat Grants	609	406	609	406	406	**2,436**
Insulation Loans	352	352	392	392	392	**1,880**

The Clean Heat programme commenced in 2009 with the purpose of encouraging the replacement of open fires or non-compliant wood burners with more efficient forms of heating. Over the period from programme commencement to the beginning of this Plan just over 6,000 open fires or non-compliant wood burners have been replaced. It is anticipated that with the current take up of financial assistance for the Clean Heat programme that the standards required under the NES will be met by 2019/20 with over 12,000 open fires or non-compliant burners having been replaced.

The repayment of loans for Heat Smart, insulation and potential solar energy efficiencies through a voluntary targeted rate over a period of up to ten years for the home owner.

The funding of the subsidies for Heat Smart loans and Heat Smart grants is through a targeted rate to all home owners within the Napier and Hastings airsheds. This rate for 2015/16 will be $8.34 (including GST) for Napier ratepayers and $8.64 (including GST) for Hastings ratepayers per $100k of land value. These rates apply to ratepayers within the airsheds.

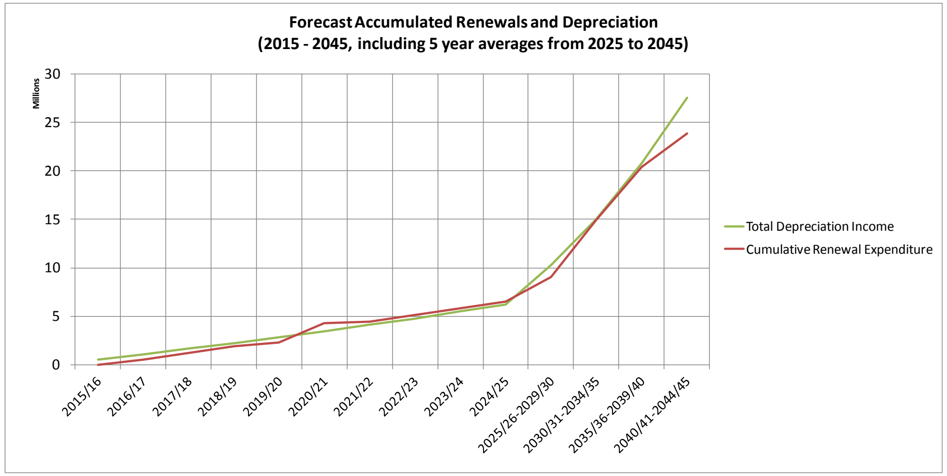
Infrastructure Assets - Flood and Drainage Schemes

HBRC manages and administers the Heretaunga Plains Flood Control scheme to maintain an effective flood control network that provides protection from frequent river flooding to communities and productive land on the Heretaunga Plains. Flood protection is provided through river control work, stopbanking and a network of drainage waterways and pumping stations. As major flooding within the Heretaunga flood plains catchment has the potential to result in a very significant economic loss for the local and regional economies, HBRC has previously consulted on increasing the level of protection afforded by these stopbanks from a 100 year to a 500 year design standard to convey a flood with a 0.2% occurrence in any one year safely to the sea. This Plan proposes that this work is staged over approximately 20 years. This can be achieved with no requirement to borrow. However should the community request that the work be done more quickly, then there will be a need to borrow for the project. The estimated cost of achieving this is $15m.

HBRC already has a substantial targeted rate in place to fund the Heretaunga flood plains flood and river scheme and the funding from this rate will be used to provide funding for the construction programme.

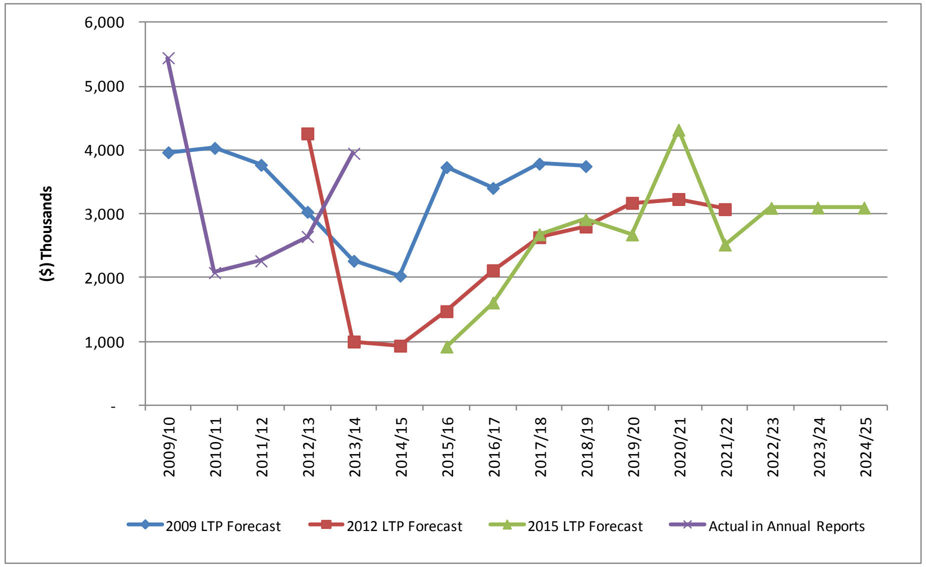
The graph following shows the extent to which funds set aside for renewal work programmes are required in the medium to long term to maintain the integrity of HBRC's flood and drainage schemes.

30 Year Forecast Accumulated Renewals and Depreciation



Infrastructure Asset Capital Expenditure – LTP Forecasts vs Annual Report Actuals

The graph below demonstrates the extent to which capital renewals and improvements to HBRC's flood and drainage schemes are delivered to Plan.

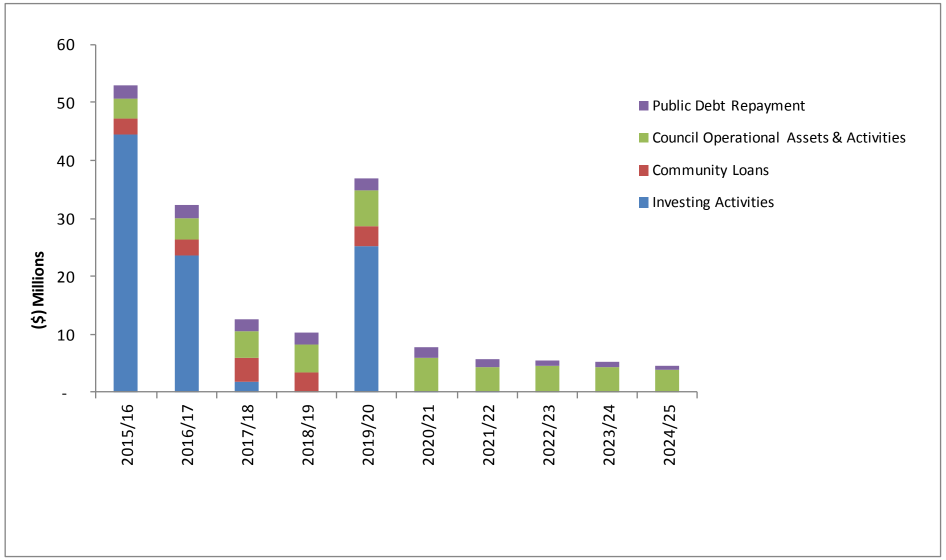


Section 5 – Summary of Capital and Borrowing

Capital Expenditure

HBRC proposed to embark on a significant capital programme across the 10 years of this Plan, mainly as a result of the proposed investment activities carried out by the Hawke's Bay Regional Investment Company. The graph below sets out the proposed capital expenditure activity across each year of the LTP.

Capital Expenditure



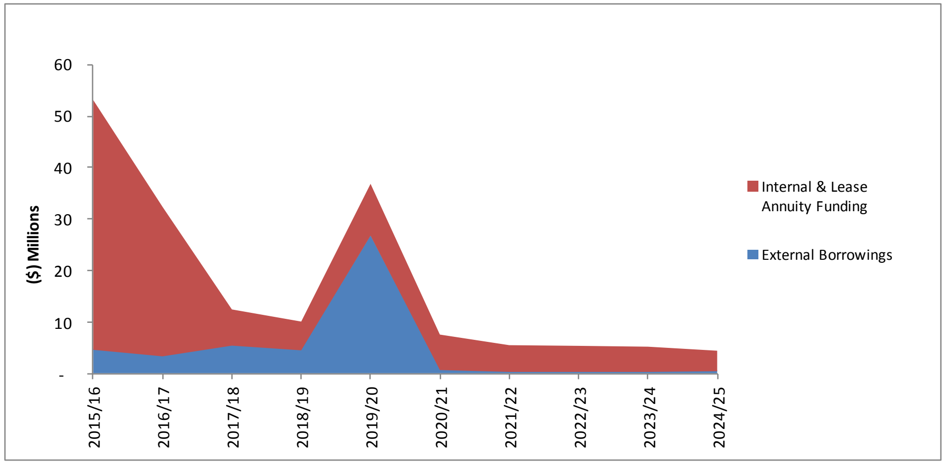
(*) Public Debt Repayment excludes repayments on funds borrowed for Community Loans as these are offset by funds repaid by community loan holders through targeted rates.

There are large increases in capital expenditure in year 1 and year 2 (specifically the Ruataniwha Water Storage Scheme) and in year 5 (specifically investment in the Ngaruroro Water Storage Scheme) of the Plan as outlined in this Financial Strategy. The level of public debt repayments remains fairly constant throughout the 10 years of this Plan. Where HBRC borrows to fund investing activities, it is assumed that these borrowings will be on an interest only basis until the point where these investments yield a commercial return on funds.

Funding of Capital Expenditure

The funding of the capital expenditure programme across the 10 years of this Plan is outlined in the graph below.

Funding of Capital Expenditure



Internal Funding

The capital expenditure programme for the 10 years of this Plan, excluding year 5 (2019/20) will predominantly be funded through the use of internal cash reserves. The cash reserves of HBRC are derived from the freeholding of Napier leasehold land to lessees of those properties, cash received from the ACC through the sale of future cash flows of Napier leasehold properties, and also from the proposed sale of HBRC's investment in Wellington leasehold properties.

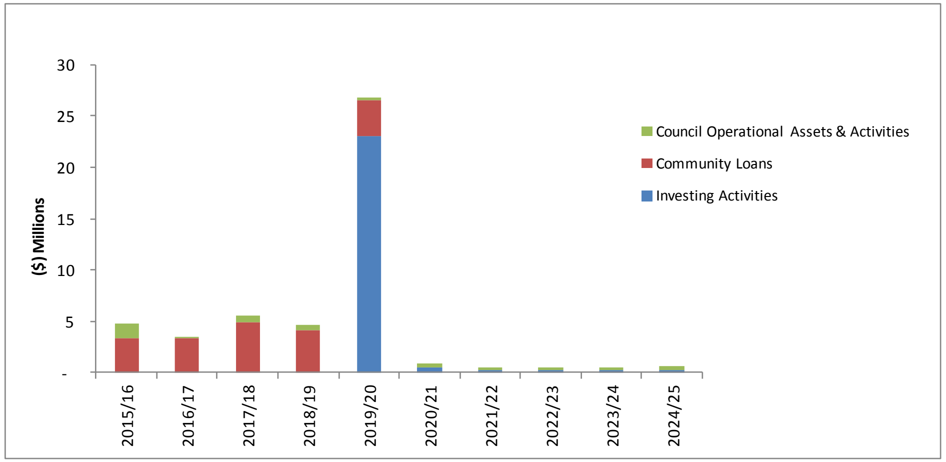
External Borrowings

This Long Term Plan (LTP) shows that HBRC continues to operate at a moderate debt level throughout the life of the Plan. HBRC proposes to borrow $48.1m over the 10 years of the Plan. Proposed budgets allow for the repayment of debt over the 10 year period, so debt will grow from its current level of $21.5m to $31.1m over the life of the Plan. The main borrowing is during 2019/20 to cover the proposed Ngaruroro Water Storage Scheme.

Borrowing to fund HBRC's proposed capital expenditure is considered to be fair in that it spreads the cost over the generations who will use the assets, rather than collect money off one generation of ratepayers.

The graph below analyses the years of the proposed new borrowings of $48.1 million and the programmes to be funded.

External Borrowings



The analysis of the proposed external borrowings shows that $4.1 million of 'Council Operational Assets and Activities' are to be funded by way of external borrowings. It is HBRC's policy to fund the majority of this capital expenditure through the use of an internal borrowing programme, specifically the depreciation reserves to fund these activities.

HBRC proposes to borrow $19.2 million to provide funding for community loans for clean heat, insulation and solar energy efficiencies. As these programmes are anticipated to cease in year 5 of the Plan (2019-20) there will be no external borrowing required from years 6 to 10 of the Plan. Security for these loans is the legal commitment of the property owner deriving the benefit of clean heat, insulation or solar energy efficiencies, to service these loans as part of the rates set on that property.

HBRC proposes to borrow $24.7 million to fund its proposed investment activities with the majority of this borrowing to be drawn down in year 5 of the LTP (2019-20). The servicing of these loans will be made from the revenue generated from those activities.

Impact on Proposed HBRC's Service Levels

The debt levels stated above are set at levels that will be able to maintain the present levels of service as stated in this LTP, but also to meet the increased levels of service that HBRC proposes to provide through its investment strategies in water harvesting, forestry and Napier Gisborne Rail.

Borrowing Limits

Total interest expense on external public debt (including lease annuity) will not exceed 25% of total annual operating expenditure. HBRC loan funding will not exceed a debt to debt equity ratio of 28%. Refer to metrics table below for the analysis for each year of this Long Term Plan.

When HBRC undertakes external borrowing it does so under the Debenture Trust Deed which was established in October 2009.

Under the Debenture Trust Deed HBRC's borrowing is secured by a floating charge over all HBRC rates levied under the Rating Act, excluding any rates collected by HBRC on behalf of any other local authority. In such circumstances, the security offered by HBRC ranks 'Pari Passu' for all stock issues by HBRC including any security stock issued.

Under the Debenture Trust Deed HBRC offers deemed rates as security for general borrowing programmes. From time to time, with prior HBRC and Debenture Trustee approval, security may be offered by providing a charge over one or more of HBRC's assets.

Physical assets will be charged only where:

- There is a direct relationship between the debt and the purchase or construction of the asset which it funds (such as an operating lease or project finance);
- HBRC considers a charge over physical assets to be appropriate;
- Any pledging of physical assets must comply with the terms and conditions contained within the Debenture Trust Deed.

Section 6 - Financial Metrics

Set out in the table below are the financial metrics that assist in the evaluation of HBRC's financial performance over the years of the Plan.

Trends of Other Financial Metrics										
Metric	2015-16	2016-17	2017-18	2018-19	2019-20	2020-21	2021-22	2022-23	2023-24	2024-25
Net Surplus Margin: (This metric shows the percentage of income retained by HBRC to fund capital expenditure, to meet repayments on debt and/or set aside to meet future contingencies).	1.74%	9.29%	9.44%	11.70%	11.46%	13.56%	10.54%	13.10%	13.45%	12.92%
Return on Investment Assets: (This metric shows the amount of interest and dividend income generated each year by HBRC's total investment asset base).	3.76%	4.47%	4.37%	4.59%	4.57%	4.57%	4.64%	4.70%	4.48%	4.61%
Rates to Total Revenue: (This metric shows the percentage of HBRC's total revenue that is collected through rates).	42.28%	40.66%	41.41%	41.16%	40.60%	39.46%	40.58%	41.05%	41.31%	41.00%
General Rates to Total Rates: (This metric shows the percentage of HBRC's total rates revenue that is collected through general rates).	18.87%	18.41%	18.27%	19.32%	19.99%	20.76%	20.96%	21.07%	21.24%	21.92%
Capex to Total Cash Payments: (This metric shows the proportion of total cash payments that has been spent on fixed assets).	3.86%	4.19%	9.25%	9.36%	7.75%	10.25%	7.20%	7.95%	7.75%	6.87%
Finance Expense (Interest on Borrowings and payments to ACC for leasehold cashflows) to Total Operating Expenditure	6.75%	6.88%	7.32%	8.22%	10.07%	11.46%	10.77%	10.59%	9.99%	9.49%
Finance Expense (Interest in Borrowings only) to Total Operating Expenditure	3.27%	3.21%	3.27%	3.51%	5.34%	6.72%	6.08%	5.72%	5.23%	4.81%
Debt to Debt Plus Equity	15.09%	14.36%	14.07%	13.99%	16.35%	15.12%	14.54%	13.57%	12.54%	12.17%