Draft 2012/13 Financial Overview

Net Surplus[1]

The net surplus is the difference between the expenses the Council incurred during the year and the income the Council received. It is represented by the following formula:

Net Surplus = Total income – Total expenses

The Council recorded a net surplus of $62.2 million. The budgeted net surplus was $51.1 million. The net surplus for the year was $11.1 million greater than budgeted.

The net surplus for the year includes income that was received to pay for capital projects such as funding from NZTA for roading projects and Housing New Zealand for the upgrades to our social housing. As the cost for capital projects is not recorded in the Statement of Comprehensive Financial Performance the Council budgets to generate a surplus.

Underlying budget variance[2]

The underlying budget variance is the difference between the budgeted and actual surplus after adjusting for items that are not used to fund operating expenditure.

The underlying budget variance was $1.1 million this year. After adjusting for specific ring-fenced activities relating to City Housing and Waste there is a $1.9 million underlying variance available to carry forward. The underlying variance to carry forward represents a surplus that has arisen from the recognition of additional operating income or though savings in expenditure. This will be considered as part of future funding decisions during the approval of the Annual Plan.

The main items contributing to the underlying variance was an increase in the weathertight homes provision of $9.9 million offset by dividend income being $13.1 million greater than expected.

The weathertight homes provision represents an estimate of the claims outstanding at the end of the reporting period together with an estimate of the claims incurred but not yet reported. The provision is based on best estimates and actuarial assessments. The $9.9 million increase in the provision this year is largely due to an increase in the estimated cost of claims that have been lodged. The total provision for weathertight homes at 30 June was $56.1 million.[3]

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[1] Annual Report, Statement of Comprehensive Financial Performance, page XX
[2] Annual Report, Notes to the financial statements, Note 33: Major Budget Variations, page XX
[3] Annual Report, Notes to the financial statements, Note 23: Provisions, page XX

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Actual costs incurred may vary significantly from those included in this provision, especially for future claims relating to weathertightness issues not yet identified or not yet reported.

Offsetting the increase in the provision, dividend income was $13.1 million greater than expected due to a special dividend being received from Wellington International Airport Limited.

	$M
Net surplus	**62.2**
Adjusted by:	
Fair Value movements	3.9
Expenditure from Wellington Waterfront and Venues projects and Porirua joint ventures	3.7
Gain or loss on disposal of property, plant and equipment - net	(6.5)
Changes to external funding for capital expenditure	(2.1)
Vested assets	(7.2)
Other adjustments	(1.8)
Underlying net surplus	**52.2**
less: budgeted net surplus	51.1
Underlying variance	**1.1**
Ringfenced (surpluses) and deficits - net variance from budget	0.8
Underlying variance available to carry forward	**1.9**

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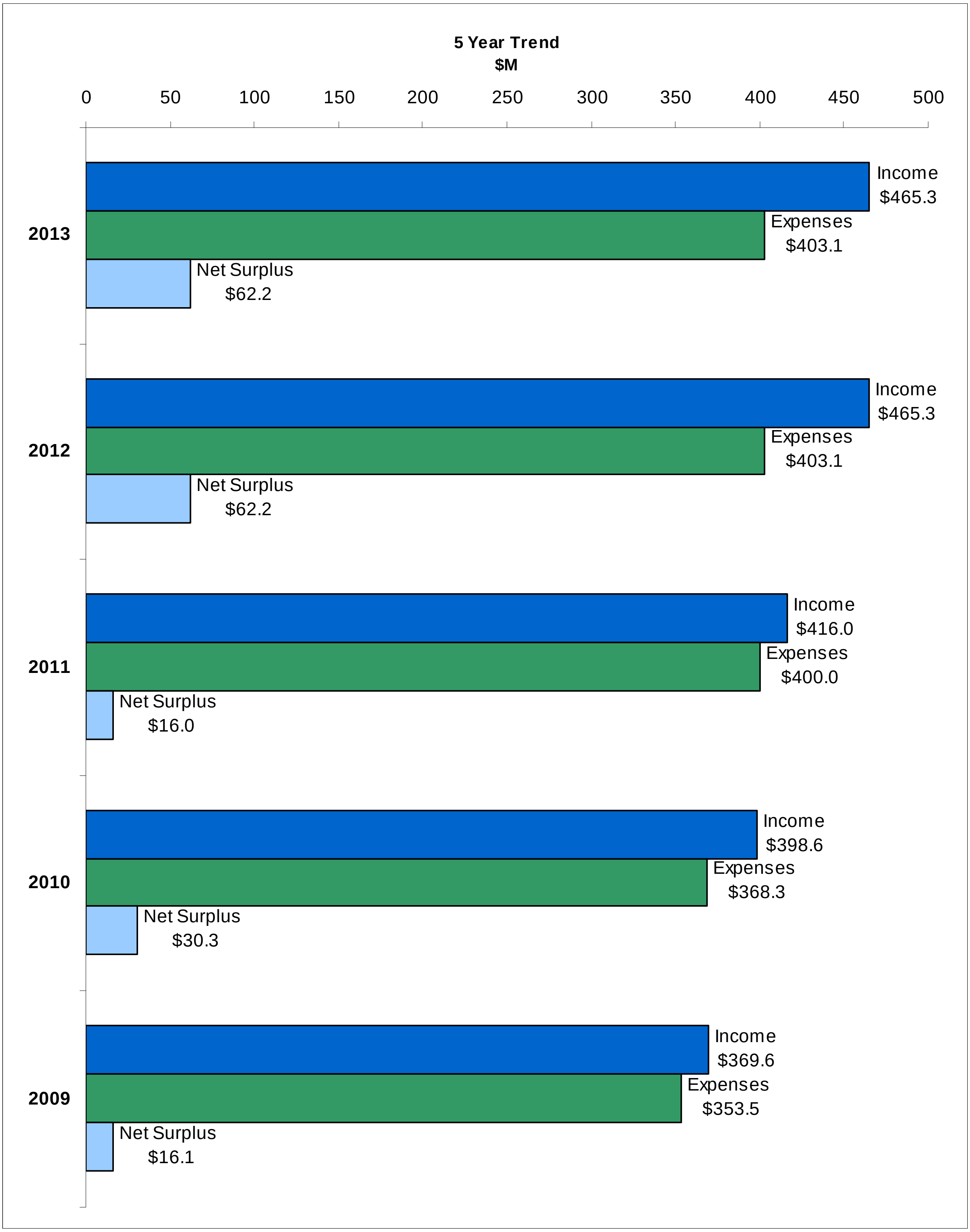
5 Year Trend
$M
0
50
100
150
200
250
300
350
400
450
500
2013
Income $465.3
Expenses $403.1
Net Surplus $62.2
2012
Income $465.3
Expenses $403.1
Net Surplus $62.2
2011
Income $416.0
Expenses $400.0
Net Surplus $16.0
2010
Income $398.6
Expenses $368.3
Net Surplus $30.3
2009
Income $369.6
Expenses $353.5
Net Surplus $16.1

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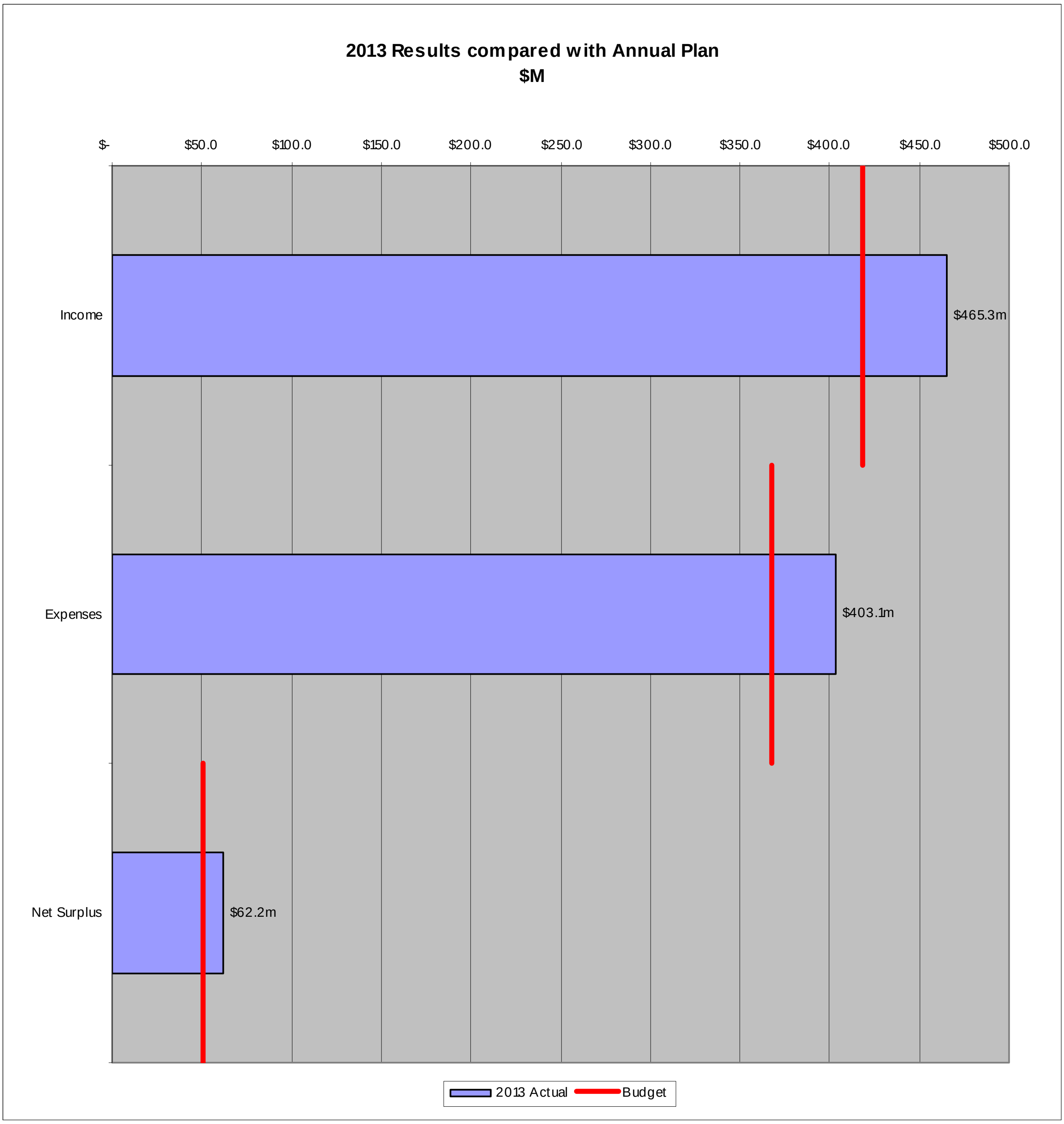
2013 Results compared with Annual Plan
$M
$-
$50.0
$100.0
$150.0
$200.0
$250.0
$300.0
$350.0
$400.0
$450.0
$500.0
Income
$465.3m
Expenses
$403.1m
Net Surplus
$62.2m
2013 Actual
Budget

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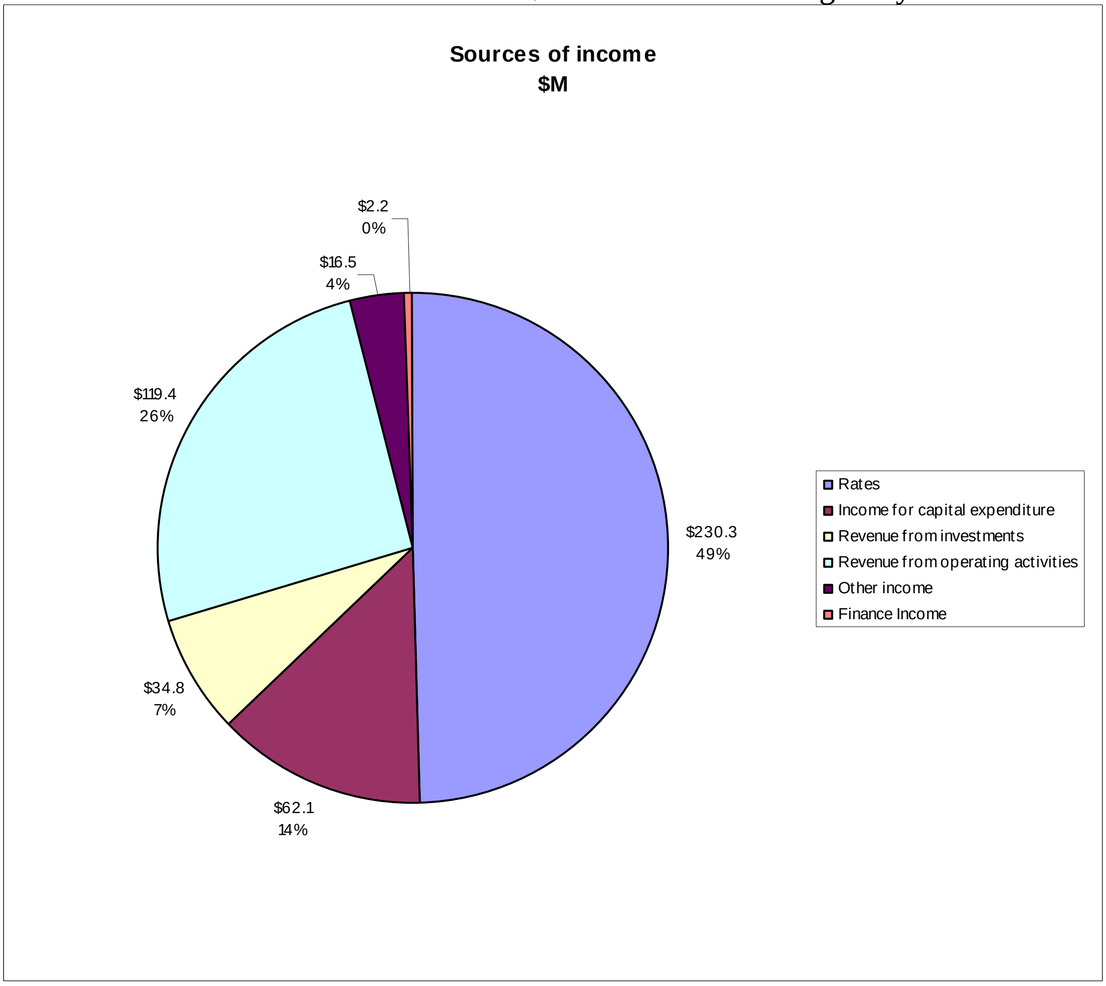
Financial Performance

Income[4]

The Council received total income of $465.3 million during the year.



Rates are the main source of funding for the Council with revenue from operating activities, which includes user fees, being the next largest source. Other sources of income for the Council include income for capital expenditure, income from interest and dividends.

We received $230.3 million of income from rates[5]. Rates income comes from a number of sources including general rates levied on properties and a range of targeted rates including stormwater and sewerage rates.

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[4] Annual Report, Statement of Comprehensive Financial Performance, page XX
[5] Annual Report, Notes to the financial statements, Note 1: Revenue from rates, page XX

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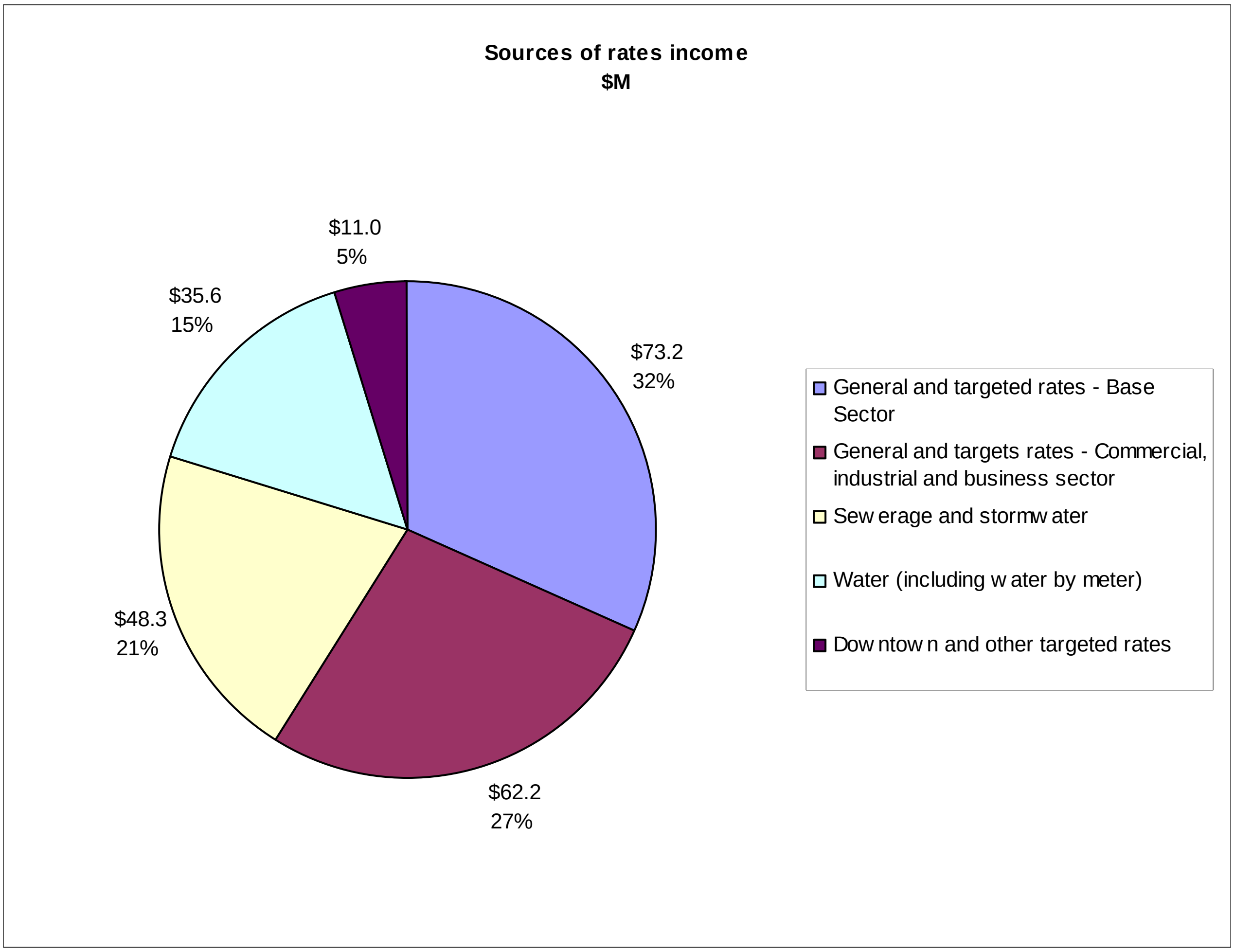

General rates revenue is collected based on property rateable values. Currently commercial properties pay rates at a higher level on their rateable value than non-commercial properties. This is called the rates differential. The rates differential during the year is shown in the graph below. Currently the ratio is 1:2.8.

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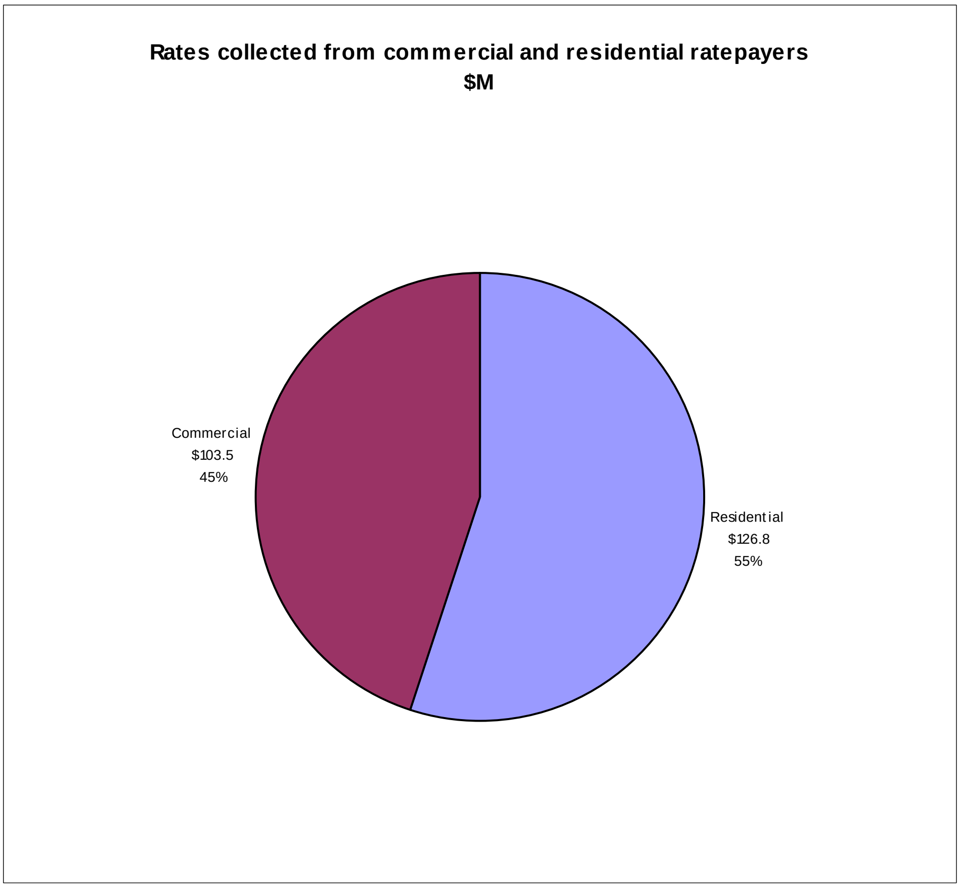
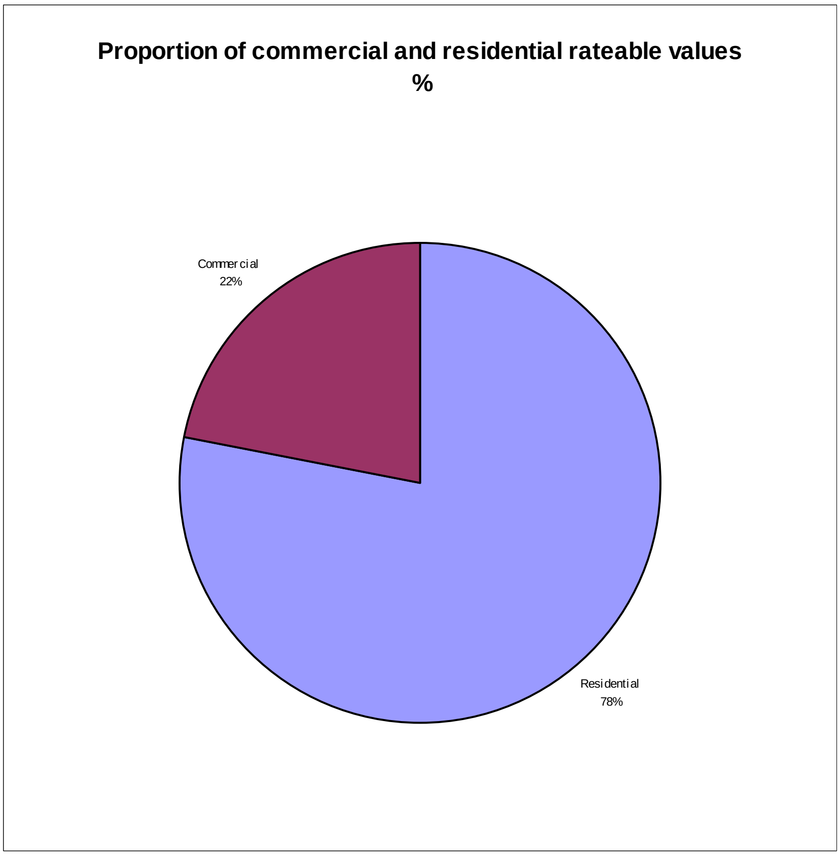

Rates collected from commercial and residential ratepayers
$M
Commercial
$103.5
45%
Residential
$126.8
55%


Proportion of commercial and residential rateable values
%
Commercial
22%
Residential
78%

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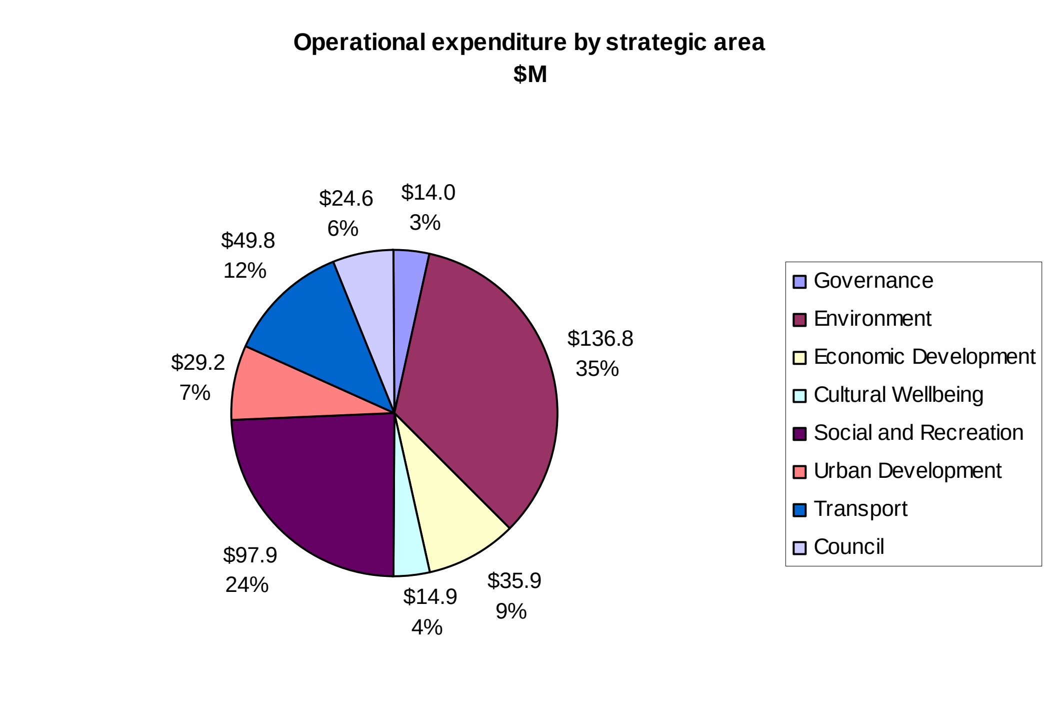
Expenses[6]

The total expenses incurred by the Council during the year were $403.1 million which represents the cost of running the city during the year. The activities of the Council are divided into seven strategic areas of focus:



The table below shows the cost per Wellington resident[7] per day for each strategic area.

Cost per strategic area per resident per day

Strategic area	Total cost $M	Cost per resident per year $	Cost per resident per day $
Governance	14.0	70	0.19
Environment	136.8	684	1.87
Economic Development	35.9	179	0.49
Cultural Wellbeing	14.9	74	0.20
Social and Recreation	97.9	489	1.34
Urban Development	29.2	146	0.40
Transport	49.8	249	0.68

[6] Annual Report, Statement of Comprehensive Financial Performance, page XX
[7] Estimated city population to be XXX,XXX by Statistics New Zealand

Council	24.6	123	0.34
	403.1	$2,014	$5.51

Deciding who pays

When we're deciding how to fund an activity (whether to use rates, user charges, or other sources of income), we consider:

- **community outcomes** that the activity contributes to;
- **who benefits** – individuals, identifiable parts of the community, or the community as a whole;
- the **timeframe** in which the benefit occurs – for example, an asset that lasts for several generations will generally be funded through borrowing and depreciation so that everyone who benefits, present and future, contributes.

Our Revenue and Financing Policy sets out how each Council activity will be funded, based on these criteria. The policy is available on our website www.Wellington.govt.nz.

How we funded our expenditure this year

The table below outlines how we funded our expenditure this year. The total spending of $403.1 million includes items that do not require funding. After adjusting for these items the remaining operational expenditure is $381.5 million.

	$M
Total operating expenditure	**403.1**
<u>Adjusted by:</u>	
City housing ring-fenced surplus	(1.3)
Waste activity ring-fenced surplus	0.7
Expenditure not funded under section 100 of LGA:[1]	
NZTA Transport funded projects	(7.8)
Sewerage treatment plant	(3.2)
Expenditure from Wellington Waterfront and Venues projects and Porirua joint ventures	(3.7)
Non-cash items:	
Loss on sale of assets	(0.2)
Vested asset expense	-

APPENDIX 4

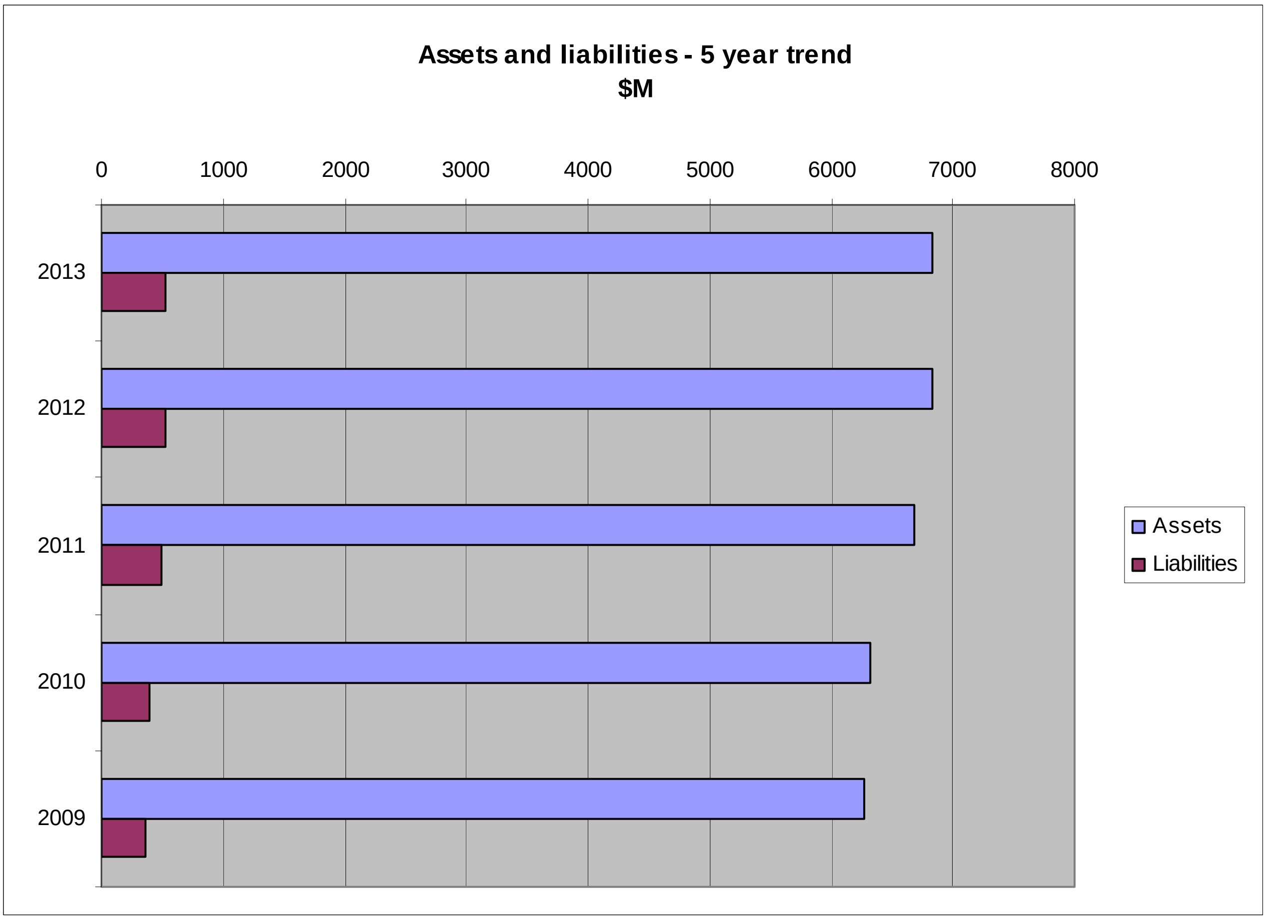
Fair value movements		(4.6)
Expenditure funded from prior year surplus		(1.5)
Total operating expenditure to be funded		**381.5**
Funded by:		
Rates		
General rates	**33%**	124.9
Targeted rates	**27%**	105.4
Less: self insurance reserve funded through rates		(0.5)
User charges and other income		
Revenue from operating activities	**28%**	107.9
Grants and subsidies	**2%**	7.5
Revenue from investments	**9%**	34.9
Other income	**1%**	2.4
Finance income	**0%**	0.9
Total sources of funding		**383.4**
Underlying surplus available to carry forward		**1.9**

Financial Position[8]

Net worth is the difference between the total assets and the total liabilities of the Council. Net worth is represented in the financial statements by the balance of equity.

The net worth of the Council at the end of the year was $6,306.3 million, an increase of $110.0 million from the previous year. The main reasons for the increase were the net surplus generated for the year and the revaluation of operational land and buildings carried out during the year.[9]

[8] Annual Report, Statement of Financial Position, page XX
[9] Annual Report, Notes to the financial statements, Note 25 Revaluations, page XX



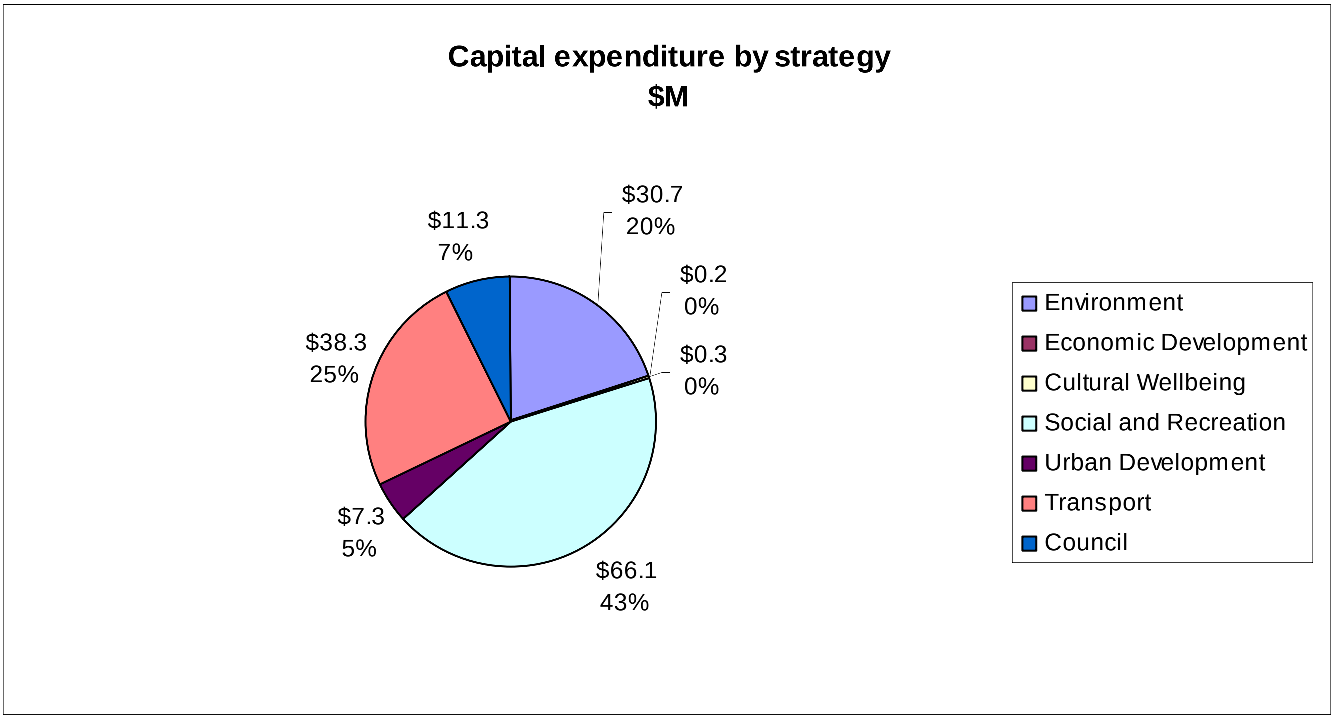
Assets

The major assets of the Council include:

- Property, Plant and Equipment (including land, buildings and infrastructure assets) – $6,501.7 million

- Other Assets (including investment properties and investments in subsidiaries and associates) – $337.8 million

During the year $154.2 million was spent on constructing and developing assets around Wellington which contributed to the balance of Property, Plant and Equipment. The chart below shows how much was spent on each strategic area during the year for constructing and developing assets:



While some capital expenditure during the year was used to pay for new assets such as the Regent Park housing complex and the Tacy Street stormwater pump station, the majority of the capital expenditure represents the replacement of existing assets.

To help spread the cost of assets to everyone who benefits the Council budgets to recover a certain amount of the value of the asset each year. This amount is called depreciation[10]. Depreciation spreads the cost of an asset over its useful life.

Liabilities

The major liabilities of Council include:

- Gross borrowings - $361.5 million[11]
- Other liabilities (including trade and other payables) - $171.7 million

The Council uses borrowings to fund the purchase or construction of new assets or upgrades to existing assets that are approved though the Annual Plan and Long Term Plan process.

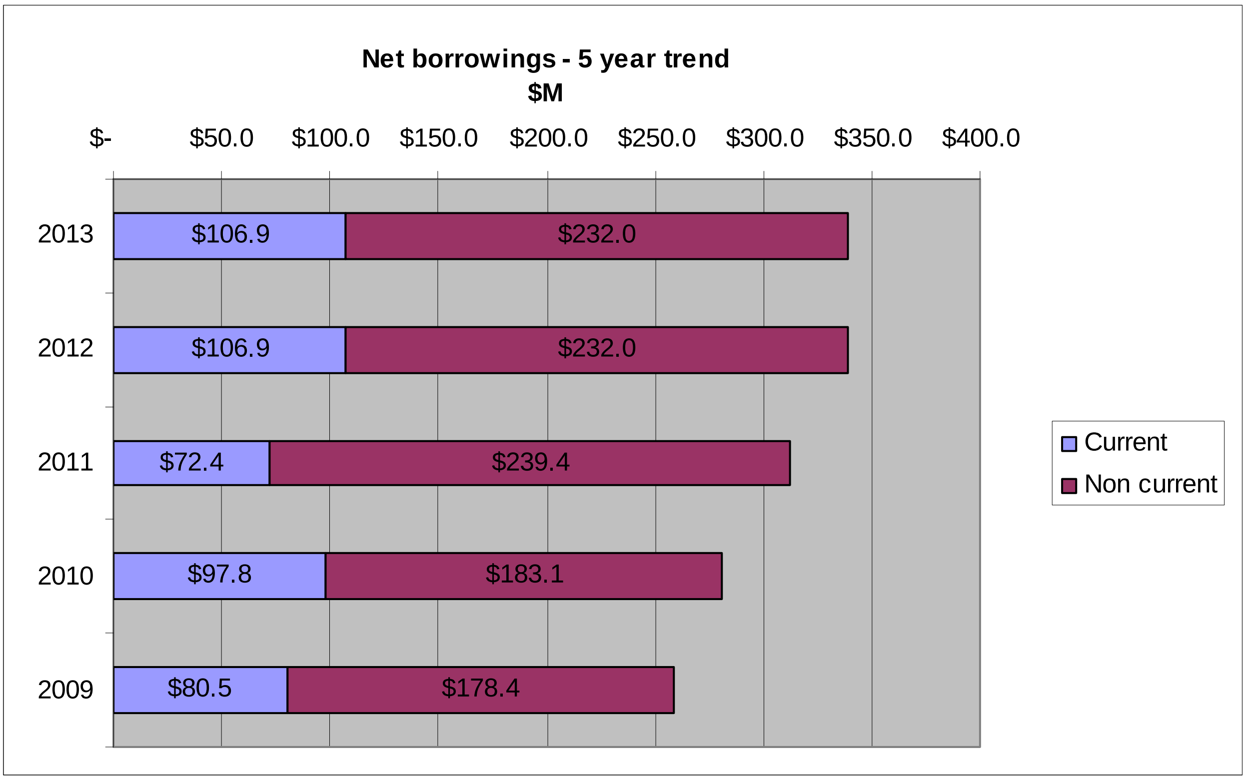
Net borrowings

Net borrowings are the total borrowings less any cash or cash equivalents.

Net Borrowings = Gross Borrowings – Cash and Cash Equivalents

[10] Annual Report, Statement of Comprehensive Financial Performance, page XX
[11] Annual Report, Notes to the financial statements, Note 21 Borrowings , page XX

The gross borrowings were $361.5 million[12], less the balance of cash and cash equivalents of $22.6 million, results in a net borrowings balance of $338.9 million at the end of the year.



Net borrowings increased by $27.1 million during the year. The net borrowings at the end of the year is $27.7 million less than budgeted in the 2012 Annual Plan. The reason for the difference is due to changes in the timing of capital projects and savings in capital expenditure.

Investment Position

The Council continues to maintain a strong investment position when compared with the level of borrowings. The graph below compares the balance of investments and net borrowings over the last five years.

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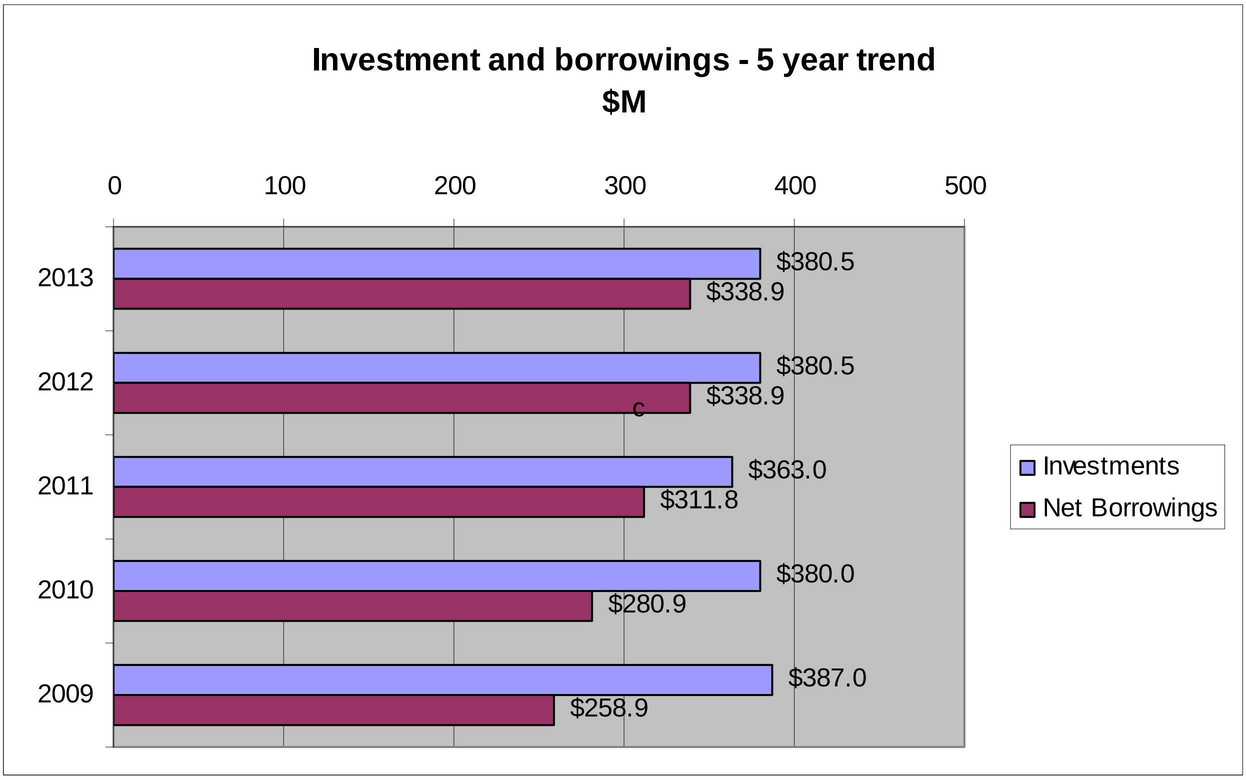
[12] Annual Report, Notes to the financial statements, Note 21 Borrowings, page XX



The balance of investments primarily comes from investment properties, our share of the net assets of our associates (including Wellington International Airport Limited) and other financial assets.

Borrowings Compliance

During the year the Council maintained its AA credit rating with Standard and Poors. The credit rating is a comparative measure of the financial strength of the Council. The AA credit rating held by the Council is the highest credit rating attributed to councils across New Zealand. Holding and maintaining such a high credit rating provides a range of benefits to the Council that would not otherwise be available. These benefits include access to lower cost borrowings and access to a wider range of borrowing alternatives.

The Council has met all of the core policy compliance requirements set out in the Council's Investment and Liability management Policy.

The prudential limits are set out in the table below:

Prudential limits	Policy Limit	Actual	Compliance
Borrowings as a % of equity	<10%	5.4%	Yes
Borrowings as a % of income	<150%	73.4%	Yes
Net interest as a % of annual rates income	<15%	8.4%	Yes

Notes:

* Equity is based on the 30 June 2012 Annual Report

* Net interest, Net borrowings, Annual Rates and Income are based on 30 June 2012 figures

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The Council uses hedging to reduce the impact of changes in interest rates. By hedging the floating rates they effectively become fixed rates. The Investment and Liability Management Policy sets out both upper and lower hedging limits. At the end of the year some 90% of the interest on borrowings was effectively fixed due to hedging[13].

Interest rate risk control limits (interest rate exposure)	Policy Limit	Actual	Compliance
Fixed interest proportion	50% - 95%	79%	Yes
Broken down as follows:			
1 - 3 year bucket	20% - 60%	20%	Yes
3 - 5 year bucket	20% - 60%	27%	Yes
5 - 10 year bucket	20% - 60%	53%	Yes

Liquidity is a measure of the Councils ability to access cash when required. The Council manages its liquidity risk by ensuring we have unused facilities available to fund future spending and by ensuring the maturity of our borrowings is well spread. The limits for liquidity are set out in the Investment and Liability Management Policy. There are some $159.5 million of unused facilities available at 30 June to cover future spending requirements and ensure that the Council has adequate access to funds at all times[14].

Liquidity/funding risk (access to funds)	Policy Limit	Actual	Compliance
Liquidity/funding risk (access to funds)	>110%	115%	Yes
Broken down as follows:			
1 - 3 year bucket	20% - 60%	50%	Yes
3 - 5 year bucket	20% - 60%	32%	Yes
5 - 10 year bucket	15 - 60%	18%	Yes

Notes:

* "Liquidity" is defined as Current borrowings + committed loan facilities divided by 12 month peak borrowings (for the purposes of measuring liquidity short dated Commercial paper is excluded)

Group highlights

The Group comprises the Council and its interests in associate and subsidiary entities. These entities include Wellington International Airport Limited and Capacity. Refer to Note 38 of the financial statements for the full Group structure diagram.

	2013 $M	**2012 $M**	**2011 $M**	**2010 $M**	**2009 $M**
Net surplus	**50.0**	50.0	8.2	23.5	16.0
Total assets	**7,006.4**	7,006.4	6,841.9	6,485.7	6,443.0
Total liabilities	**(540.1)**	(540.1)	(495.1)	(397.6)	(375.4)

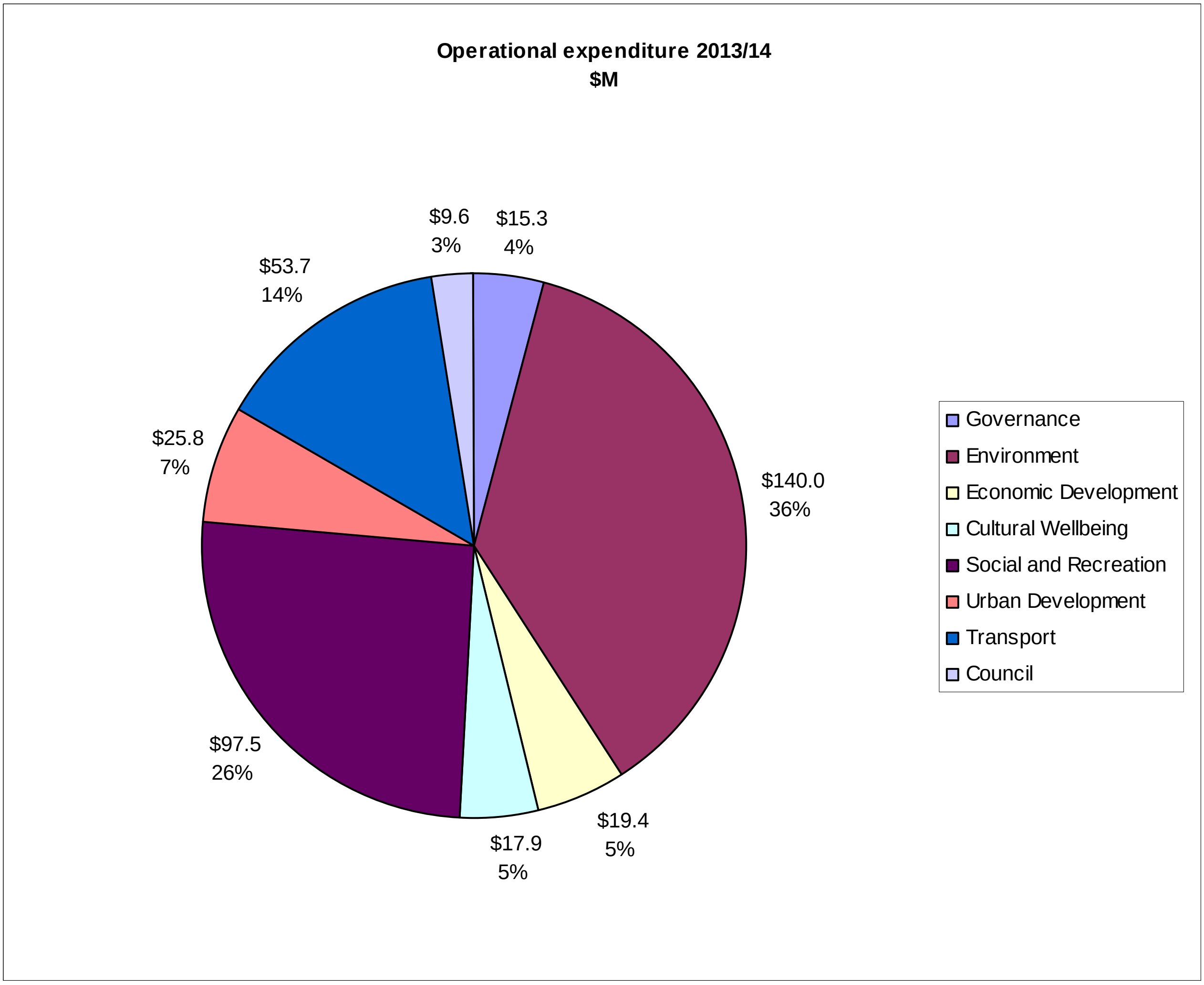
13 Annual Report, Notes to the financial statements, Note 31 Financial instruments, page XX
14 Annual Report, Notes to the financial statements, Note 21 Borrowings, page XX

Total equity	**6,466.2**	6,466.2	6,346.8	6,088.0	6,067.6

Looking forward

The results for the year ended 30 June 2012 reflect the delivery of high quality, cost effective services and products to the residents of Wellington.
The 2012-22 Long Term Plan sets out the Council's planned operating expenditure programmes for the 2012/13 year. The following graphs highlight the Council's spending plans for the 2012/13 financial year.

Operational Expenditure 2013/14 ($M)



Total operational expenditure: $379.2 million

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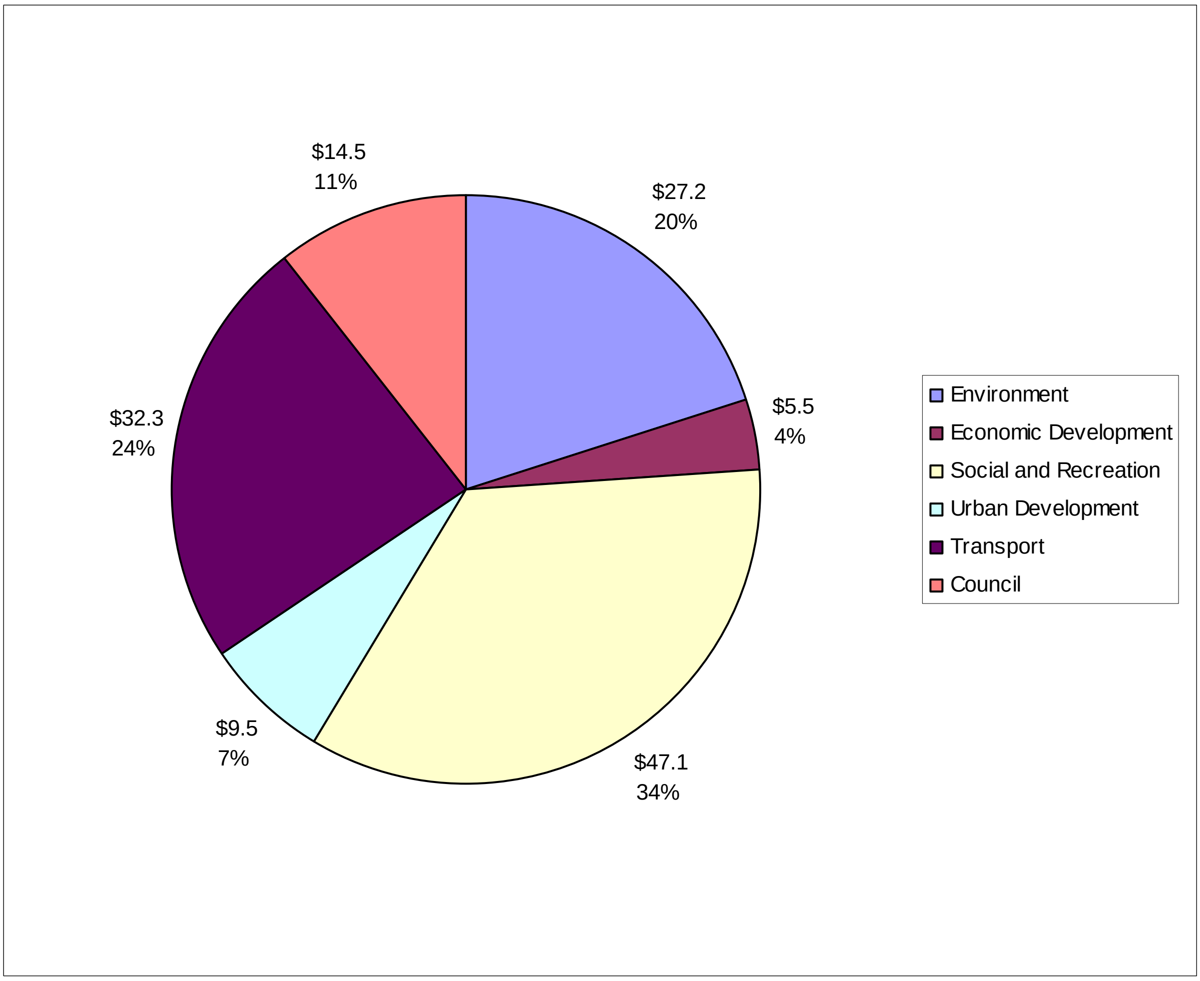
Capital Expenditure 2013/14 ($M)



Total capital expenditure: $136.1 million. This does not include the $XX.X million of capital expenditure carried forward from the 2012/13 financial year.[15]

Glossary

Associates – are entities that the Council owns a share of but does not control. Our share of the associates' surplus/deficit and net assets is recorded in the Group financial statements. The Council's associates are Basin Reserve Trust (50%), Capacity (63%), Chaffers Marina Holding Ltd (12%), Wellington International Airport limited (34%) and Wellington Regional Stadium Trust (50%).

Cash and cash equivalents – includes cash as well as deposits which mature in less than three months.

Current asset – an asset that can readily be converted to cash or will be used to repay a liability within 12 months of balance date.

Current liability – a liability that is required to be discharged within 12 months of balance date.

Depreciation (amortisation) – an expense charged each year to reflect the estimated cost of using our assets over their lives. Amortisation relates to

[15] Annual Report, Notes to the financial statements, Note 34 Analysis of capital expenditure by strategy, page XX

‘intangible’ assets such as software (as distinct from physical assets, which are covered by the term depreciation).

Fair value – essentially reflects the market value of assets or liabilities.

Investment properties – these are properties that are primarily held by the Council to earn rental income.

Liquidity/funding risk – this is the risk that the Council will not have access to the required funds to meet its present obligations.

Prudential limits – these are limits applied to the level of borrowings to ensure we are managing the Council’s assets and liabilities prudently. These limits are outlined in the Investment and Liability Management Policy in the Long Term Plan.

Ring-fenced – funds that can only be used for a specific purpose.

Vested assets – assets that are created by others and passed into Council ownership (e.g. roads built by a developer as part of a subdivision).