

# Significant Forecasting Assumptions

## Budget and Forecasting Assumptions and Risk Assessment

Schedule 10 of the Local Government Act 2002 requires that the Council identifies the significant forecasting assumptions and risks underlying the financial information set out in the ten year Long Term Council Community Plan (LTCCP). Where there is a high level of uncertainty the Council is required to state the reason for that level of uncertainty and provide an

estimate of the potential effects on the financial assumptions. The level of uncertainty is determined by reference to both the likelihood of occurrence and the financial materiality.

The Council has made a number of significant assumptions in the preparation of the financial forecasts in this LTCCP. These

assumptions are necessary as the LTCCP covers a 10 year period and to ensure that there is a consistent and justifiable basis for the preparation of the financial forecasts. The significant forecasting assumptions used in developing the financial forecasts in the LTCCP are detailed in the table below.

Forecasting Assumptions	Risk	Level of Uncertainty	Reasons and Financial Effect of Uncertainty
<b>General Assumptions:</b>			
<p><b>Projected growth change factors:</b></p> <p>City growth assumptions underpin the Council's Asset Management Plans and capital expenditure budgets in the LTCCP.</p> <p>These assumptions are informed by forecasts based on Greater Wellington Regional Council's MERA projection modelling on population, dwellings and employment based on Statistics NZ census data.</p> <p>We generally use the "medium series" population projections which are recommended by Statistics NZ. They are derived from a top-down perspective - national first then applied to individual territorial local authorities based on their make-up and historical trend.</p> <p>Statistics NZ make assumptions on fertility and mortality rates and migration. The migration assumptions also have low, medium and high rates based on historic trends and short-run migration levels that are based on an analysis of immigration permits, residence applications and approvals, overseas student numbers, and arrivals and departures analysed by characteristics such as citizenship, country of last/next permanent residence and age.</p>	<p>That growth is higher than projected thereby putting pressure on Council to provide additional infrastructure and services.</p>	Low	<p>Low to moderate growth can be accommodated within the present level of Council infrastructure. Where growth requires additional infrastructure, Council will collect development contributions to meet a portion of the cost of new or upgraded investment. Capital costs over this amount will result in additional Council expenditure which will need to be funded through new borrowings.</p>
	<p>That growth is lower than projected thereby resulting in surplus capacity in existing or planned infrastructure and services.</p>	Low	<p>Negative growth may not necessarily result in a lower number of ratepayers as on average the number of people per household is decreasing.</p> <p>A consistent and significant decline in population would likely result in moderate increases in rates.</p>

Forecasting Assumptions	Risk	Level of Uncertainty	Reasons and Financial Effect of Uncertainty
<b>General Assumptions:</b>			
<p><b>Growth in ratepayer base:</b></p> <p>The estimated growth in the City's ratepayer base is:</p> <p>2009/10 1.2%</p> <p>2010/11 0.5%</p> <p>2011/12 0.7%</p> <p>2012/13 1.0%</p> <p>2013/14 1.0%</p> <p>2014/15 1.5%</p> <p>2015/16 1.5%</p> <p>2016/17 1.5%</p> <p>2017/18 1.5%</p> <p>2018/19 1.5%</p> <p>As a result, the "real" average rates funding increase will be reduced by an equivalent amount as there are a greater number of ratepayers across which the rates funding requirement will be allocated.</p>	<p>The growth in the ratepayer base is higher or lower than projected.</p>	<p>Low–Med</p>	<p>The Council has used current property information from its valuation service provider (Quotable Value) to assess the level of growth in rating units. The projected growth for 2009/10 is considered robust, with a higher level of estimation for out-years.</p>
<p><b>Levels of Service</b></p> <p>Demand for Council Services and customer expectations regarding levels of service will not significantly change and therefore there will be no significant effect on asset requirements or operating expenditure.</p>	<p>There are significant changes in customer expectations regarding demand for services or levels of service.</p>	<p>Low</p>	<p>The Council has well defined service levels for its planned activities. Customer Satisfaction Surveys and other engagement strategies generally support this key assumption and therefore there are currently no areas of the Council's service that require significant modification.</p>
<p><b>Resource consents</b></p> <p>Conditions for existing resource consents held by Council will not be significantly altered. Any resource consents due for renewal during the 10 year period will be renewed accordingly.</p>	<p>Conditions of resource consents are altered significantly.</p> <p>Council is unable to renew existing resource consents upon expiry.</p>	<p>Low</p>	<p>The financial 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 the next 10 years.</p>
<p><b>Development Contributions</b></p> <p>Significant assumptions in relation to development contributions are included within the Development Contributions Policy.</p>	<p>Projected growth does not eventuate resulting in lower than expected development contributions.</p>	<p>Low</p>	<p>Growth assumptions are considered robust as they are informed by forecasts based on Greater Wellington Regional Council's MERA projection modelling on population, dwellings and employment based on Statistics NZ census data.</p>

Forecasting Assumptions	Risk	Level of Uncertainty	Reasons and Financial Effect of Uncertainty
<b>General Assumptions:</b>			
<p><b>Climate Change</b></p> <p>The Council has adjusted base financial projections to reflect the estimated impact of climate change related charges on the costs of electricity, natural gas and landfill emissions.</p>	That changes in government legislation will result in charges and revenue that are significantly different from estimated impacts of the Emissions Trading Scheme under the previous government	Medium-High (years 2-10)	Emission based charges are affected by external political and economic factors, most of which are outside of the Councils control and influence. The Council has estimated its costs and revenue based on assumptions contained within the Emissions Trading Scheme which, while currently under review, the Council deems to be the most reliable estimate available.
<b>Significant Financial Assumptions:</b>			
<p><b>Inflation</b></p> <p>The Council has adjusted base financial projections to reflect the estimated impact of inflation.</p>	That actual inflation will be significantly different from the assumed inflation.	Low-Medium Years (1-3) Medium-High Years (4-10)	Inflation is affected by external economic factors, most of which are outside of the Council's control and influence.  Council's costs and the income required to fund those costs will increase by the rate of inflation unless efficiency gains can be made.
<p><b>Inflation Rates Applied:</b></p> <p>Inflation rates have been estimated using the BERL "Forecasts of Price level Change Adjustors to 2019." The applicable rates are (shown cumulative):</p>			While individual indices will at times vary from what has been included in this LTCCP, the Council has relied on the Reserve Bank use of monetary controls to keep inflation within the 1.5 to 3% range.

	2009/10	2010/11	2011/12	2012/13	2013/14	2014/15	2015/16	2016/17	2017/18	2018/19
<b>Roading</b>	1.000	1.030	1.059	1.084	1.110	1.135	1.161	1.188	1.217	1.244
<b>Property</b>	1.000	1.030	1.058	1.088	1.118	1.150	1.186	1.216	1.244	1.272
<b>Water</b>	1.000	1.030	1.059	1.088	1.123	1.156	1.196	1.233	1.273	1.315
<b>Energy</b>	1.000	1.023	1.050	1.082	1.113	1.150	1.187	1.227	1.269	1.313
<b>Staff</b>	1.000	1.027	1.055	1.081	1.108	1.136	1.165	1.202	1.235	1.273
<b>Other Expense</b>	1.000	1.033	1.056	1.082	1.105	1.128	1.154	1.181	1.209	1.240
<b>Other Income</b>	1.000	1.030	1.061	1.093	1.126	1.159	1.194	1.230	1.267	1.305

Forecasting Assumptions	Risk	Level of Uncertainty	Reasons and Financial Effect of Uncertainty
<b>Significant Financial Assumptions:</b>			
<p><b>Application of the Inflation Rates:</b></p> <p>The inflation rates above have been applied across all items within the financial statements with the exception of:</p> <p>Revenue from investment properties – not inflated as most ground leases are subject to fixed rentals across the period.</p> <p>Petrol tax – forecast to remain constant. Revenue from petrol tax is driven by tax rates and volumes – both of which are expected to remain constant over the 10 year period.</p> <p>Interest revenue and expenditure – Interest rates do not increase annually in line with rates of inflation. Interest rates have been forecast to remain constant. Refer section below.</p> <p>Dividends – Although rates of inflation will affect the revenues and expenditures of those entities distributing dividends to the Council it is not anticipated that the level of dividend will be influenced by rates of inflation in the future.</p>	<p>That the revenue streams identified are influenced by changes in prices or the rate of inflation.</p> <p>That the revenue streams identified fluctuate annually as a result of external factors outside the control of the Council.</p>	<p>Low</p> <p>Low-Mod</p>	<p>The assumption is considered reasonable in these cases due to the specific circumstances noted.</p> <p>Although the revenue streams may vary annually due to factors outside the control of the Council (eg, petrol consumption may vary and therefore affect the revenue received from Petrol Tax) it is not considered that annual variances will have a material effect on the financial forecasts in the LTCCP.</p>
<p><b>Expected return on investments:</b></p> <p>Council has forecast the following returns for significant investments:</p>			
<p><b>Wellington International Airport Limited shareholding</b> – it is assumed that the Council will retain its existing investment in WIAL of 34% and that a regular flow of revenue will be received by way of dividend.</p>	<p>That Council will not achieve the forecast level of dividends.</p>	<p>Mod</p>	<p>The forecast annual dividend from Wellington International Airport Limited is \$5 million. Wellington International Airport Limited does not have a dividend policy in place. The level of dividend is dependent on the financial performance of the company. The Council has utilised historical results and future projections of the company to determine the forecast return.</p>
<p><b>Wellington Cable Car Limited</b> – it is assumed that the Council will retain its existing investment at the same level. Dividends are assumed to remain constant across the 10 year period.</p>	<p>That Council will not achieve the forecast level of dividends.</p>	<p>Mod</p>	<p>The forecast dividend from Wellington Cable Car Limited is \$250,000 per annum. The level of dividend is dependent on the financial performance of the company. The Council has utilised historical results and future projections of the company to determine the forecast return.</p>

Forecasting Assumptions	Risk	Level of Uncertainty	Reasons and Financial Effect of Uncertainty
<b>Significant Financial Assumptions:</b>			
<p><b>Wellington Regional Stadium Trust loan</b> – in accordance with the terms of the loan, no interest has been forecast across the 10 year period.</p> <p>The loan is due to be repaid once the Trust has repaid all of its other liabilities and borrowings. The Trust may return part of its annual operating surplus to the Council to repay all or part of the outstanding loan.</p>	The loan will not be repaid.	Low	As the Trust is currently servicing its other loan obligations to commercial lenders, the Council considers that it is unlikely that the Trust will make an annual repayment of the outstanding loan. Once these commercial loans have been repaid the Council expects that the Trust will be in a position to repay the loan advanced by the Council. There is currently no information / reason to suggest that the Trust will not be in a position to repay the Council's loan.
<p><b>Expected interest rates on borrowings</b></p> <p>Interest is calculated at 6.75% per annum.</p>	That prevailing interest rates will differ significantly from those estimated.	Mod	Interest rates are largely driven by factors external to the NZ economy. Council is predicting a significant increase in borrowings over the 10 year period. Based on Council projected borrowings levels, interest costs will increase/decrease by between \$3m and \$3.3m per annum for every 1% movement in interest rates.
<p><b>NZTA subsidies</b></p> <p>NZTA requirements and specifications for the performance of subsidised work and subsidy rates will not alter to the extent that they impact significantly on operating costs.</p>	Changes in the subsidy rate and variation in criteria for inclusion in the subsidised works programme.	Low	NZTA funding priorities may change as a result of the Land Transport Management Act 2003. Variations in subsidy rates will increase/decrease Council's operational revenue by \$0.09m to \$0.12m for every 1% change in subsidy.
<p><b>Vested assets</b></p> <p>No vesting of assets is forecast across the 10 year period.</p>	That Council will have assets vested thereby increasing the depreciation expense in subsequent years.	High	<p>The level of vested assets fluctuates considerably from year to year. Historical levels have not been material. The recognition of vested assets in the income statement is non-cash in nature and will have no effect on rates.</p> <p>The financial effect of the uncertainty is expected to be low.</p>
<p><b>Sources of funds for the future replacement of significant assets</b></p> <p>Sources of funds for operating and capital expenditure are as per the Revenue and Earnings Policy.</p>	That sources of funds are not achieved.	Low	User charges have been set at previously achieved levels. Depreciation is funded through rates. The Council is able to access borrowings at levels forecast within the LTCCP.
<p><b>Useful lives of significant assets</b></p> <p>The useful lives of significant assets is shown in the Statement of Accounting Policies.</p> <p>It is assumed that there will be no reassessment of useful lives throughout the 10 year period.</p>	That assets wear out earlier or later than estimated.	Low – Asset lives are based upon estimates made by engineers and registered valuers.	<p>The financial effect of the uncertainty is likely to be immaterial. Depreciation and interest costs would increase if capital expenditure was required earlier than anticipated.</p> <p>However, these impacts could be mitigated as capital projects could be reprioritised in the event of early expiration of assets.</p>

Forecasting Assumptions	Risk	Level of Uncertainty	Reasons and Financial Effect of Uncertainty
<b>Significant Financial Assumptions:</b>			
It is assumed that assets will be replaced at the end of their useful life.	That Council activities change, resulting in decisions not to replace existing assets.	Low	Council has a comprehensive asset management planning process. Where a decision is made not to replace an asset, this will be factored into capital projections.
Planned asset acquisitions (as per the capital expenditure programme) shall be depreciated on the same basis as existing assets.	That more detailed analysis of planned capital projects may alter the useful life and therefore the depreciation expense.	Low	Asset capacity and condition is monitored, with replacement works being planned accordingly. Depreciation is calculated in accordance with accounting and asset management requirements.
<p><b>Revaluation of property, plant and equipment</b></p> <p>These forecasts include a three yearly estimate to reflect the change in asset valuations for property, plant and equipment in accordance with the Council's accounting policies.</p> <p>The following assumptions have been applied to projected asset revaluations:</p> <p>Revaluation movements shall equate the inflation rates applied for all depreciable property, plant and equipment (refer section "Inflation").</p> <p>The depreciation impact of inflation shall be in the year following revaluation.</p> <p>The value of non-depreciable assets (eg land) is forecast to remain constant.</p>	That actual revaluation movements will be significantly different from those forecast.	Mod	<p>The majority of Council's depreciable property, plant and equipment assets is valued on a depreciated replacement cost basis. Therefore, using the projected inflation rate as a proxy for revaluation movements is appropriate and consistent with the treatment of price changes generally within the LTCCP.</p> <p>For land assets valued at market value (based on sales evidence), values have been assumed to remain constant. This reflects the wide disparity in views on the sustainability of current residential market prices. This assumption has no impact on depreciation as these assets are not depreciated.</p>
<p><b>Revaluation of other assets</b></p> <p>It is assumed that the value of all other assets (eg investment properties) accounted for at fair/market value will remain constant across the 10 year plan.</p>	That actual revaluation movements will be significantly different from those forecast.	Mod	For assets valued at market value (based on sales evidence), values have been assumed to remain constant. This reflects the wide disparity in views on the sustainability of current residential market prices. This assumption has no impact on depreciation as these assets are not depreciated.
<p><b>Renewal of External Funding</b></p> <p>It is assumed that Council will be able to renew existing borrowings on equivalent terms</p>	That new borrowings cannot be accessed to fund future capital requirements.	Low	<p>The Council minimises its liquidity risk by maintaining a mix of current and non-current borrowings in accordance with its Investment and Liability Management Policy.</p> <p>In accordance with the Liability Management Policy the Council must maintain its borrowing facilities at a level that exceeds 110% of peak borrowing levels over the next 12 months.</p>

# Other Financial Forecasting Information

In addition to the significant forecasting assumptions outlined above, the Council makes a number of other judgements and estimates in preparing the LTCCP. This section details other relevant forecasting information.

## 1. Funding Principles:

### Revenue and Financing Policy

Assumptions and principles in relation to funding of the Council's activities and capital expenditure programme are included within the Council's Revenue and Financing Policy. It is assumed that the current Revenue and Financing Policy will remain in effect for the entire 10 year period covered by the LTCCP.

## 2. Balanced Budget Requirement:

Section 100 of the Local Government Act 2002 (LGA) requires local authorities to set each year's operating revenue at a level sufficient to meet its operating expenditure for that year. This is known as the balanced budget requirement.

However, the LGA provides local authorities with discretion to vary its operating revenues where it resolves that it is financially prudent to do so. In reaching this decision a local authority must have regard to:

“(a) the estimated expenses of achieving and maintaining the predicted levels of service provision set out in the long-term council community plan, including the estimated

expenses associated with maintaining the service capacity and integrity of assets throughout their useful life; and

- (b) the projected revenue available to fund the estimated expenses associated with maintaining the service capacity and integrity of assets throughout their useful life; and
- (c) the equitable allocation of responsibility for funding the provision and maintenance of assets and facilities throughout their useful life; and
- (d) the funding and financial policies adopted under section 102.”

The overarching principles for application of the balanced budget requirement are contained in the Council's Revenue and Financing Policy. The financial impact of these principles is detailed in both the Funding Impact Statement and within the Significant Forecasting Assumptions.

In accordance with section 100 of the LGA the Council has resolved that it is financially prudent to depart from the balanced budget requirement in the following circumstances:

### Accounting for fair value changes

#### Principle

Under New Zealand equivalents of International Financial Reporting Standards (NZ IFRS), changes in the fair value of certain assets must be accounted for within the Statement of Comprehensive Financial Performance. In accordance with Section 100 of the Local Government Act 2002, it is

not considered financially prudent to fund changes in the fair value of assets or liabilities as these are essentially “unrealised” accounting adjustments.

#### Rationale

Changes in the fair value of assets and liabilities are non cash in nature but are required to be recorded in the Statement of Comprehensive Financial Performance for accounting purposes. The associated gains and losses will remain unrealised until disposal of the underlying assets. The proposed exemption will ensure that non cash income and expenditure movements are excluded from the assessment of the level of rates funding required to pay for the projected operating expenditure. Further, in the event that the gains / losses are realised during the disposal of the underlying assets / liabilities then the proceeds from disposal will be used to repay borrowings in accordance with the Council's Investment Policy.

No inter-generational equity issues have been identified in applying this exemption. Therefore, having had regard to the principles in section 100 (2), it is recommended that it is financially prudent not to fund, or account for, unrealised gains and losses arising from the change in fair value of underlying assets and liabilities.

### Non-funding of depreciation on Council assets

#### Principle

In accordance with section 100 of the Local Government Act 2002 the Council has previously satisfied itself that it is

not financially prudent to fund all/part of the depreciation expenditure on the following assets:

- Clearwater Sewerage Treatment Plant.
- Living Earth Joint Venture.
- Transport assets funded by NZTA.

In principle, the Council will fund depreciation on existing assets as a way of either replacing the asset at the end of its useful life or to repay the borrowings on the original construction or purchase of the asset. Accordingly, as a matter of principle the Council considers that it is not financially prudent to ask ratepayers to fund all / part of the depreciation expenditure on an asset.

- Where the original asset purchase was not funded by borrowings, or the original borrowings have been repaid, and
  - Where, on an ongoing basis, the replacement of the asset at the end of its useful life will be funded by a third party, or
  - Where the Council has elected not to replace the asset at the end of its useful life.
- Where a third party has a contractual obligation to either maintain the service potential of the asset throughout all or part of its useful life (or to replace the asset at the end of its useful life) and the Council already effectively funds this through operating grants/tariffs payable to the third party.

### **Rationale**

With respect to the specific assets identified above the Council considers that it is not financially prudent to fund all / part of the depreciation on these assets because:

### **Clearwater Sewerage Treatment Plant**

United Water has a 21-year contract to operate and maintain the Clearwater plant, so the Council has no need to put aside extra maintenance money. United Water is required to fund any repairs over this period. United Water is also required to return the plant to the Council after the end of its 21-year contract with a future life expectancy of at least 25 years. Despite this contractual arrangement, the Council still owns the Clearwater plant assets and is required to cover all operating expenses associated with the plant, including depreciation and financing costs.

### **Living Earth joint venture**

The Council has elected not to fund depreciation on these assets for the following reasons:

- the Council has considered that the assets associated with the former Living Earth venture are not critical to the Council's long term treatment and disposal of sewage
- the Council has not planned to replace these assets at the end of their useful life, and
- not funding depreciation will not alter the planned life of the Council's landfills, nor will it affect the environment objectives the Council is achieving.

### **Transport assets funded by NZTA**

Each year the Council receives funding from NZTA as part of the overall replacement and renewal programme for the City's roading infrastructure. The Council recognises the subsidies as income in accordance with GAAP. As the subsidies are received for capital purposes, they cannot be used to offset the rates requirement. Therefore the Council shall recognise a surplus equivalent to the amount of NZTA subsidies for capital purposes, and account for this as a special reserve to be applied against funding the depreciation expense that results on completion of the associated asset.

A non-funding exemption is available in respect of the associated depreciation to the extent that replacement is funded by NZTA. It is financially prudent for the Council not to fund this depreciation through rates, as it would be inequitable to place the funding burden on ratepayers when NZTA is already contributing the overall cost of replacement.

The exemptions from the balanced budget requirement in respect of the non-funding of depreciation on the assets identified above will not impact on the predicted levels of service provision set out in the LTCCP. No inter-generational equity issues have been identified in applying this exemption. Therefore, having had regard to the principles in section 100 (2), it is recommended that it is financially prudent not to fund all / part of the depreciation expenditure on the assets identified above.

### **Receipt of Capital Revenues**

#### **Principle**

The financial forecasts in the LTCCP include a level of projected revenue that will be received for the purpose of funding capital projects. For example, the Council receives subsidies from NZTA in respect of its transport capital projects and from development contributions for growth related capital expenditure. The receipt of this revenue is recognised as income in the Statement of Comprehensive Financial Performance in accordance with generally accepted accounting practice even though the subsidies represent an inflow of cash specifically for capital, rather than operating, purposes. As a result, it is inappropriate for these capital subsidies to be treated as income for rates funding purposes. The Council shall therefore recognise an operating surplus equivalent to the amount of NZTA subsidies and development contributions received for capital purposes in each year.



### *Rationale*

The exemption from the balanced budget requirement will not impact on the predicted levels of service provision set out in the LTCCP. The approach of applying capital subsidies for the purpose for which they were received (ie, to fund capital expenditure projects) supports the concept of inter-generational equity as it ensures that funding received for capital projects is not utilised to offset the rates requirement in a particular year but instead the benefit is spread over the life of the asset by way of reduced borrowings.

Therefore, having had regard to the principles in section 100 (2), it is recommended that it is financially prudent not to apply the receipt of capital subsidies, recognised as income in the Statement of Comprehensive Financial Performance, to offset the rates funding requirement in each year.

## **3. Capital Expenditure Programme**

All significant capital expenditure is included within the LTCCP. The Council's capital expenditure programme includes:

- Renewal of existing assets (principally in accordance with the underlying Asset Management Plans).
- Planned upgrades of existing assets.
- New investment in the City's asset infrastructure base where these have been identified, planned and approved by the Council.
- No asset sales are planned except as disclosed in the LTCCP.

## **4. Financial Reporting Standard 42: Prospective Financial Statements**

In accordance with the New Zealand Institute of Chartered Accountants Financial Reporting Standard 42: Prospective Financial Statements, the following information is provided in respect of the LTCCP:

### **(i) Description of the nature of the entity's current operations and its principal activities**

The Council is a territorial local authority, as defined in the Local Government Act 2002. The Council's principal activities are outlined on pages 34 to 189.

### **(ii) Purpose for which the prospective financial statements are prepared**

It is a requirement of the Local Government Act 2002 to present prospective financial statements that span 10 years, and that these are presented in the Council's LTCCP. This provides an opportunity for ratepayers and residents to review the projected financial results and position of the Council.

### **(iii) Bases for assumptions, risks and uncertainties**

The financial information has been prepared on the basis of best estimate assumptions as to future events which the Council expects to take place. The Council has considered factors that may lead to a material difference between information in the prospective financial statements and actual results. These factors, and the assumptions made in relation to the sources of uncertainty and potential effect, are included within the principal assumptions underlying the forecasts are noted on page 22.

### **(iv) Cautionary Note**

The financial information is prospective. Actual results are likely to vary from the information presented, and the variations may be material.

### **(v) Other Disclosures**

The prospective financial statements were authorised for issue on 29 June 2009 by Wellington City Council. The Council is responsible for the prospective financial statements presented, including the assumptions underlying the prospective financial statements and all other disclosures.

The LTCCP is prospective and as such contains no actual operating results.