Significant financial forecasting assumptions

March 2016

General assumptions

Assumption and impact of assumption	Risk	Likelihood	Financial impact	Impact of risk
The Northland **economy** has taken longer to move out of the recession caused by the global financial crisis than other regions of New Zealand, due in large part to climatic conditions. Between 2009 and 2014, Northland's GDP grew by 1.2% per annum compared to a 1.6% annual increase nationally. While there may be large annual variations, we are forecasting an average annual growth rate of 2.0% over the 10 years - slightly lower than the New Zealand Treasury forecast for the New Zealand economy. Treasury is forecasting a 2.4% increase in national GDP for 2016-17. Sources: Northland Region Economic Profile 2015 and The Treasury Half Year Economic and Fiscal Update 2015.	The current recovery stalls, is slower than expected or significantly deepens.	Low to medium	A 1% reduction in region wide rating revenue in year one is $146,699, equivalent to 0.44% of our total operating budget.	A slow economy has the effect of perpetuating affordability issues and potentially resulting in increased rating arrears.

Population growth will be positive but slow (a 0.6% per annum increase compared to a national increase of 1.1% over the 10-year period 2013-2023) leading to a similar increase in separately used or inhabited parts of a property and rating units (SUIP's/RU's). Population growth is generally in the older age groups (e.g. 65+). These people are more likely to, want to age in place (at home) and retire on low fixed incomes (predominantly reliant on superannuation in their later years). Impact: No additional expenditure has been provided in this plan for addressing issues related to population growth. Source: Statistics New Zealand, Subnational population projections by sex and age, 2013 (base) – 2043.	Population growth and/or growth in properties will be significantly different from projected. Rate postponements increase as a proportion of rates owed.		Low This equates to a potential increase of 541 SUIP's/rating units per year. The average regional wide targeted rate per SUIP/rating unit is $186.56.	Short-term population changes have very little impact on regional council services. Existing resources have generally coped with service demands without major adjustments. The challenges of an ageing population are largely borne by the district councils of Northland (pressures on infrastructure, matching services to demand etc.) A greater demand for public transport services may result in the urban areas, particularly Whāngārei, as it is likely to expand at a greater rate than other areas within the region. A higher number of older people ageing in

				place (at home) will create demand for public transport/mobility to be available to access services and amenities.
Resource consents Conditions for existing resource consents held by council will not be significantly altered. Any resource consent due for renewal during the year will be renewed accordingly.	Conditions of resource consents are altered significantly. Council is unable to renew existing resource consents upon expiry.	Low	Low	The final effect of any change to resource consent requirements would depend upon the extent of the change. A significant change in requirements could result in the council needing to spend additional funds to enable compliance. Generally, the council considers that it is fully compliant with existing resource consents and does not contemplate any material departure from these requirements over 2016/17.
Changes to council's business	Changes to council	Medium	Low	The final effect of any

There will be no significant change to council business dictated by as yet unknown/unconfirmed legislation or central government policy change.	business significantly alter operations and activities carried out by council.			change to council's business would depend upon the extent of the change. A significant change could result in the council altering its activities or spending additional funds to enable compliance.
Any **indirect** impacts of the **Emissions Trading Scheme** through price increases being passed on to council are assumed to be covered by council's inflation assumptions. The **direct** impact of the **Emission Trading Scheme** is that council will be required to replant its forestry holdings after any harvest. The council's forestry management plan prescribes this approach. Council has received Emission Trading Scheme credits to financially compensate for this requirement.	Changes in government legislation result in charges greater than the budgeted expenditure.	Low	Low	Any annual changes to the Emission Trading Scheme will not have any material effect on the overall financial forecasts in this plan.
Climate change impacts Climate change will match the Ministry for the Environment's climate change predictions, which are based on recommendations from the International Panel on Climate Change (IPCC).	Climate change impacts coming earlier than expected – creating issues re civil defence, coastal structures, etc.	Medium	Low	Variations to long term budget forecasts and levels of service will be required and will be addressed by subsequent long term plans.

Budget provision will be adequate to address costs arising from **natural disasters**. Council holds insurance for its assets, including the Awanui River Flood Management Scheme. In addition, council holds a reserve titled the Land Management Reserve which if required, may be used to fund emergency works.	Natural or other hazard emergencies require work that cannot be funded out of normal budgetary provisions.	Low	Medium	The council's financial position is strong enough short-term funding requirements that may be required in the event of damage caused from natural disasters. Council may need to consult with the community retrospectively to repay any expense incurred.

Financial assumptions

Assumption and impact of assumption	Risk	Likelihood	Financial impact	Impact of risk
Inflation rates applied – operating expenditure 2016-17 budget forecasts were developed on the basis that expenditure for the year could be determined and did not require the application of an inflation adjustor.	The actual rate of inflation varies from the assumed rate of inflation.	Low to medium	Low to medium A 1% point increase in the inflation rate over and above the BERL rates will increase council's total operating expenditure by $188,123. Should operating	Inflation is affected by external factors, all of which are outside of council's control and influence. Actual individual indices will at times vary from what has been assumed in this plan. The council has relied on the Reserve Bank's use of monetary controls to keep inflation within the 1% to 3% range.

			expenditure increase and council is not able to achieve savings to offset the increase, it is likely there will be a proportional impact on council's funding and expenditure in the following year.	
Inflation rates applied - salaries 2016-17 salaries were estimated on the basis of 1.1% increase as per the published BERL "Staff" price adjustor.	The actual rate of salary increases will vary from the assumed rate of salary increases.	Low to Medium	Low A 1% point increase in salaries in year one over and above the rate applied will increase operating expenditure by $129,123.	Although the actual annual salaries expenditure incurred by council may vary against its corresponding forecast, it is expected to be manageable and it is not considered that any annual salaries variance will have a material effect on the overall financial forecasts in the Annual Plan.
Inflation rates applied - electricity 2016-17 budget forecasts were developed on the basis that expenditure for the year could be determined and did not require the application of an inflation adjustor.	The actual rate of increases in energy related expenditure will vary from the assumed rate of energy increases.	Low to Medium	Low A 1% point increase in electricity expenditure in year one over and above the BERL rates will increase operating expenditure by $1,249.	Although the actual annual energy expenditure incurred by council may vary against its corresponding forecast, it is expected to be manageable and it is not considered that any annual variance in energy related expenditure will have a material effect on the overall financial forecasts Annual Plan.
Inflation rates applied – activity income	The actual activity revenue is influenced	Low	Low	Although activity income streams may vary annually due to factors

Activity income sources subject to inflation are assumed to increase throughout years 2-10 of the plan using the BERL Opex price adjustor displayed below (at a per annum change), with the exception of Rating revenues and New Zealand Transport Agency subsidies: 2016-17 budget forecasts were developed on the basis of a council resolution to increase user fees and charges by 2.34% which was based on the BERL Opex price adjustor	by rates of inflation different than the assumed rate.			outside of councils control, it is considered manageable and it is not considered to have a material effect on the overall financial forecasts in the Annual Plan.
Inflation rates applied – New Zealand Transport Agency subsidy income Subsidy income is a function of transport activity cost and work categories. The subsidy available for the work categories varies from no subsidy to 54%. Council has assumed there will be no change to the current government funding formula and as such, has applied the subsidy at the level advised by New Zealand Transport Agency at the time of preparing the plan.	That actual subsidy rates and criteria for approved works change from the time the long term plan is compiled.	Medium	Low The maximum financial impact would be the total elimination of the total subsidy income estimated in the plan at $948,050.	Changes to the funding priorities of the New Zealand Transport Agency are outside council's control. If the level of New Zealand Transport Agency subsidy income is lower than forecast it may require a reprioritisation of the transport work program or an increase in funding from alternative sources (e.g. regional-wide rates).
Rates increases applied – rating income In order to fund the expenditure outlined in the annual plan, council intends to increase its targeted regional wide rates by 2.34%.	That the projected rate increases are insufficient to cover expenditure increases resulting from	Low – Medium	Low – Medium During 2016-17 regional wide rate funding provides	Although the disparity is considered manageable, it may result in a reprioritisation of council's work programme and/or an increase in funding from alternative sources.

	inflation.		approximately 41% of council revenue, with the remaining revenue coming from targeted rates, investment income, user charges, grants and subsidies. A 1% increase in regional wide rating income would provide $146,699 additional income, while a 1% increase in operating costs would equate to an additional $317,246 of expenditure.	
Investment income transferred to the Investment and Growth Reserve $1.7M of Investment income will be transferred from being a source of operational funding to the Investment and Growth Reserve.	The council will speed up the transition. The council will slow down the transition.	Low – Medium Low	An increase or decrease of 1% in the forecast transfer to the Investment and Growth Reserve will result in a $17,000 movement in the balance of the Reserve.	There will be a higher rate increase than projected in the Annual Plan. There will be less funds available in the Investment and Growth Reserve for allocation.
Forecast return on council investments	Actual interest rates vary from those	Low – Medium	Low – Medium	If actual interest rates are lower than the forecast rates, then the

Cash investments Interest income derived from cash deposits is calculated upon an assumption of 3.15% per annum for the call account, 5.36% to 6.31% for existing term deposits and 5.14% to 5.43% for re-investment into fixed income investments. **Stocks and bonds (fixed)** Interest income derived from fixed investments is calculated at the relevant coupon rate until maturity of such investment. **Externally managed funds** Interest income derived from investments in externally managed funds is calculated upon an assumption of 6.00% to 7.00 per annum.	projected.		An increase (or decrease) of 1% above (or below) forecast returns on cash deposits will result in a variance in interest and financial gains in the plan of $372,269.	Growth and Investment Reserve may receive a reduced allocation and/or other funding sources or savings may be considered to offset the difference.
Forestry Investment Revenue Forestry revenue is projected in line with the forestry management plan. The forestry is revalued annually. The valuation adjustments are provided by an independent forestry consultant. These are non-cash and as the forest is a long-term asset, the adjustments do not impact on funding or expenditure requirements.	Projected forestry returns differ significantly from those estimated.	Low – Medium	Low	If the projected harvest return is below expectations, the council is able to defer harvesting for a number of years.

Forecast return on investments made from the Investment and Growth Reserve It is assumed funding set aside in the Investment and Growth Reserve will earn a return of 5.14% to 5.43% per annum. Investment and Growth Reserve funds will be invested in accordance with council's Treasury Management Policy criteria until such time as they are allocated to projects in accordance with the Investment and Growth Reserve Criteria. The actual return on project allocations from the IGR will vary significantly. Council recognises higher risk investments, may provide higher returns, but there is also a risk of the project not delivering the expected return. It is also possible that council will accept a lower return on projects that contribute positively to social and cultural well-beings.	Actual returns vary from those projected.	Medium	Low to medium An increase (or decrease) of 1% above (or below) forecast returns on funding set aside in the Investment and Growth Reserve will result in a variance in investment revenue in the plan of $26,121.	If actual investment returns are lower than forecasted rates there will be less funding available to invest in further projects. This may have an impact on council's ability to make a positive contribution towards promoting economic development in Northland. Rating levels will not be affected.

The proportion of the reserve allocated to impact funding remains as expected	Council chooses to allocate a higher level of impact funding which provided minimal or no return	High	Medium	Lower levels of funding available for commercial ventures.
Income from the Community Investment Fund The opening balance of the fund is assumed at $11.382 million. The Community Investment Fund managers have forecast income from the fund for 2016-17 at $836,000. Council intends to increase the value of the capital of fund by reinvesting all the interest derived from the fund in 2016-17 and also 2017-18 From 2018-19, Council intends to maintain the real	That the income from the Community Investment Fund differs to forecast.	Medium	Medium A 1% change in income from the Community Investment Fund equates to $8,360. Any reduction in Community Investment Fund income may result in the Investment and Growth Reserve being called upon to fund	If actual Community Investment Fund income is lower than the forecast levels, then the Growth and Investment Reserve will need to contribute a greater level of funding to the council-controlled organisation.

value of the Fund by increasing the capital amount of the Fund by the level of inflation forecast for each year thereafter. The fund's capital value may be subject to market fluctuations that are beyond the control of the council. The income (less the reinvested amount) from the fund will be distributed to council, and council will use this income as well as income from the Investment and Growth Reserve to provide annual funding to Northland Inc. Limited.			the shortfall.	
Borrowing costs (external and internal) **External Borrowing** Council has borrowed $13,000,000 in 2015-16. The borrowing is for fixed terms and at fixed rates for the term of the loans. The funds have been used to offset internal loans associated with several reserves operated by the council. The rate is more favourable then council can offer and reduces the overall cost for the reserve. As these reserves are funded from targeted rates there is a direct benefit to ratepayers in either reduced annual rates or shorter terms that the rate will be	The prevailing interest rate varies from those assumed.	Low Borrowing rates are fixed for the term of the loans.	Medium A 1% movement in interest rates will result in a variance of $130,000.	If the council was required to find additional funds to service higher interest rates this could be achieved through reduced levels of service or adjusted targeted rates in the effected reserves.

applied. **Internal borrowing** Interest Income derived from internal borrowing has been calculated on the assumption of 7% per annum. Internal interest cost of 7% is considered appropriate as council considers it can achieve the same rate by investing in fixed longer-term stock and bond investments. Any internal interest expense applicable to internal borrowings is allocated directly to the activity to which the loan relates. The actual internal borrowing rate may be subject to change and will be based upon the cost of borrowing and available investment returns at the time of borrowing. If at any point in time an internal loan has a positive balance (i.e. the capital repayments exceed the amount borrowed) then interest will be paid on that positive balance at 5% per annum.				Interest expense and interest income associated with internal borrowing offset each other in the financial forecasts.
Dividends It is assumed that council will maintain its	Council chooses not to maintain its	Low Low	Low An alternative	If actual dividend income is lower than the forecast other funding sources or savings will be considered

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<tr>
<td>shareholding in Marsden Maritime Holdings Limited.

It is assumed that the dividend, expressed as a cents per share amount (cps), received from this shareholding will be 12.75 cents.

Council is not forecasting any dividends from Regional Software Holdings Limited nor any special dividends from Marsden Maritime Holdings Limited.</td>
<td>shareholding.

The actual dividend per share will vary from the assumed amount.

No dividend return from RSHL.</td>
<td></td>
<td>investment would be sought with an annual return.

Low

A one cent per share movement in the declared Northland Port Corporation (NZ) Limited dividend will have an impact on council’s dividend income by $221,429.</td>
<td>to offset the difference.</td>
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<td>Investment property rental income

It is assumed the council’s investment property portfolio will be tenanted throughout the plan at the current occupancy rates and that rents will be increased at review date by the following adjustors:

<table>
<tr><td>21-year review occurring at any time throughout the plan</td><td>50%</td></tr>
<tr><td>20-year review occurring at any time throughout the plan.</td><td>50%</td></tr>
<tr><td>7-year review occurring in the years 1-3 of the plan.</td><td>5%</td></tr>
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</td>
<td>Occupancy rates decline and/or rent reviews are less than forecast – resulting in less than forecast rental income.</td>
<td>Low</td>
<td>Low

A 1% reduction in council’s investment property rental income equates to $26,135.</td>
<td>All investment property rentals are subject to contractual obligations which have varying renewal and review periods. The large majority of rental properties have 5, 7 and 21-year lease reviews, and the reviews falling due in any one year will not have an material impact on the annual rental income.</td>
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<tr><td>7-year review occurring in years 4-10 of the plan.</td><td>10%</td></tr>
<tr><td>A five-year review occurring in years 1-5 of the plan.</td><td>10%</td></tr>
<tr><td>A five-year review occurring in years 6-10 of the plan.</td><td>15%</td></tr>
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Commercial property sales

It is assumed the proceeds from any investment property sale will be reinvested in an investment that provides a return of 7% per annum.
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<td>Revaluation of investment properties

It is assumed that the value of council’s investment properties will not change.

This assumption is consistent with the expectation that Northland‘s population and economy will grow slower than the national average.</td>
<td>That the actual revaluation movements will vary from those assumed.</td>
<td>Medium</td>
<td>Low

A 1% increase in council’s investment property portfolio equates to an estimated increase of $386,500 in the value of the portfolio.</td>
<td>Any investment revaluations are non-cash in nature so will have no material impact on council’s funding sources.

There is no impact on depreciation as investment properties are not depreciated.</td>
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<td>Revaluation of infrastructure assets

It is assumed that the value of council’s infrastructure assets will not change.</td>
<td>That the actual revaluation movements will be significantly different</td>
<td>Medium</td>
<td>Low

A 1% increase in infrastructure asset</td>
<td>If the revaluations are different from those forecast, it will affect the fixed asset values and flow through to changed levels of depreciation</td>
</tr>
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	from those forecasted.		values will equate to an increase in depreciation of $10,253. For land assets there is no impact on depreciation as these assets are not depreciated.	expense.
Sufficient **sources of funds for the future replacement of significant assets** will be available at the end of their useful life	Insufficient funds will be available to replace significant assets at the end of their useful lives.	Low	Low	Targeted regional-wide rates, user charges and other targeted rates will increase to achieve the funding requirements. The council may use borrowings in accordance with the Revenue and Financing Policy and Treasury Management Policy.
Useful lives of significant assets The useful lives of significant assets are shown in council's Statement of Accounting Policies. It is assumed that no significant assets will fail before the end of their useful lives as set out in accounting policy of council. Council is aware of all planned asset acquisitions and all asset acquisitions (as per the capital expenditure program) shall be depreciated on the same basis as	That council assets wear out earlier or later than estimated. That council changes activities resulting in decisions not to replace certain existing assets.	Low	Low	Council has very little in way of major infrastructural assets. As part of its asset management planning process council identifies the capacity and condition of such assets, and plans its replacement program accordingly. Depreciation and interest costs (if borrowing was required) would increase if capital expenditure was

existing assets.				required earlier than anticipated, and any earlier replacement may result in the deferral of other discretionary capital projects. Where a decision is made not to replace an asset this will be factored into the capital expenditure projections.
Vested assets There is no vesting or divesting of assets in the Annual Plan.	Assets will be vested with the council	Low	Low	Vested assets have an associated depreciation expense and this would increase the level of rating required if the council decide that the asset would be replaced at the end of its useful life.
Joint venture with KiwiRail (Ontrack) for the proposed Marsden Point Rail Link The council is holding properties purchased along the Marsden Point rail corridor as Investment Properties. It is further assumed that should any of these properties be sold there will be no change in the total Investment revenue earned by council.	That the timing or amount of disposal of the sale of Investment Assets differs from that assumed. That the value of the designation inventory asset is impaired or realised during the term of the plan.	Medium Medium	Low A 1% decrease in the Marsden Point rail corridor investment property revenue equates to $8,749. Low A 1% decrease in the Marsden to Oakleigh rail corridor designation in year 1	If the actual proceeds received from the sale of Joint Venture Investment Assets differ to those forecasted there will be less investment income available to either subsidise operational funding. A 1% increase or decrease in the sale value of joint Venture Investment Assets held will result in a +/-24,830 increase or decrease in cash available to be invested. Any impairment of the inventory

			equates to an impairment cost of $50,941.	asset is a non-cash expense and therefore any impact will be immaterial.