Local Authority Assets and Debt – Options for the treatment of council debt and assets in a reorganisation of the Wairarapa district councils

Report to the Local Government Commission

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Purpose

1. Following engagement with the Wairarapa community, the Local Government Commission is doing more detailed work on the community's preferred option for local government reorganisation: a single district council for the Wairarapa, combining the current South Wairarapa, Carterton and Masterton District Councils.

2. The impact of reorganisation on council debt, assets and liabilities is likely to be an important factor in their consideration of a reorganisation proposal. Accordingly the Commission is considering whether ring fencing debt and assets should be included in any draft proposal.

3. This paper explores the current debt and assets of the Wairarapa councils and considers options for the treatment of debt and assets to fairly treat the ratepayers of each district. The first sections provide information on the three councils. The final section provides our comments on the treatment of debt and assets of the three councils.

4. This report relies on the annual financial statements, and planning documents (Long Term Plans, Infrastructure Strategy and Asset Management Plans) of the three councils, as well as conversations with officers of each of the three councils. The 2015/16 Annual Reports available here are prior to final sign-off by Audit New Zealand.

Background

5. In principle there is an issue of equity that the Commission should have regard to in considering the possible merger of councils. It may not be fair or equitable to expect the current residents of a neighbouring local authority to take on the burden of debt through a merger of the local authorities where one has a larger level of indebtedness that reflects either: the poor management of the council, or decisions to fund assets by borrowing rather than to save up for them first, or decisions to adopt a higher level of service.

6. Councils make differing decisions on when and how assets are paid for. Councils may fully fund the construction of infrastructure by borrowing and then pay off the debt using its future provision for depreciation. This approach means that those who benefit from the infrastructure pay for it over its useful life. Other councils may save up for an asset and then build it. This approach places the burden on current ratepayers who may not fully benefit from the investment. Both approaches are legitimate, but an issue arises when two differing approaches need to be combined.

7. Equally, differences in the level of debt at any point in time may reflect differences in the cyclical renewal and replacement of major assets, or the presence or absence of growth in a district. A focus on current debt may obscure differences in asset condition and the differences in future financial liabilities that they might imply.

8. Councils generally operate a consolidated treasury with a net external debt position that is designed to minimise the cost of borrowing. Whilst it was commonplace in the 1980s for

councils to raise particular loans that are related to a specific asset that practice is increasingly rare.

9. Councils often use internal borrowing to minimise external debt. This means that they will have used the cash associated with a particular reserve to fund another activity, but they will have recorded within their accounts both the financial value of the reserve and the internal loan. When the council decides to commit the funds from the reserve for the purpose for which they are held, it must then either repay the internal loan, or raise external debt to support the expenditure. In some circumstances internal borrowing is from a council's general reserves. Simply looking at the external debt position of a council can be misleading.

10. Capital expenditure on major assets is frequently very lumpy. Large projects tend to be built associated with large developments, in particular with major subdivisions and new construction. Consequently, the total amount of debt and funding required will rise and fall depending on which part of the construction, renewal and maintenance lifecycle the council is at.

11. Despite the qualifications noted above, it is far easier to focus on external debt than it is to focus on the future liabilities that a council may face with respect to its assets. Water and wastewater infrastructure is almost all below the ground. Its state and condition can be difficult to assess. These are long-life assets that will need to be repaired and replaced at some point in time. Understanding where each council is at in the process of maintaining and renewing its infrastructure provides an important counterpoint to the visible external debt.

12. There is a considerable amount of effort devoted to understanding the state and quality of roading networks. Despite this, there are significant challenges comparing the current position of councils because they adopt differing approaches in providing for depreciation and they have differing approaches to determining the point at which they will intervene to repair, reseal, or upgrade a road.

13. If you adopt a discounted future revenue and expenditure accounting basis, the net present value of a council with very good assets and high external debt could be much the same as one that has very low external debt but poorly maintained and aging infrastructure that will require significant future expenditure. Both of these could also have the same net worth as a council that has low external debt, good assets but obligations with respect to special purpose reserves that it holds, that it cannot fulfil without external borrowing.

The Analysis Undertaken for the Commission

14. As part of its consideration of a reorganisation of the Wairarapa territorial authorities, the Commission has engaged McGredy Winder & Co to:

    (a) Identify the current assets, external debt and overall financial position for each of the three councils

(b) Identify the extent to which the councils use internal borrowing and how this impacts on relative levels of external debt

(c) Identify the implications of expenditure plans contained in the council long term plans over the 10 years of those plans for future assets and debt

(d) Identify the key indications in infrastructure strategies and asset management plans that are likely to impact significantly on assets and debt over the 30 year life spans of those plans

(e) Integrate the above streams of information and present observations on the current relative positions of the three councils, and how these appear likely to evolve over the coming 10 and 30 years.

Information on the Three Councils

Population, Rates and Overall Financial Position

15. Likely population growth (or decline) is an important factor in considering the on-going financial position of each local authority. Table 1 shows the total usually resident population of each Wairarapa council district from the 2013 census and the forecast future population of each district up to 2043. Under the Statistics New Zealand Medium Growth Forecast, the population of Wairarapa is projected to grow by 1,760 (0.1%) from 2013 to 2043, with growth being the greatest in the Carterton District.

Table 1: Population Projections

Wairarapa Councils - population projections	2013	2015	2018	2023	2028	2033	2038	2043	Share of Wairarapa district population in 2015	Average Annual Growth 2013-2043
Masterton District	24,100	24,400	24,700	24,800	24,800	24,700	24,300	23,700	56.5%	-0.1%
Carterton District	8,490	8,790	9,360	9,650	9,900	10,050	10,150	10,200	20.4%	0.6%
South Wairarapa District	9,800	10,000	10,250	10,400	10,450	10,450	10,400	10,250	23.2%	0.1%
Total	**42,390**	**43,190**	**44,310**	**44,850**	**45,150**	**45,200**	**44,850**	**44,150**	**100.0%**	**0.1%**

Source: SNZ Subnational Population Estimates by Age and Sex, 2013(base) -2043
Subnational population estimates (TA, CB), by age and sex, at 30 June 2013-15 (2015 boundaries)
Estimates for 2013 differ from the Census night population count due to SNZ revisions

16. These projections are generally consistent with the planning assumptions of Masterton and Carterton District Councils. South Wairarapa District Council’s Long Term Plan (LTP) is prepared on the assumption that population will remain static over the ten year LTP period. However, South Wairarapa District Council advises that it has capacity for population increase without material additional expenditure.

17. Table 2 summarises some key financial and non-financial indicators for the three councils as at 30 June 2016, and shows the relative sizes of the three districts. Masterton District comprising around 56% of the area’s combined population – between 2-3 times the population of South Wairarapa District (23%) or Carterton District (20%).

18. By rating unit, South Wairarapa District has a higher proportion of rating units compared to its population, which is attributed to a larger share of absentee owners. Masterton District has a lower proportion of rating units compared to its population.

Table 2: Comparison of Councils

Key Indicators and Financial Position as at 30 June 2016	Carterton District Council	% of total of councils	Masterton District Council	% of total of councils	South Wairarapa District Council	% of total of councils
Population estimate as at 2015 (SNZ estimate)	8,790	20%	24,400	56%	10,000	23%
Total Rating Units	4,963	21%	12,220	51%	6,825	28%
Total Rates Revenue ($000)	10,298	21%	26,238	53%	12,602	26%
Average rates per person	$1,172		$1,075		$1,260	
Average rates per rating unit	$2,075		$2,147		$1,846	
Capital value	$2,510m	23%	$4,686m	43%	$3,693m	34%
Land value	$1,378m	23%	$2,472m	41%	$2,224m	37%
Total Assets	$176m	13%	$748m	56%	$401m	30%
Total Liabilities	$10m	11%	$64m	70%	$18m	19%
Total Equity	$166m	13%	$684m	55%	$384m	31%

Source: 2015/16 Annual Reports; SNZ Subnational population estimates (TA, CB), by age and sex, at 30 June 2013-15 (2015 boundaries)

19. Table 2 also shows total rates revenue for 2015/16 by council. Rates revenue is reasonably proportional to each council's share of the combined population and rating units. Average rates of $1,846 per rating unit in South Wairarapa district are around 10% lower than in Carterton and Masterton districts ($2,075 and $2,147 respectively). Nevertheless, these averages don't provide fair comparisons, given the different rating bases, and significant differences in rating policies for urban and rural properties between the councils.

20. In terms of asset levels, Carterton District Council has a lower proportion of assets to its population (13% to 20%), and South Wairarapa District Council has a higher proportion (30% to 23%). Carterton District Council's total equity is also lower relative to its population (13% to 20%), and South Wairarapa District Council has a higher proportion (31% to 23%).

21. In terms of liabilities, Masterton District Council has a higher proportion of liabilities to its population (70% to 56%).

22. The rating bases vary across the three councils. Carterton District Council primarily uses general rates based on capital value and a uniform annual general charge.

Masterton District Council has targeted rates and charges for each of its services, with the majority of those rates based on capital value. South Wairarapa District Council primarily uses land value. Noticeably from Table 2, South Wairarapa District Council has a proportionally higher share of the region's land value and capital value. The most recent valuation round for the three councils was September 2014.

	Rating basis for General Rates	**General rate (including uniform annual general charge) as percent of total rates**
Carterton DC	Capital value, set on a differential basis over residential, commercial, and rural	66% *(based on 2015/16 Annual Report)*
Masterton DC	A number of targeted rates, set on a differential basis (urban/rural allocated by service) and levied on either land value or capital value or by targeted uniform charge	n/a – around 50% of rates based on capital value
South Wairarapa DC	Land value, set on a differential basis over residential, commercial, and rural	54% *(based on 2015/16 Annual Report, excludes metered water)*

Financial Position

23. Table 3 provides more detail on the financial positions of the councils, as at 30 June 2016 (based on the 2015/16 Annual Reports). Noticeable features, common to all three councils, are:

(a) The dominance of infrastructure assets in their asset bases. Property, plant and equipment makes up around 95% of the total assets of each of the councils. Roading comprises from 68% to 76% of total assets.

(b) The low levels of borrowing and other liabilities (4% to 8% of total liabilities and equity) and high levels of equity (91% to 96% of total liabilities and equity).

(c) Each council has a number of restricted and other reserves, which range from 3% to 4% of Total Liabilities and Equity.

Table 3: Summary of Assets and Liabilities of Councils

Summary of Statement of Financial Position as at 30 June 2016	Carterton District Council		Masterton District Council		South Wairarapa District Council	
	$000	% of total assets/ liabilities and equity	$000	% of total assets/ liabilities and equity	$000	% of total assets/ liabilities and equity
Assets						
Current assets						
Cash & cash equivalents	4,395	2%	3,619	0%	5,653	1%
Other short term financial assets	1,827	1%	5,270	1%	1,610	0%
Other short-term assets	1,337	1%	3,603	0%	4,817	1%
Total current assets	**7,559**	**4%**	**12,492**	**2%**	**12,080**	**3%**
Non-current assets						
Property Plant & Equipment						
Roading	124,713	71%	505,044	68%	303,761	76%
Water systems	7,831	4%	36,014	5%	20,047	5%
Sewerage systems	6,179	4%	66,993	9%	13,302	3%
Storm water	5,521	3%	18,973	3%	2,927	1%
Other infrastructure		0%	4,045	1%		0%
Operational	22,838	13%	86,978	12%	33,976	8%
Other	380	0%	644	0%	7,981	2%
Forestry assets	491	0%	450	0%		0%
Investment assets - financial		0%	10,060	1%	125	0%
Investment in CCOs and other entities	49	0%	307	0%	88	0%
Other fixed assets, incl investment property	422	0%	6,192	1%	7,173	2%
Total non-current assets	**168,424**	**96%**	**735,700**	**98%**	**389,380**	**97%**
Total assets	**175,983**	**100%**	**748,192**	**100%**	**401,460**	**100%**
Liabilities						
Current liabilities						
Borrowing - current	5,748	3%	3,008	0%	1,000	0%
Other short term liabilities	1,779	1%	6,207	1%	3,941	1%
Total current liabilities	**7,527**	**4%**	**9,215**	**1%**	**4,941**	**1%**
Non-current liabilities						
Borrowing - non-current	2,493	1%	54,564	7%	12,402	3%
Other short term liabilities	84	0%	242	0%	407	0%
Total non-current liabilities	**2,577**	**1%**	**54,806**	**7%**	**12,809**	**3%**
Equity						
Public equity	112,426	64%	424,669	57%	146,737	37%
Restricted & other reserves	2,301	1%	21,882	3%	17,652	4%
Asset valuation reserves	45,839	26%	237,619	32%	219,317	55%
Other reserves	5,311	3%		0%	3	0%
Total equity	**165,877**	**94%**	**684,170**	**91%**	**383,709**	**96%**
Total liabilities and equity	**175,981**	**100%**	**748,191**	**100%**	**401,459**	**100%**
Source: 2015/16 Annual Reports						

24. Table 3 also shows a key difference between Masterton District Council and the other two councils. Masterton District Council has a proportionally higher investment in wastewater infrastructure (9% for Masterton District Council compared to 3-4% for the other two), and proportionally higher levels of external public debt (7% for MDC compared to 3-4% for the other two).

25. The higher proportional investment by Masterton District Council on wastewater infrastructure reflects its investment over the past 6 years in its Homebush wastewater treatment plant (WWTP). Annual Reports from 2009-10 to 2014-15 show capital expenditure of $34.4 million, funded through loans of $34 million and reserves of $0.4 million. Masterton District Council advises that, in addition to this, $6 million was incurred for the purchase of the land around 2003-2006. Table 5 later in this report shows that Masterton District Council's $63.7 million external and internal debt at 30 June 2016 is primarily for Wastewater Services, of which Homebush WWTP would be the largest component.

26. This investment in its Homebush WWTP explains its different asset mix and higher debt level. This tends to reflect Masterton District Council's point in the renewal of its WWTP, and is not out-of-line with other councils of comparable population.

Public Debt, Internal Borrowing and Net Debt

27. Table 4 shows the public debt (including derivative instruments) by council from their 2015/16 annual reports, as well as their respective share of the councils' combined public debt.

Table 4: Public Debt by Council

Public Debt as at 30 June 2016	**Carterton District Council**		**Masterton District Council**		**South Wairarapa District Council**	
	$000	**% to total**	**$000**	**%**	**$000**	**%**
Gross Public Debt, including derivative instruments	8,241	10%	57,572	73%	13,402	17%
Internal debt	1,250		6,168		540	
External and Internal Debt	**9,491**	11%	**63,740**	73%	**13,942**	16%
Source: 2015/16 Annual Reports						

28. Table 4 also includes internal debt. The use of internal debt may reduce council funding costs, but may also indicate that debt levels and levels of cash/term deposits would have been higher but for that internal borrowing. Therefore, it is important to recognise both the internal and the external debt of each council. The internal debt reported by each council as at 30 June 2016 is:

(a) Carterton District Council - internal borrowing of $1,250,000 for infrastructure and community facilities.

(b) Masterton District Council - internal borrowing of $6,168,000 for infrastructure and community facilities.

(c) South Wairarapa District Council - internal borrowing of $540,000 for amenities, roading and sewerage.

29. Table 5 shows how the debt is split across each council's activity groups, including the internal debt in paragraph 28 above.

Table 5: External and Internal Debt by Activity Group as at 30 June 2016

External and Internal Debt by Activity Group as at 30 June 2016			
	Carterton District Council $000	Masterton District Council $000	South Wairarapa District Council $000
Roading	1,062	467	1,192
Water Supply	340	2,677	679
Wastewater	4,453	48,876	11,690
Stormwater	313	868	
Solid Waste		1,922	
Community Facilities	3,180	3,653	250
Internal/Administration	53		
Not identified/Derivative Financial Instruments/Lease	90	5,276	132
Total Debt	**9,491**	**63,740**	**13,942**
Source: District Councils			

30. The best measure of the overall positions of the councils is their Net Financial Assets – being Gross Financial Assets less Internal and External Borrowing. All of the councils have external financial assets that earn a return, with the proportion for 2015/16 being similar across the three councils, as shown in Table 3.

31. The Net Financial Assets of the councils as at 30 June 2016 are shown in Table 6. It ranges from $38.6 million of net debt held by Masterton District Council to $6.0 million net debt held by South Wairarapa District Council. On all of the measures below - net financial assets per person, net financial assets per rating unit, net financial assets per dollar of rates revenue, and net financial assets per capital value, MDC's debt is higher than the two other councils.

Table 6: Debt Positions adjusted for Internal Borrowing and Financial Assets

Net Financial Assets (NFA) as at 30 June 2016			
	Carterton District Council $000	Masterton District Council $000	South Wairarapa District Council $000
External Debt	(8,241)	(57,572)	(13,402)
Internal debt	(1,250)	(6,168)	(540)
Debt position adjusted for internal borrowing	(9,491)	(63,740)	(13,942)
Financial assets	6,222	18,949	7,388
Financial assets adjusted for internal borrowing	7,472	25,117	7,928
Net financial assets	**(2,019)**	**(38,623)**	**(6,014)**
NFA per person (SNZ 2015 estimate)	($230)	($1,583)	($601)
NFA per rating unit	($407)	($3,161)	($881)
NFA per $ rates revenue	($0.20)	($1.47)	($0.48)
NFA per $ capital value	($0.0008)	($0.0082)	($0.0016)
Source: 2015/16 Annual Reports			

Note 1: *Financial Assets include external current and non-current financial assets and internal borrowing. However, they exclude investment properties. They also exclude biological assets and investments in associates. These are relatively illiquid long-term assets, held for strategic reasons and for the benefit of communities.*

Note 2: *Where Financial Assets are greater than Borrowing the number is positive, where Borrowing exceeds Financial Assets the number is negative.*

32. Finally, both Masterton and South Wairarapa District Councils own investment properties. South Wairarapa District Council has earmarked some, but not all, for sale. Nevertheless, these properties could potentially be sold. Table 6 is re-stated to show the impact of including these properties. South Wairarapa District Council now has positive assets of $3.9 million. Masterton District Council continues to have comparatively higher levels of net debt.

Table 7: Net Financial Assets and Investment Properties

Net Financial Assets and Investment Properties as at 30 June 2016			
	Carterton District Council **$000**	**Masterton District Council** **$000**	**South Wairarapa District Council** **$000**
Net financial assets (per table 5)	(2,019)	(38,623)	(6,014)
Investment properties		2,087	9,872
Net financial assets incl investment properties	**(2,019)**	**(36,536)**	**3,858**
NFA per person (SNZ 2015 estimate)	($230)	($1,497)	$386
NFA per rating unit	($407)	($2,990)	$565
NFA per $ rates revenue	($0.20)	($1.39)	$0.31
NFA per $ capital value	($0.0008)	($0.0078)	$0.0010
Source: 2015/16 Annual Reports			

Special Funds and Reserves

33. Each of the councils has reserves where there may be restrictions on the use of those funds, either by reason of the council's policy, or due to conditions of the funding (such as development contributions and targeted rates), or terms of the trusts. Based on advice from each of the councils, they are divided broadly into those that are policy-driven (although they may still be sensitive in the community), those that have requirements that must be met as a condition of funding, and trusts. We have not verified the underlying terms of each fund, or whether the reserve is 100% funded from that source. The Commission will need to consider how these reserves would be transferred to a merged council.

Table 8: Special Funds and Reserves

Special Funds and Reserves as at 30 June 2016	Carterton District Council	$000	Masterton District Council	$000	South Wairarapa District Council	$000
Policy-driven Reserves	Plant Purchase & Renewal	2	Plant & Equipment Funds	1,684	District Property	32
	Roading Emergency Works Fund	312	General Capital Funds	3,379	Asset Realisation	163
	Rural Water Contingency	52	Investment Interest Fund	107	Plantation Reserve	65
	Keep Carterton Beautiful Fund	5	Reserves and Development Funds	975	Community Board Reserves	9
	Election Contingency Fund	36	Building Depreciation Funds	6,366	Combined District Plan Reserve	(104)
	Workshop Depot Upgrade Fund	23	Roading, bridges and flood damage	4,806	Kotui Library Software	
	Combined District Plan Fund	0	Miscelleneous	1,927	Martinborough Town Hall	(445)
	Waingawa Industrial Zone Services Deficit	36			Loan Redemption Reserve	412
					Depreciation Reserve	15,072
Reserves funded by targeted rates or contributions, or with specific conditions of funding	Recreation Reserve Levy fund	360	Urban Infrastructure depreciation	2,638	Restricted Reserves	366
	Waste Disposal Fund	57			Water Race Reserves	192
	Creative NZ Fund	3			Infrastructure contributions	1,358
	Roading Contribution Fund	609			Wastewater reserve	0
	Infrastructure Contribution Reserve	562			Rural Roading Reserve	200
	Waingawa Infrastructure Contribution Reserve	141			Housing Reserve	(19)
Trusts	Clareville Grave Maintenance Trust Fund	2			Various trusts	350
	Memorial Square Trust Fund	7				
	WWII Memorial Trust Fund	62				
	Longbush Domain Board Fund	3				
	West Taratahi Hall Board	25				
	Belvedere Hall Fund	1				
Total Reserves		**2,299**		**21,882**		**17,651**
Source: 2015/16 Annual Reports						

Asset Condition and Valuation

34. Table 9 shows the replacement cost and the depreciated replacement costs for network assets held by the councils, as at 30 June 2015. The Depreciated Replacement Cost is the replacement cost of the assets less accumulated depreciation. This reflects their current condition and the 'already consumed' economic benefits to date. The ratio of the depreciated replacement value of a council's physical assets to the replacement value provides a useful proxy for the value of their remaining useful economic life. Land under roads, road formation, other non-depreciating roading assets, and operational assets are not included. For Masterton District Council, the airport runway is also excluded.

Table 9: Replacement Cost of Network Assets

Asset Valuation (Network assets, excluding land, formation nd non-depreciating assets)	(Optimised) Replacement Cost ($000)	Depreciated Replacement Cost ($000)	Depreciated RC as percent of Replacement Cost ($000)
Carterton District Council			
Roading	101,220	64,662	64%
Water systems	19,037	8,050	42%
Sewerage systems	12,302	5,526	45%
Stormwater	6,254	3,955	63%
Carterton DC	**138,813**	**82,193**	**59%**
Masterton District Council			
Roading, excl airport runway	253,600	160,354	63%
Water systems	76,965	34,156	44%
Sewerage systems	125,545	64,381	51%
Stormwater	30,871	19,318	63%
Masterton DC	**486,981**	**278,209**	**57%**
South Wairarapa District Council			
Roading - other	150,733	91,057	60%
Water systems	42,053	20,728	49%
Sewerage systems	23,483	13,303	57%
Stormwater	6,937	3,032	44%
South Wairarapa DC	**223,206**	**128,120**	**57%**
All Councils	**849,000**	**488,522**	**58%**

Source: AMPs and Valuation Reports

35. The three councils are not dissimilar in the ratios of Depreciated Replacement Cost to (Optimised) Replacement Cost, suggesting that their assets are in similar condition.

36. Table 10 shows the rate of asset renewal over the past five years, as measured by the ratio of asset renewal to depreciation. The ratios are similar for Masterton and South Wairarapa District Councils, but lower for Carterton District Council.

Table 10: Rate of Asset Renewal

Ratio of Renewal Capital Expenditure to Depreciation - 2011/12 - 2015/16	
Carterton District Council	79%
Masterton District Council	87%
South Wairarapa District Council	86%

Source: Annual Reports 2011/12 - 2015/16

37. Despite limitations arising from the difficulty in assessing asset condition, the valuation data from the councils has been relied upon in this report and it is the best and most consistent data that is currently available, and it has all come directly from the relevant councils.

Projected Capital Expenditure and Debt

38. Table 11 shows each council's planned capital expenditure and depreciation over the LTP period. Most capital expenditure is to maintain existing assets (82%), with only 1% of capital expenditure to meet demand. This is consistent with the relatively flat growth projections for the area.

39. Table 11 also calculates the ratio of total capex to depreciation, which ranges from 86% to 98%, and asset renewal as a percentage of depreciation, ranging from 75% to 84%. There are no material differences between the councils in terms of their levels of asset replacement.

Table 11: Planned Capital Expenditure and Depreciation 2015-2025

	2016 ($000)	2017 ($000)	2018 ($000)	2019 ($000)	2020 ($000)	2021 ($000)	2022 ($000)	2023 ($000)	2024 ($000)	2025 ($000)	Total ($000)	Percent
Carterton District Council												
to meet demand	217	158	109	-	3	-	-	-	-	-	**487**	**2%**
to improve Levels of Service	1,210	525	229	297	376	477	146	150	127	98	**3,635**	**11%**
to renew assets	2,952	2,756	3,130	2,623	2,541	2,447	2,771	2,846	2,824	2,835	**27,726**	**87%**
Planned capital expenditure	**4,378**	**3,439**	**3,468**	**2,919**	**2,921**	**2,924**	**2,918**	**2,997**	**2,951**	**2,933**	**31,848**	**100%**
Asset depreciation	3,476	3,601	3,759	3,782	3,782	3,807	3,730	3,672	3,663	3,740	**37,012**	
Total capital expenditure as a percent of depreciation											**86%**	
Asset renewal as a percent of depreciation											**75%**	
Masterton District Council												
to meet demand	-	606	-	75	-	760	-	-	-	-	**1,441**	**1%**
to improve Levels of Service	2,608	2,828	5,071	5,351	4,258	750	806	802	819	884	**24,177**	**20%**
to renew assets	10,935	10,824	9,980	9,398	9,569	7,764	8,600	8,176	8,443	8,970	**92,659**	**78%**
Planned capital expenditure	**13,543**	**14,258**	**15,051**	**14,824**	**13,827**	**9,274**	**9,406**	**8,978**	**9,262**	**9,854**	**118,277**	**100%**
Asset depreciation	10,834	10,903	11,800	11,379	11,575	12,437	12,448	12,485	13,504	13,511	**120,876**	
Total capital expenditure as a percent of depreciation											**98%**	
Asset renewal as a percent of depreciation											**77%**	
South Wairarapa District Council												
to meet demand	46	-	-	-	-	-	-	-	-	-	**46**	**0%**
to improve Levels of Service	609	995	701	408	476	572	329	169	145	168	**4,572**	**11%**
to renew assets	3,839	6,958	3,103	3,057	3,260	3,212	3,382	3,377	3,515	3,554	**37,257**	**89%**
Planned capital expenditure	**4,494**	**7,953**	**3,804**	**3,465**	**3,736**	**3,784**	**3,711**	**3,546**	**3,660**	**3,722**	**41,875**	**100%**
Asset depreciation	3,959	4,187	4,289	4,329	4,431	4,474	4,593	4,634	4,699	4,811	**44,406**	
Total capital expenditure as a percent of depreciation											**94%**	
Asset renewal as a percent of depreciation											**84%**	
Total Capital Expenditure												
to meet demand	263	764	109	75	3	760	-	-	-	-	**1,974**	**1%**
to improve Levels of Service	4,427	4,348	6,001	6,056	5,110	1,799	1,281	1,121	1,091	1,150	**32,384**	**17%**
to renew assets	17,726	20,538	16,213	15,078	15,370	13,423	14,753	14,399	14,782	15,359	**157,642**	**82%**
Planned capital expenditure	**22,415**	**25,650**	**22,323**	**21,208**	**20,484**	**15,982**	**16,035**	**15,521**	**15,873**	**16,509**	**192,000**	**100%**
Asset depreciation	18,269	18,691	19,848	19,490	19,788	20,718	20,771	20,791	21,866	22,062	**202,294**	
Total capital expenditure as a percent of depreciation											**95%**	
Asset renewal as a percent of depreciation											**78%**	

Source: Long Term Plans 2015-2025

40. Table 12 breaks down the expenditure on asset renewal for infrastructure assets only. It is noticeable that Masterton and Carterton District Councils have higher levels of replacement of infrastructure assets (as measured by the ratio of renewal expenditure to depreciation) than South Wairarapa District Council. There are marked differences

between councils and between the treatment of roads and other asset types. Carterton District Council allocates 120% on replacement of roading assets (the largest asset class), down to 74%-83% for the other two councils.

Table 12 – Renewal of Infrastructure Assets 2015-2025

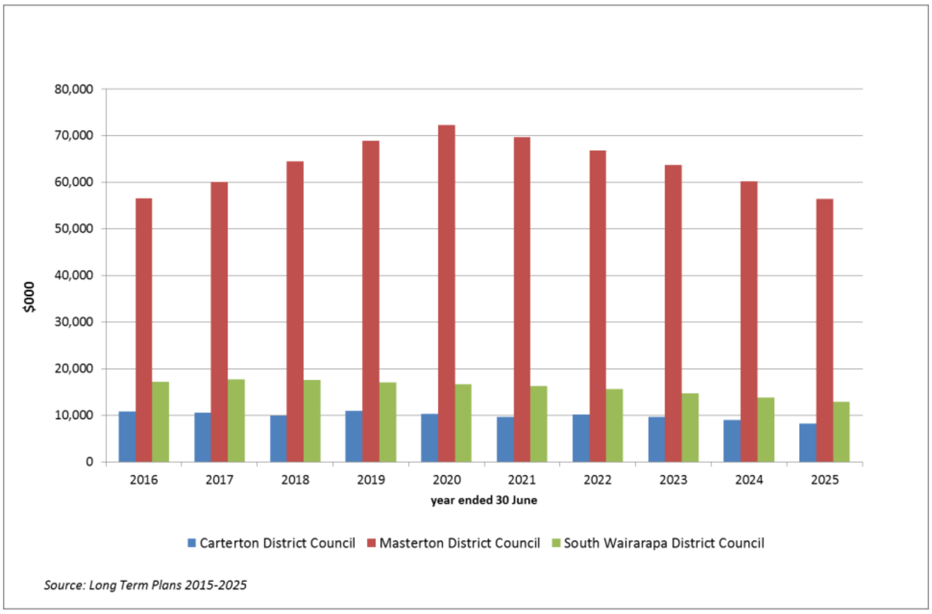
	Renewal 2015-2025 ($000)	Depreciation 2015-2025 ($000)	Percent Renewal to Depreciation
Carterton District Council			
Roading	17,724	14,776	120%
Water Services	1,644	5,163	32%
Sewerage Services	3,719	6,458	58%
Stormwater	-	940	0%
Total for infrastructure classes	23,087	27,338	84%
Masterton District Council			
Roading	38,569	52,395	74%
Water Services	22,187	14,992	148%
Sewerage Services	16,272	27,208	60%
Stormwater	3,862	3,179	121%
Total for infrastructure classes	80,890	97,774	83%
South Wairarapa District Council			
Roading	21,194	25,487	83%
Water Services	4,140	7,962	52%
Sewerage Services	2,555	4,404	58%
Stormwater	575	954	60%
Total for infrastructure classes	28,464	38,807	73%

Source: Long Term Plans 2015-2025

Debt and Net Financial Assets over Long Term Plan Period

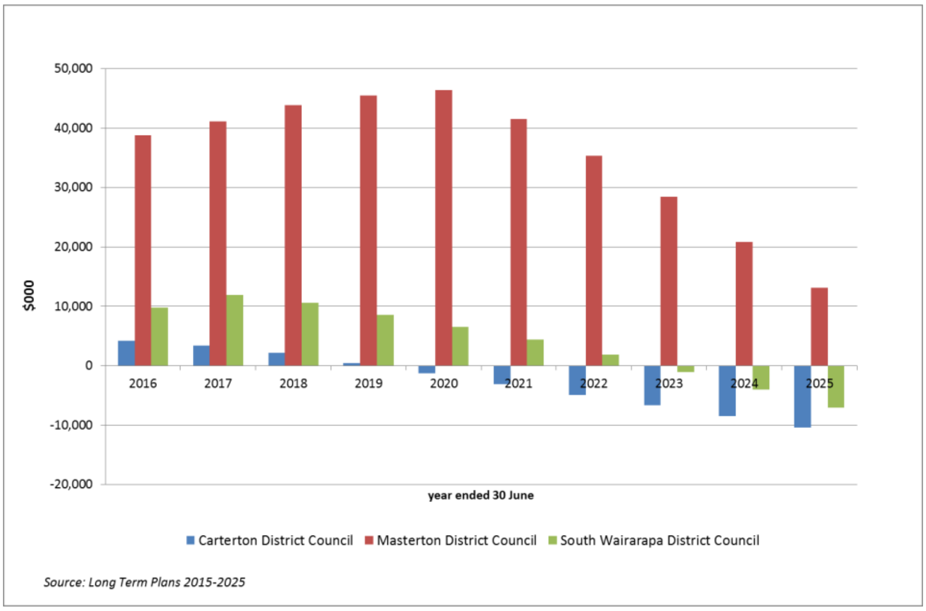
41. The LTPs show variations in the levels of borrowing by each council over the 10 year period. However, the overall picture and the relative positions of the councils with respect to both financial assets and total borrowing do not change. Figure 1 shows the projected levels of external borrowing of the three councils from 2015 to 2025. Masterton District Council's external debt of $56.5 million in 2025 remains considerably higher than that of Carterton District Council ($8.2 million) and South Wairarapa District Council ($12.9 million).

Figure 1: Gross Debt Levels 2015-2025



42. Figure 2 shows net debt after deducting financial assets for the three councils. (No adjustment is made for internal borrowing. Investment properties are not included). Again, it confirms the picture of their net financial positions as at 30 June 2016, with Masterton District Council's net debt of $14.0 million, while Carterton District Council and South Wairarapa District Council move into positive net financial assets ($10.4 million and $7.1 million respectively).

Figure 2: Net debt positions 2015-2025



Note: An adjustment has been made to remove the estimated value of Masterton District Council's investments in companies from its Net Debt Position. Although estimated, the adjustment does not affect the financial picture of MDC.

43. Figure 1 and Figure 2 above show that each council's opening and closing debt levels over the period are similar, yet net debt for each council reduces significantly over the period. This is due to large increases to cash equivalents and financial investments, resulting in large reductions in net debt over the period. The reductions for each council are primarily due to the accumulation of capital reserves as a result of capital expenditure being lower than depreciation funding.

Table 13: Reductions in Debt and Net Financial Assets from 2016 to 2025

	Reduction in Public Debt	Reduction in Debt and Increase in Financial Assets
	$000	$000
Carterton District Council	(2,559)	(14,625)
Masterton District Council	(140)	(25,709)
South Wairarapa District Council	(4,250)	(16,828)

Source: Long Term Plans 2015-2025

44. Although the decreases in debt and increases in financial assets are common to all three councils, they do differ in the activity groups where those changes occur. Table 14 shows the changes to debt and reserves by activity group, which shows the areas where funding has exceeded expenditure, leading to the reduced debt and increased financial assets. Carterton District Council's improved $14.6 million financial position comes largely from Water Supply, Administrative Support and Community Facilities/Activities. Masterton District Council's improved $25.7 million financial position comes largely from Wastewater Services and Internal Functions, offset by increased debt/decreased reserves for Water Supply. South Wairarapa District Council's improved $16.8 million financial position comes largely from Roading, Water Supply and Wastewater activities. (Note that the Change in Debt and Reserves does not exactly equate to change in Net Financial Position, as there will be other balance sheet movements).

Table 14: Change in Debt and Reserves by Activity Group from 2016 to 2025

Change in Debt and Reserves by Activity 2016-2025	Carterton District Council $000	Masterton District Council $000	South Wairarapa District Council $000
Roading	73	(1,934)	(6,354)
Water Supply	(3,264)	7,374	(4,962)
Wastewater	(1,311)	(14,830)	(3,849)
Stormwater	(1,003)	1,832	(341)
Other	(9,289)	(15,096)	(595)
Total	**(14,794)**	**(22,654)**	**(16,101)**

Source: Long Term Plans 2015-2025

45. Each council's approach to capital funding, as outlined in their Revenue and Financing Policies, is summarised below, although it should be noted that there are variations depending upon the types of assets being replaced.

	Approach to Funding Capital Items
Carterton DC	The funding for capital expenditure will generally come from depreciation reserves, subdivision financial contributions, borrowing, or a combination. Targeted rates may also fund some of the loan principal repayments for community support, water supply, stormwater drainage, sewerage and the treatment and disposal of sewage, waste management, and regulatory and planning services. The Council's overall borrowing requirement is reduced to the extent that other funds are available to fund capital expenditure
Masterton DC	Fund roading renewal expenditure from NZTA subsidies and annual rates Fund other replacement assets from depreciation reserve funds to the extent that those funds are available. Where depreciation reserves are insufficient, loan funding will be used Fund assets which increase levels of service by borrowing/loans Fund assets needed because of growth, from developers, either by the developer providing the infrastructure or by them making financial contributions at the outset of the development.
South Wairarapa DC	A combination of fees and charges, rates, surplus funds, contributions and loans, depending upon the assets

Indications of Future Impacts on Assets and Debt From Infrastructure Strategies and Asset Management Plans

Carterton District Council Infrastructure Strategy and AMPs

46. Carterton District Council's Infrastructure Strategy outlines a 30 year operating and capital expenditure plan for the 2015-2025 period, for roading and the three waters. Capital expenditure from 2015-2025 of $31.8 million has been included in its LTP.

Table 15 - Carterton District Council Capital Expenditure 2015-2045

Carterton District Council	**2015-2025** ($000)	**2025-2035** ($000)	**2035-2045** ($000)
Roading	17,970	21,203	21,092
Water Services	1,701	1,875	1,875
Sewerage Services	5,742	7,950	4,950
Stormwater	215	0	0
Subtotal Infrastructure Assets	**25,629**	**31,028**	**27,916**
Other capital expenditure	6,219		
Total	**31,848**		

Source LTP 2015-25 and Infrastructure Strategy

Note: Projections not inflated past 2025.

47. Infrastructure capex in the second and third decades is similar to the first decade, and is mainly for renewal of assets. The only major project is $5.5 million in decade 2 and $2.5 million in decade 3 for upgrade of sewerage treatment facilities.

48. Given its relatively static population, growth is not considered to be a major driver of capital expenditure.

49. Other risks explored with Carterton District Council include:

(a) Earthquake – Carterton District Council has recently upgraded its Civic building. Carterton District Council did not think it had any liability as building control authority for approval of earthquake strengthening work.

(b) Water tightness – Carterton District Council did not think it had any liability as building control authority.

Masterton District Council Infrastructure Strategy and AMPs

50. Masterton District Council's Infrastructure Strategy outlines a 30 year operating and capital expenditure plan for the 2015-2025 period, for roading and the three waters. Capital expenditure from 2015-2025 of $118 million has been incorporated into its LTP.

Table 16 - Masterton District Council Capital Expenditure 2015-2045

Masterton District Council	2015-2025 ($000)	2025-2035 ($000)	2035-2045 ($000)
Roading	51,978	58,624	80,218
Water Services	26,719	28,290	26,572
Sewerage Services	16,422	84,596	25,957
Stormwater	3,862	11,834	16,256
Subtotal Infrastructure Assets	**98,981**	**183,344**	**149,003**
Other capital expenditure	19,289		
Total	**118,270**		

Source LTP 2015-25 and Infrastructure Strategy

Note: Expenditure of $22.7m in decade 2 for flood protection has been excluded as it is expenditure that would be funded by Greater Wellington Regional Council

51. Infrastructure capex in the second and third decades is much higher than for the first decade. Major projects are:

- $10.4 million in decade 2 to upgrade Mataikona Hill Road. This would be part-funded by NZTA at a 57% FAR
- $7.3 million in decade 2 for water storage dams (water supply)
- $63 million in decade 2 to upgrade the Homebush wastewater treatment plant, and a further $2.8 million for the Riversdale waste water treatment plant
- $6.5 million in decade 2 and $9 million in decade 3 for stormwater treatment
- higher renewals in decade 2 & 3 than decade 1.

52. Given its relatively static population, growth is not considered to be a major driver of capital expenditure.

53. Other risks explored with Masterton District Council include:

(a) Earthquake – Masterton District Council has provisioned $2.265 million in its LTP to strengthen the Masterton Town Hall. More may be needed to modernise and refurbish the building, although the location of a combined location is not known.

Masterton District Council did not think it had any liability as building control authority for approval of earthquake strengthening work.

(b) Watertightness – Masterton District Council did not think it had any liability as building control authority.

(c) Landfill and other remediation - Masterton District Council has provisioned for landfill remediation. There are three gaswork sites in Masterton, but current costs are not material.

South Wairarapa District Council Infrastructure Strategy

54. South Wairarapa District Council's Infrastructure Strategy outlines a 30 year operating and capital expenditure plan for the 2015-2025 period, for roading and the three waters. Capital expenditure from 2015-2025 of $41.9 million has been incorporated into its LTP.

Table 17 – South Wairarapa District Council Capital Expenditure 2015-2045

South Wairarapa District Council	2015-2025 ($000)	2025-2035 ($000)	2035-2045 ($000)
Roading	22,533	30,325	41,675
Water Services	4,140	4,824	6,630
Sewerage Services	5,788	3,328	4,573
Stormwater	575	776	1,066
Subtotal Infrastructure Assets	**33,036**	**39,253**	**53,944**
Other capital expenditure	8,840		
Total	**41,876**		

Source LTP 2015-25 and Infrastructure Strategy

55. Infrastructure capex in the second and third decades is similar to the first decade (after taking account of inflation). The only major project is to upgrade the Martinborough, Greytown and Featherston wastewater treatment plants at costs of $7.9 million in decade 2 and $6.9 million in decade 3. This profile has since been revised to $2.4 million in the LTP period, $10.5 million in decade 2 and $6.9 million in decade 3.

56. Given its relatively static population, growth is not considered to be a major driver of capital expenditure.

57. South Wairarapa District Council did not consider it had material risks relating to earthquake or water tightness. It has provisioned for its landfill remediation costs. The coastal Palliser Road has risks around erosion and damage, however, South Wairarapa

District Council advises that it has agreed with NZTA to take responsibility for the lower risk areas, with NZTA managing the higher risk areas.

Wastewater Treatment Across the Councils

58. The measures in Table 6 above show that there is a considerable difference between the debt positions of the three councils. Table 3 shows that the main difference can be traced to Masterton District Council's $40 million wastewater treatment plant.

59. As the past and future costs of wastewater treatment appear to be a major driver of the differences between the councils' debt positions, the current status of wastewater for each is set out below. Their positions should be seen in the context of Greater Wellington Regional Council's (GWRC) proposed Natural Resources Plan (PNRP), which indicates a preference for discharge of wastewater to land rather than to freshwater.

Carterton District Council

60. The primary purpose of Carterton District Council's wastewater system is to service the Carterton urban community. There are approximately 2,400 properties connected to the municipal wastewater system. Flows gravitate to Carterton District Council's Dalefield Road wastewater treatment plant, and treated wastewater is discharged to both land and water, depending on weather conditions. The land irrigation system, including recent additions constructed in 2014, at Daleton Farm reuses wastewater for crop irrigation and avoids discharge to water for the summer and autumn periods.

61. Nevertheless, Carterton District Council anticipates that more infrastructure expenditure will be required in the form of improved treatment and irrigation of treated wastewater to land. The LTP, Infrastructure Strategy and AMP show expenditure of $18.6 million over the next 30 years:

Wastewater Capex, including renewals	LTP 2015-2025	IS/AMP 2025-2035	IS/AMP 2035-2045
	$5.7m	$7.9m	$4.9m

NB Amounts to 2025 are inflation adjusted. Thereafter, forecasts are in 2025 dollar values.

62. Carterton District Council received a number of short-term consents in 2014, but will be seeking a long-term consent in 2017. Given the PNRP is still in draft, Carterton District Council could not confirm that its investment would be sufficient to secure new consents.

63. Sewerage services costs, comprising operating costs, depreciation recovery and interest and principal repayment, are funded 10 percent from general rates and 90 percent from targeted rates. Owners of residential properties that are connected to the public sewerage system pay a set targeted rate for sewage disposal. All other properties that can be connected directly or through a private drain to the public sewerage system pay a set targeted rate on the basis that they can be connected.

64. New capital and renewal of existing capital items for the sewerage group of activities are funded by way of the annual depreciation provision and/or by loans.

Masterton District Council

65. Masterton District Council provides a reticulated wastewater network to collect and dispose of wastewater from residential, commercial and industrial properties in the Masterton urban area (including Waingawa industrial area), and at Riversdale, Castlepoint and Tinui. Wastewater treatment plant facilities are at Homebush (for Masterton urban), Riversdale, Castlepoint and Tinui.

66. Homebush is the largest, with approximately 8,800 properties connected to the municipal wastewater system. The treatment plant has stabilisation ponds that dispose primarily to border strips and then to water, depending on river levels and weather conditions.

67. The LTP, Infrastructure Strategy and AMP show expenditure of $126 million over the next 30 years:

Wastewater Capex, including renewals	LTP 2015-2025	IS/AMP 2025-2035	IS/AMP 2035-2045
	$16.4m	$84.6m	$26.0m

68. Masterton District Council has a new consent from GWRC for the Homebush Treatment Plant (around early 2000s), and will need to renew this consent around 2034. Capex of around $60 million ($37 million in current dollars) is planned around that time. Masterton District Council could not confirm that its current arrangements would meet the PNRP standards, given the PNRP's draft status. Its Infrastructure Strategy[1] comments that the PNRP would "*require the Council to further reduce treated wastewater discharged into the river…until the NRP is fully implemented, the Homebush upgrade timetable and scope creates significant uncertainty for the Council.*"

69. Capital expenditure is loan-funded, although new wastewater assets may also be funded by developers. Operating costs, partial recovery of depreciation, as well as interest and principal repayments, are largely funded through targeted rates and charges. (There are a limited number of fees and charges). Targeted rates apply for Masterton urban (residential and non-residential), Riversdale, Castlepoint and Tinui. Rural properties are not subject to these targeted rates.

South Wairarapa District Council

70. South Wairarapa District Council has four wastewater community systems at Featherston, Greytown, Martinborough and Lake Ferry. Treated wastewater is

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[1] P.38.

discharged to land or water, with different arrangements for the four systems. South Wairarapa District Council plans to move to 100% discharge to land over the next 35 years, and recently purchased farmland at Greytown and Featherston ($7.4 million total), to support this strategy.

71. South Wairarapa District Council anticipates that more infrastructure expenditure will be required in the form of improved treatment and irrigation of treated wastewater to land. Its LTP and Infrastructure Strategy show expenditure of $13.7 million over the next 30 years, although this profile has been increased to $19.8 million:

Wastewater Capex, including renewals	LTP 2015-2025	IS/AMP 2025-2035	IS/AMP 2035-2045
	$5.8m	$3.3m	$4.6m
Revised profile	$2.4m	$10.5m	$6.9m

72. South Wairarapa District Council's current consents expire for Martinborough in 2035, Greytown in 2050, and Featherston in 2040. South Wairarapa District Council is confident its strategy would meet the PNRP standards.

73. Capital expenditure is loan-funded. Operating costs, partial recovery of depreciation, and interest and principal repayments, are funded through a uniform targeted rate for a serviced rating unit (ie connected to the system), or a 50% rate for a serviceable rating unit (ie which could be connected to the system but are not at this time).

Options for the Treatment of Debt and Assets Upon a Council Reorganisation

Can the Commission 'Ring-Fence' Debt and or Assets, or Specify Rates?

74. Part 4 of Schedule 3 of the Local Government Act sets out the framework for reorganisation schemes. Clause 42 sets out broad scope in the preparation of a reorganisation scheme, including the mandatory requirements and broad scope for other matters are below.

"42 Provisions for inclusion in reorganisation schemes

(1) In preparing a reorganisation scheme, the Commission-

…

(b) must include the provisions that are necessary to give effect to the scheme and, in particular, must include –

(i) the provisions specified in clause 43 that are considered necessary or desirable as a consequence of the scheme; and

(ii) any provisions considered necessary for –

(A) the purposes of the district or region of an affected authority; or

(B) the discharge of responsibilities of an affected local authority; or

(C) any other matter that is necessary to give effect to the provisions; and …

(e) may make provision for any arrangements the Commission considers necessary or desirable for the purposes of the reorganisation; and

(f) may incorporate other matters that it considers necessary or appropriate to give effect to the proposal."

75. Clause 43 expands on Clause 42 as follows:

"43 Provisions to be included if necessary or desirable

(1) If considered necessary or desirable, the following provisions may be included in a reorganisation scheme:

…

(i) provisions dealing with the apportionment or disposition of the assets and liabilities of all or any of the local authorities affected by the scheme, which provisions may include the date on which any of the apportionment or disposition takes place or may be treated as having taken place:

…

(k) provisions concerning rating in a new district or region, or enlarged district of region, which may –

(i) specify the date by which a single integrated rating system must be adopted in the district or region; and

(ii) specify the valuation system for any general rate forming part of the initial integrated rating system; and

(iii) specify the basis on which rates may be set and assessed within the district or region between the date the order takes effect and the date specified under subparagraph (i), which may include the use of different rating systems for specified rates, or for specified rates in different parts of the district or region; and

(iv) make such other provision for the transition to, or implementation of, the single integrated rating system as the Commission considers desirable:"

76. These provisions are broadly enabling, but sit within the context of the Commission establishing competent local authorities that will make their own future decisions and be accountable to the electorate for their performance. It is considered that these provisions provide the authority for the Commission to make decisions about the treatment of current assets and liabilities in a re-organisation scheme, or to specify rating

requirements. The Commission may wish to take formal legal advice on these points before proceeding.

77. Aside from the scope of the authority that the Commission has, the most important question is whether decisions in relation to the disposition of assets and debt are practical and workable.

Is There a Case for Ring-Fencing Assets or Debt?

78. In considering the merger of the Wairarapa councils, one of the important considerations is the extent to which the disposition of assets and debt within the region is fair. Fairness needs to be considered both between geographic areas, but also between generations.

79. The analysis above suggests that there are differences between the starting financial positions of the three councils. Looking at net financial assets and investment properties in Table 7, Masterton District Council starts in a net debt position of $36.5 million. Carterton District Council also has a net debt position of $2 million, while South Wairarapa District Council starts with a net surplus position of $3.9 million. Over time, the gap between MDC and the other two councils does not close. (The gap between South Wairarapa District Council and Carterton District Council closes but not completely).

80. From Table 9 and Table 10 above, there is no information to suggest that the councils start from different positions with respect to the condition of their infrastructure. The conclusion is therefore that there are material differences between the net financial assets of the merging councils.

81. However, before concluding that debt or net financial assets should be ring-fenced, consideration needs to be given to the impact of a merger on the burden of rates impact that will fall on each community and how that may change in a merger. Whilst the treatment of assets and debt addresses an issue of fairness with respect to the historic financial position of each council, the incidence of future rates raises issues of future fairness. It is important that both of these aspects are considered in the merger of the councils.

82. As is shown in Table 2, the current rates burden across the three councils is fairly evenly distributed, at least as measured as average rates per person. However, South Wairarapa District Council has a higher proportion of rating units due to absentee owners, and hence it has a lower average rate per rating unit than Carterton and Masterton District Councils.

83. A merger of the councils would focus attention on differences in the rating bases (capital and land value, fixed or variable charges etc). Local authorities use the value of land and improvements as the basis of allocating their total rates requirement between property owners in their districts. Whilst councils can use a range of factors to determine the incidence of rates they must use either the land value or the capital value of properties to assess any general rate that they apply. Using capital value or land value

to assess a general rate will broadly allocate rates in proportion to the share of regional capital or land value between the parts of the region.

84. Table 2 shows the total value and share of the capital and land value in each of the current territorial authority areas. Adopting either land or capital value as the bases of general rates (without any other change or refinement to the rating system) is likely to result in South Wairarapa District Council contributing a higher proportion of total rates revenue than it currently pays. We understand that the Local Government Commission is aware of this and has commissioned a separate piece of work to assess rating incidence issues and possible responses.

Options available to the Commission

85. The Commission's powers extend to determining the treatment of assets and liabilities, and determining aspects of the new rating arrangements that a merged council must adopt. Three options are proposed.

<u>Option 1 – No intervention</u>

86. There is an argument to simply merge the councils and leave the future council to resolve any of the inequities between the residents of the local authorities as part of a new integrated rating system. This option would be consistent with the approach that was adopted in Auckland.

87. Ultimately the elected representatives of the new council will be responsible for the ongoing management of the infrastructure assets of the region. They will need to manage the renewal and development of assets and fund that work within a region-wide financial management strategy and an integrated rating system. It is desirable that the new council has as much latitude as possible over the way in which it does that.

<u>Option 2 – Ring some or all of the council's debt and financial assets</u>

88. There are arguments in favour of recognising the differences between the councils in some way. This approach would better resonate with the public perception of the relative position of the three councils. Two variants are:

(a) to ring-fence the debt and financial assets of the three councils, so that each council's legacy debt was paid off over time solely by the residents in that area. As Carterton District Council has net financial assets, this would involve crediting them (through their rates) with the value of the net assets.

(b) to ring-fence some portion of Masterton District Council's debt, so that it is paid off solely by the ratepayers of Masterton district. The level of ring-fenced debt would need to be sufficient to broadly reflect the higher share of debt per rating unit held by Masterton District Council.

89. Table 18 (and extract from Table 6 above) shows the different NFA positions of the three councils as at 30 June 2016. Allocations of net debt/(assets) could be made on the basis of an updated table such as below.

Table 18: Net Financial Assets per Rating Unit

Net Financial Assets (NFA) as at 30 June 2016	Carterton District Council $000	Masterton District Council $000	South Wairarapa District Council $000
NFA per rating unit	($407)	($3,161)	($881)
NFA and investment properties per rating unit	($407)	($2,990)	$565
Source: 2015/16 Annual Reports			

90. Both variations are complex. The 'clean slate' approach in variant 1 means that all debt and financial assets of the merged council would be ring-fenced, leaving the new council with a clean slate. However, the council would simultaneously be managing the legacy debt/assets in three pools whilst introducing new debt and financial assets onto its balance sheet. The more 'targeted' approach in variant two would leave Masterton residents paying off old debt, as well as contributing to the replacement of assets funded from that debt.

91. More importantly, this approach is predicated on the basis that the current assets and future investment requirements are 'neutral' over the three councils, and that debt/NFA is the only difference between them that should be equalised. In practice, this is unlikely. With respect to wastewater treatment, the three councils are at different points in their investment cycles, with Masterton District Council having largely completed its investment in Homebush wastewater treatment plant, Carterton District Council seeking long-term consents in 2017 with the standards required from the PNRP still uncertain, and South Wairarapa District Council commencing its own programme of investment. Masterton residents could end up paying for their own wastewater treatment plant, as well as contributing to the new costs of Carterton District Council and South Wairarapa District Council. In other infrastructure areas, assessing asset condition is difficult, particularly for the below-ground assets, and (although there is no evidence of such from the financial information available), the condition of assets will vary across the councils.

92. Finally, if debt is ring-fenced, it must allocated fairly so that Masterton residents are not required to fund Masterton District Council's debt and also contribute disproportionately to the debt of the other two councils. . Table 5 shows Masterton District Council's debt by activity group. The Commission would need to determine *what* debt would be ring-fenced, taking into account how the future rating system would itself allocate responsibility for debt repayment.

93. If the Commission decides to ring-fence both assets and debt it would need to determine the period of time for which such restrictions should apply. If there is an argument for ring-fencing, the debt could be ring-fenced until it is paid off, although the difference in net financials assets (including investment properties) of $3,555 per rating unit between Masterton and South Wairarapa districts as shown in Table 7 suggests that the difference would take some time to pay off.

94. Finally, consideration would also be given to whether a share of Carterton District Council's debt should also be ring-fenced, so that the share of debt per rating unit was equalised across the ratepayers of all three councils.

Option 3 – Set rating policy as it relates to wastewater-related debt

95. As it appears that capex and debt associated with wastewater treatment (past capex for Masterton District Council, future capex for Carterton District Council and South Wairarapa District Council), a third option would be to set the new council's rating policy, as it relates to wastewater treatment, so that the cost of wastewater in each district is funded from the residents in that district. (Our lay-interpretation is that this is provided for in the legislation, although the Commission will need to obtain its own view on this.)

96. This is essentially the current arrangement for the three councils. Masterton District Council has separate sewerage rates for Masterton Urban, Riversdale, Castlepoint, and Tinui. Carterton District Council has a uniform sewerage charge for properties connected (or able to be connected) to the urban sewerage system. South Wairarapa District Council has a single uniform charge for properties connected or able to be connected to one of its four wastewater treatment plants. Rural properties, unable to be connected to the WWTPs, do not pay the sewerage rate or charge. For Masterton, in effect, the interest and principal repayment for the Homebush-related debt is already ring-fenced to urban residents.

97. The rating policy could be specified for a period of three or six years (being one or two electoral terms). This would span the period of time that the new council would have to develop and implement a new integrated rating system.

Conclusion

98. This is a high level assessment of debt and asset issues. It is designed to enable the Commission to test whether or not there might be a case for ring fencing debt and financial assets in a reorganisation of these three territorial authorities. The current levels of debt and financial assets vary between the councils, most noticeably between Masterton District Council and the other two councils. Investment requirements for wastewater however, are uncertain, and the three councils are at different points in the investment cycle, in a period where there is some uncertainty in respect of the standard they must achieve. There was no evidence of differences in asset condition in a way that would offset the differences in debt levels, but it is noted that assessing asset condition is difficult, the councils are undertaking ongoing assessments of asset condition, and the financial information only gives broad proxies of asset consideration.

99. On the basis of this analysis, three options are presented – either no ring-fencing, or ring-fencing debt or assets (in part or in full), or handling differences in debt through the rating system.

100. A decision on this cannot be made in isolation of other decisions relating to a council merger. Any new council will need to address differences between the predecessor

councils in rating systems and incidence of rates, levels of service, asset condition and risk, and future development plans. These matters are interrelated. The Commission can determine the basis of general rates (capital or land value) and any initial allocation of debt and assets, but it cannot determine rating policy, levels of service, long-term investment strategy or future development plans. Determining one of these matters in isolation from the others will constrain future decisions by a new council, and could also result in some perverse outcomes.