Significant forecasting assumptions

August 2020

A1279045 – August 2020

Northland
REGIONAL COUNCIL
Te Kaunihera ā rohe o Te Taitokerau

General assumptions

Assumption and impact of assumption	Risk	Likelihood	Financial impact	Impact of risk
Over the last 5 years (2014-2019) **real GDP** in Northland has increased by 3.2% per annum on average, slightly below the national average growth rate of 3.4%. We are forecasting that the Northland economy will grow 2.5% in 2020/21 - slightly lower than the New Zealand Treasury forecast for the New Zealand economy (2.8%). Sources: Northland Region Economic Profile 2019 and Half Year Economic and Fiscal Update 2019.	The current recovery stalls, is slower than expected or significantly deepens.	Low to medium	A 1% reduction in rating revenue is $323,529 equivalent to 0.60% of our total operating budget.	A slow economy has the effect of perpetuating affordability issues and potentially resulting in increased rating arrears.
Over the last five years (2014-2019) the **estimated resident population** of Northland has grown by an average of 2.5% per annum. This is slightly higher than the 1.8% average annual increase in the national population and well-above the medium projection based on the 2013 census (projected increase of 1.3% per annum). We are forecasting that the Northland population will increase by 1.5-2.0% in 2020/21 leading to a similar increase in separately used or inhabited parts of a property and rating units (SUIP's) and rating units. 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 estimates and Subnational population projections by sex and age, 2013 (base) – 2043 update (released February 2017).	Population growth and/or growth in properties will be significantly different from projected. Rate postponements increase as a proportion of rates owed.	Low	Low This equates to an increase of 1428 SUIP's/rating units per year. The average rate per SUIP/rating unit is $340.69 excl GST.	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 aging 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.

Assumption and impact of assumption	Risk	Likelihood	Financial impact	Impact of risk
We expect that 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 2019/20.
We expect there will be no significant change to **council business** dictated by as yet unknown/unconfirmed legislation or central government policy change.	Changes to council business significantly alter operations and activities carried out by council.	Medium	Low	The final effect of any 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. The 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.
We expect that **climate change impacts** 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 regarding 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 future long term plans.
Budget provision will be adequate to address costs arising from **natural disasters.** The council holds insurance for its assets, including the Awanui River Flood Management Scheme.	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. The 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
The council has adjusted its base financial projections to reflect the estimated impact of **inflation** using the Business and Economic Research Limited (BERL) "Forecasts of Price Level Change Adjustors – 2017 Update" displayed below (at a per annum change). The BERL Opex price adjustor forecast has been applied to all operational expenditure items subject to inflation, with the exception of salaries at 2.2% The BERL Capex price adjustor forecasts have been applied to capital expenditure items at 2.2%.	The actual rate of inflation varies from the assumed rate of inflation.	Low to Medium	Low to Medium A 1% increase in the inflation rate over and above the BERL rates will increase council's total operating expenditure by $312,205. Should operating 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 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.
Inflation rates applied – salaries Salaries are based on a council-led staffing initiative. Salary increases have been estimated at 3%.	The actual rate of salary increases will vary from the assumed rate of salary increases.	Low	Low A 1% increase in salaries over and above the rate applied will increase operating expenditure by $195,723.	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 – activity income Activity income sources subject to inflation are assumed to increase using the BERL Opex price adjustor (at a per annum change), with the exception of rating revenues and New Zealand Transport Agency subsidies: Budget forecasts were developed on the basis of a council resolution to increase user fees and charges by 2.2%.	The actual activity revenue is influenced by rates of inflation different than the assumed rate.	Low	Low	Although activity income streams may vary annually due to factors 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.

Assumption and impact of assumption	Risk	Likelihood	Financial impact	Impact of risk
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%. The 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.	Actual subsidy rates and criteria for approved works change from the time the Annual Plan is compiled.	Medium	Low The maximum financial impact would be the total elimination of the total subsidy income estimated at $1,897,308.	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 throughout the Annual Plan, the council intends to increase its rates 8.6% on average.	That the projected rate increases are insufficient to cover expenditure increases resulting from inflation.	Low to Medium	Low to Medium Rate funding provides approximately 61% of council revenue, with the remaining revenue coming from investment income, user charges, grants and subsidies. A 1% increase in rating income would provide $323,529 additional income, whilst a 1% increase in operating costs would equate to an additional $507,927 of expenditure.	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.
Rates collection Rates collection for the 2020/21 year is assumed to be 87% of overall rated income, or 87 cents in the dollar.	Rates arrears are higher than anticipated, with possible link to new legislation managing Māori freehold land.	Low to medium	Medium A 1% decrease in rates collection would result in $311,283 less income.	A higher amount of unpaid rates would negatively impact council's budgeted cashflow.
Rates revenue The net impact on rates revenue of: • Discounts. • Postponement. • Maori Freehold Land impairment. • Penalties. is offset by a separate budgeted provision.	The provision is not set high enough to offset the impact of all factors,	Low to Medium	Medium A 1% decrease in rates collection would result in $311,283 less income.	A higher amount of unpaid rates would negatively impact council's budgeted cashflow.

Assumption and impact of assumption	Risk	Likelihood	Financial impact	Impact of risk
Forecast return on council investments **Cash investments** We assume no interest income will be derived from cash investments. The council hold working capital in managed funds and releases funds as required. **Externally managed funds** Revenue derived from investments in externally managed funds is calculated upon an assumption of returns of 4.6% in the short term fund, being 3% plus the 90 day bank bill rate calculated on the index of 1.6% (12 month rolling period at 30/1/2020) and 6.5% for the long term fund, being a real return of 4.5% after assuming long term inflation of 2%. The Investment and Growth Reserve and Community Investment Fund are discussed separately below.	Actual interest rates vary from those projected.	Medium	Medium An increase (or decrease) of 1% above (or below) forecast returns on council externally managed funds will result in a variance in interest and capital gains of approximately $14,577.	If actual interest rates are lower than the forecast rates, then the Investment and Growth Reserve may receive a reduced allocation and/or other funding sources or savings may be considered to offset the difference.
There will be no **fair value movements to the managed fund investment portfolio.** Managed funds values will only change by investment gains earned and retained.	Managed fund fair value will vary from the assumption	Low	Low	Any investment revaluations are non-cash in nature so will have no material impact on council's funding sources.
We project that **forestry investment revenue** will be 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.
Each year for the life of the plan, **1.7 million of investment income will be redirected to the Investment and Growth Reserve**, but will be invested via the Community Investment Fund. Inflation will be applied to the 1.7 million using the BERL Opex price adjustor. This inflation adjustment will be funded from Community Investment Fund revenue.	The council will increase the redirection. The council will decrease the redirection.	Low – Medium Low	An increase or decrease of 1% in the forecast redirection of the Investment and Growth Reserve will result in a $17,721 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 to the Investment and Growth Reserve for allocation.

Assumption and impact of assumption	Risk	Likelihood	Financial impact	Impact of risk
Forecast return on investments made from the Investment and Growth Reserve We forecast that funding set aside in the Investment and Growth Reserve (invested in the Community Investment Fund) will earn a return of 6.5% per annum. Investment and Growth Reserve funds will be invested in accordance with council's Investment Policy 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 Investement and Growth Reserve will vary significantly. The 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 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 of $4,711.	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.
Income from the Community Investment Fund Community Investment Fund revenue earned will be reinvested in the fund (except the portion required for the inflation adjustment to the redirection to the Investment and Growth Reserve of 1.7 million and any general funding required). We assume the opening balance of the fund at $15.2 million.	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 $7,153. Any reduction in Community Investment Fund income may result in the Investment and Growth Reserve being called upon to fund the shortfall.	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.
Borrowing costs (external and internal) We have assumed the cost of existing external borrowing (18.5 million at 1 June 2019) is at the current borrowing rates, and that the cost of new debt (from the 1 June 2019) is 6.5%. Internal borrowing rates are outlined in the Financial Strategy. 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.	The prevailing interest rate varies from those assumed.	Medium	Low	Borrowing costs increase or decrease. Small changes are unlikely to affect rates, large changes, however, may result in an increase or decrease to associated rates. Interest expense and interest income associated with internal borrowing offset each other in the financial forecasts.

Assumption and impact of assumption	Risk	Likelihood	Financial impact	Impact of risk
Dividends We assumed that council will maintain its shareholding in Marsden Maritime Holdings Limited and that the dividend, expressed as a cents per share amount (cps), received from this shareholding will be 16.00. The council is not forecasting any dividends from Regional Software Holdings Limited nor any special dividends from Marsden Maritime Holdings Limited.	The council chooses not to maintain its shareholding in Marsden Maritime Holdings Limited. The actual dividend per share in Marsden Maritime Holdings Limited will vary from the assumed amount. Dividend return is received from Regional Software Holdings Limited.	Low Low Low	Low An alternative investment would be sought with an annual return. Low A 1 cent per share movement in the declared Marsden Maritime Holdings Limited dividend will have an impact on council's dividend income by $221,400. Low	If actual dividend income is lower than the forecast other funding sources or savings will be considered to offset the difference.
Investment property rental income We assume that the council's investment property portfolio will be tenanted throughout the year at the current occupancy rates and that rents will be maintained. **Commercial property sales** The proceeds from any investment property sale will be reinvested in an investment that provides a return of 6.5% per annum.	Occupancy rates decline resulting in less than forecast rental income.	Low	Low A 1% reduction in council's investment property rental income equates to $34,906.	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 a material impact on the annual rental income.
Revaluation of investment properties. We assume 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.	That the actual revaluation movements will vary from those assumed.	Medium	Low A 1% increase in council's investment property portfolio equates to an estimated increase of $638,637 in the value of the portfolio.	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.
Revaluation of land and buildings. We assume that the value of the council's land and buildings will not change.	The actual revaluation movements will vary from those assumed.	Medium	Low A 1% increase in building asset values will equate to a minimal increase in depreciation. For land assets there is no impact on depreciation as these assets are not depreciated.	Any land and building revaluations are non-cash in nature so will have no material impact on the council's funding sources. If the revaluations are different from those forecast, it will affect the fixed asset values and flow through to changed levels of depreciation expense.

Assumption and impact of assumption	Risk	Likelihood	Financial impact	Impact of risk
Revaluation of infrastructure assets We assume that the value of the council's infrastructure assets will not change.	That the actual revaluation movements will be significantly different from those forecasted.	Medium	Low A 1% increase in infrastructure asset values will equate to a minimal increase in depreciation. For land assets there is no impact on depreciation as these assets are not depreciated.	Any infrastructure asset revaluations are non-cash in nature so will have no material impact on the council's funding sources. If the revaluations are different from those forecast, it will affect the fixed asset values and flow through to changed levels of depreciation expense.
We assume that 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, Liability Management 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 the council's accounting policy. The 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 existing assets.	That council assets wear out earlier or later than estimated. That the council changes activities resulting in decisions not to replace certain existing assets.	Low	Low	The council has several 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 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

Assumption and impact of assumption	Risk	Likelihood	Financial impact	Impact of risk
Vested assets We expect no vesting or divesting of assets.	Assets will be vested with the council	Low	Low	Vested assets have an associated depreciation expense and this will 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. Should any of these properties be sold, we assume there will be no change in the total investment revenue earned by the council.	That the timing or amount of disposal of the sale of Joint Venture Investment Assets differs from that assumed. That the value of the designation inventory asset is impaired or realised.	Medium Medium	Low A 1% decrease in the Marsden Point rail corridor investment property revenue equates to $8,345. Low A 1% decrease in the Marsden to Oakleigh rail corridor designation in year 1 equates to an impairment cost of $30,655	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 $35,430 increase or decrease in cash available to be invested. Any impairment of the inventory asset is a non-cash expense and therefore any impact will be immaterial.