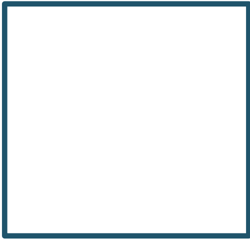

Local Government Sector

COVID-19 Financial Implications Report 2 – Alert Level Scenarios, Assumptions and Updated Analysis

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Foreword

1. As noted in our first, April 2020, financial implications report COVID-19 will have profound impacts on New Zealand's local government sector as well as wider economic and financial systems.
2. The analysis in this report builds on our initial work and provides more detailed information with reference to possible COVID-19 scenarios and impact assumptions. This information confirms the diversity of local government and how COVID-19 impacts will vary considerably in districts and regions around the country. We expect the information will assist with recovery planning at national, regional and local levels.
3. As with our first report, some of the information relates to forecasts undertaken before the COVID-19 pandemic (for example, 2018-2028 Long Term Plans). However, we have also been able to gather further information from councils and other organisations to develop Alert Level scenarios and assumptions about the impacts of COVID-19 in New Zealand. In turn, that has provided a basis for some further analysis of what that might mean for the local government sector over coming weeks and during the 2020/21 financial year.
4. This updated analysis includes summary information on what councils responding to a Society of Local Government Managers (SOLGM) survey said about:
    - the overall financial impacts they expect during the fourth-quarter of the current financial year; and
    - what might happen with rate-setting for the 2020/21 year.
5. Once again, compiling and producing this report has been a team effort with contributions from Local Government New Zealand (LGNZ), SOLGM, Local Government Funding Agency (LGFA), the Treasury and the Department of Internal Affairs (DIA).
6. Several other government agencies were also very generous with their time and information as we worked through the process of formulating scenarios and assumptions. We are very grateful to them and the councils who continue to engage with surveys, give up their time to discuss key issues and questions and share their own analyses and conclusions about COVID-19 and its effects on their communities as well as council revenue and expenditures.
7. We welcome feedback on this report and will continue to support the sector as New Zealand progresses through different Alert Levels and the recovery focus intensifies.
8. Stay safe and well.

Snapshot

9. This updated analysis in this report is based on modelling against the 2020/21 financial year as per councils' 2018 – 2028 long-term plans (LTPs) and additional survey information received from councils in the last week about likely rates revenue for the 2020/21 financial year. It is also informed by three Alert Level scenarios, initially developed by the Ministry of Transport with reference to Treasury scenarios released on 14 April 2020. The best-case scenario (scenario A) is a progression from the current Alert Level 3 down to Alert Level 0 in early 2021 without having to raise the Alert Level again. The worst-case scenario (scenario C) includes two further periods at Alert Level 4.

10. Our updated analysis suggests that, overall, councils' revenues for the 2020/21 financial year are likely to be between 2.3 and 11 percent lower than the forecast pre-COVID-19 levels. This is quite different to our *Initial Analysis* report, which indicated much higher potential revenue reductions – ranging between 15 and 20 percent. With the 2018 Long-Term Plans forecasting total revenue in 2020/21 of almost $15.5 billion, this forecast revenue reduction of between 2.3 to 11 percent equates to approximately $355 million - $1.5 billion.

11. The most significant revenue items that influence the new estimates of revenue reductions are rates revenue, fees and charges, and fuel tax (primarily Auckland), fines and infringement fees. It would require large rate rises to make up the total estimated revenue shortfall (an average of 9.5 percent in our best-case scenario).

12. This collated national picture needs to be treated with caution as the local government sector is not homogeneous. Within this national picture, there are councils that our analysis shows are in a very challenging situation. Typically, they are councils that were carefully managing budgets and making trade-offs before the COVID-19 pandemic. The pandemic effects have simply amplified or added to their pre-existing difficulties.

13. Councils that are in the most challenging position include those with a high tourism dependence, high levels of growth and/or rely on significant revenue from investments and dividends.

14. Our analysis also shows that even relatively small reductions in revenue can have a large practical impact. Small revenue reductions may lead to increased borrowing to make up the shortfall or reduced expenditure, particularly on capital items, to balance the budget, or some mixture of the two.

15. A key unknown is how the forecast shortfall in the National Land Transport Fund (NLTF) will be treated. If this forecast shortfall is passed through to councils then this pushes the council revenue reduction towards the top of the range.

16. Identified revenue reductions indicate that around eight councils could be at-risk of breaching the Local Government Funding Agency debt covenants (net debt/revenue criteria), in the unlikely event that those councils took no action to maintain revenue or reduce expenditure. A further 7 councils could come within 20 percent of the covenant thresholds, giving little headroom in case of a further financial shock (eg, due to a natural disaster event).

17. We expect that councils will defer the replacement of assets for a period and potentially reduce the priority of capital expenditure so they can sustain service levels. The deferral of asset replacement may increase infrastructure resilience risks and increase long term costs for councils. High growth councils are likely to come under pressure to defer capital expenditure for growth by a year or more.

Part 1: Background

Local Government COVID-19 Response Unit

18. This is the second financial implications report from the Local Government COVID-19 Response Unit, which is a joint initiative of DIA, LGNZ, SOLGM and the National Emergency Management Agency (NEMA).

19. The Unit's focus is to ensure council Mayors, Chairs and Chief Executives can continue to make the necessary decisions to support the wellbeing of their communities to protect New Zealand and eradicate COVID-19.

20. The Unit aims to:

    20.1 Co-ordinate and unite with councils to ensure the continued delivery of essential services to all our communities, in alignment with the national response to COVID-19.

    20.2 Integrate DIA's national-level response functions with LGNZ, SOLGM, NEMA, other agencies and national command structures.

    20.3 Ensure effective two-way communications between central government agencies and councils to enable central government to provide nationally consistent guidance and information to assist councils to understand and comply with relevant requirements of local government legislation. This includes any legislative changes or statutory overrides implemented by the Government.

    20.4 Keep the Minister of Local Government informed of urgent issues and provide advice on legislative 'fixes' that may be required.

    20.5 Provide guidance and assistance to enable and support recovery post-lockdown by councils and their communities.

21. The Unit includes the following workstreams: Essential Services; Governance and Regulatory; **Finance;** Recovery; Social Wellbeing; and Project Management.

Finance Workstream

22. The main roles of the Unit's Finance Workstream are:

    22.1 Identification and resolution, if required, of material legislative constraints and impediments to finance-related processes in varying Alert Level situations (linked to the Governance and Regulatory Workstream).

    22.2 Understanding financial implications for the sector, groups of councils and individual councils of the pandemic – revenue, expenditure, borrowings, cashflow, liquidity.

    22.3 Provision of advice and guidance to the local government sector on navigating the COVID-19 situation as it relates to financial processes and practices, including annual rates setting.

    22.4 Tracking and reflecting economic forecasts to inform analysis and provision of best possible advice.

23. As per the bold text above, this report relates primarily to understanding the financial implications for the sector.

Targeted information gathering

24. To support this analysis and to supplement readily available data and information on council finances and evolving economic conditions post-COVID-19, SOLGM conducted the following two rapid surveys of councils.

25. Firstly, councils were asked to identify the financial impacts of COVID-19 during the fourth quarter of the 2019/20 financial year (April – June 2020). They were asked to compare their annual plan forecasts with any new, post-COVID-19 estimates. Thirty-one territorial authorities and two regional councils responded.

26. The first survey scope included key revenue, expenditure and balance sheet items. Councils were also asked to note any particular assumptions or areas of risk in the forecast. Each council made its own assumptions about the COVID-19 response and its impact on local economies.

27. Secondly, councils were asked about their rating intentions in March 2020 (i.e. prior to Alert Level 4) and their updated intentions as of the end of April 2020. Councils were also asked to confirm the level of rates income that the 2018 - 2028 LTPs had projected for the 2020/21 financial year. Recognising that many councils are yet to make decisions and may still be formulating and/or consulting on their options they were able to indicate more than one possible option for their updated intentions.

28. Seven of the 37 respondents indicated they were still considering more than one option (most commonly two, though one council presented six). Where councils presented options, there were two sets of data constructed. One of these used the options with the highest level of associated rates income, and one with the lowest associated level of rates income.

Part 2: Scenarios, economic context and assumptions

Alert Level scenarios to inform the analysis

29. What New Zealand's ongoing response to COVID-19 will exactly involve and when Alert Levels will apply nationally or in different regions or districts is uncertain.

30. For this financial analysis, we have chosen to adapt a Ministry of Transport COVID-19 Alert Level scenario model as summarised in the table below. The Ministry of Transport scenarios align closely with Treasury scenarios and have been built on a month-by-month basis. This disaggregation works well for modelling. We have adapted the first two months of the scenarios to reflect Government decisions on Alert Levels made since the Ministry of Transport scenarios were developed on 8 April 2020.

Table 1: Scenarios and Alert Levels

Actual date, notified decision date and future months	Financial Year (FY)	FY Quarter	Scenario and alert level		
			A	B	C
23 Mar 2020	2020	3	3	3	3
25 Mar 2020	2020	3	4	4	4
28 Apr 2020	2020	4	3	3	3
11 May 2020	2020	4	3 or 2?	3 or 2?	3 or 2?
Jun 2020	2020	4	2	2	2
Jul 2020	2021	1	2	2	1
Aug 2020	2021	1	2	2	4
Sep 2020	2021	1	2	2	3
Oct 2020	2021	2	2	2	2
Nov 2020	2021	2	2	1	1
Dec 2020	2021	2	2	4	4
Jan 2021	2021	3	2	3	3
Feb 2021	2021	3	2	2	2
Mar 2021	2021	3	2	1	1
Apr 2021	2021	4	1	1	1
May 2021	2021	4	1	1	1
Jun 2021	2021	4	1	1	1
Jul 2021 onwards	2022	1	0	0	0

31. The three scenarios are therefore best described as:

31.1 **Scenario A:** A progressive reduction in COVID-19 Alert Levels in the 2020 and 2021 calendar years. A successful public health response quickly limits the health impact of COVID-19, enabling the start of the post-COVID-19 period by April 2021. Government financial support and favourable global economic conditions enable a rapid economic recovery. Compliance of the population and technology advancement in case detection and tracing enable successful management of the virus.

31.2 **Scenario B**: A reduction in COVID-19 Alert Levels for most of the 2020 calendar year with a return to Alert Level 4 in December 2020, followed by a fast reduction in COVID-19 Alert Levels in the 2021 calendar year. In this scenario, the public health response is somewhat effective. However, limited technology improvement in case detection and tracing results in a growth in the number of cases over time. This post-COVID-19 scenario is likely to start in July 2021 with a slower economic recovery.

31.3 **Scenario C: An oscillation between COVID-19 Alert Levels 1 – 4 in the 2020 and 2021 calendar years.** In this scenario, New Zealand both struggles to contain COVID-19, with Alert Level 4 reinstated in both August and December 2020 delaying the economic recovery. There are waves of reinfection causing significant loss of life and deep economic disruption over a prolonged period, delaying recovery.

Economic geography/context

Importance of sector make up

32. As indicated in the following table, how the scenarios impact on each of New Zealand's territorial authorities and regional councils will vary substantially. The short- and long-term impacts on councils are influenced by the differing characteristics of each council district.

33. The short-term refers to the initial shock to the economy, varying between sectors. For commodity good exporters and businesses reliant on imported inputs, the initial shock occurred from the beginning of the year as demand fell from China and other major trading partners.

34. However, most other sectors only began to be affected in the fourth quarter of financial year 2021, when the country entered Alert Level 4. The long-term impact captures the ongoing challenges to sectors as the economy moves into the recovery phase.

35. The impact varies widely, both between and within sectors. Construction, air travel, tourism, manufacturing, transport, and consumer goods industries face significant restrictions under Alert Level 4. Productivity will be severely impacted at Level 3 even if businesses in these sectors are able to operate. However, some businesses within these sectors will be able to get underway or recover quicker than others, especially if they have been able to operate under Alert Level 4.

- The inactivity in the building and construction sector will affect small sub-contractors and supplier industries, such as secondary metal machining.
- The forestry sector will feel the effects of the combined slowdown in demand from China and the country wide lockdown.
- Food manufacturers remained in operation under Alert Level 4, but their production may have been restricted due to social distancing requirements.

- Non grocery retailers, including motor vehicle retailing, are closed during the country wide lockdown and will also face reluctant demand from consumers once the lockdown is lifted.
- Layoffs and business failures have a higher chance of occurring in industries that feature a high proportion of small firms. For example, wholesale and retail, hospitality, rental and leasing, tourism and small manufacturers.

Table2: Long- and short-term sector impact and key influencing factors

Sector	Short term	Long term	Influencing Factors			
			Travel Restriction / Reduced travel/ Lockdown in NZ	Supply Chain Interruption	Reduced Consumption/ Interruption to Retail Operation	Working Capital Pressure
Retail trade	M	N	x	X	x	
Construction	H	M	x	x	x	X
Air travel	H	H	x		x	x
Wholesale trade	M	M	x	x	x	
Tourism	H	H	x			
Manufacturing	H	M		x	x	x
Telecommunications	O	O			Increase	
Electricity, gas, water & waste	M	N	x		x	
Transport, postal & warehousing	H	M	x	x		
Consumer goods (luxury goods)	H	M		x	x	x
Financial Services	M	M	x			x

Key	Meaning	Key	Meaning	Key	Meaning
Short term	Impact over the next four to six weeks	H	High impact	N	Neutral or low impact
Long term	Impact through 2020, assume the Governments' response is effective	M	Medium impact	O	High demand/opportunity

Source: Author analysis based on Deloitte

36. We have undertaken a more detailed economic geography analysis of economic impacts and sought to apply this at a local authority level. The results of this are in Appendix 1. Particular points to note include:

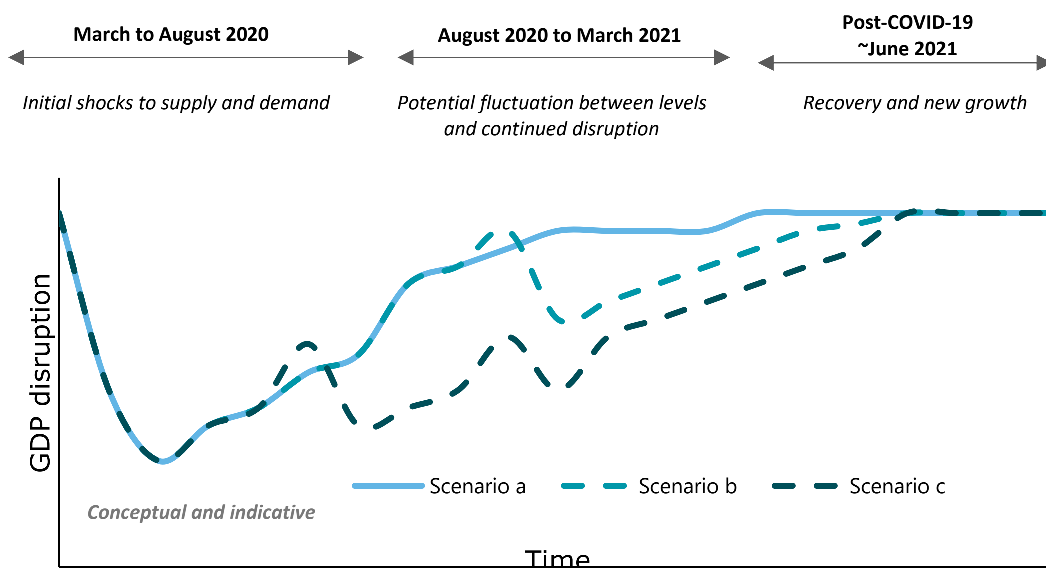
- The impact of COVID-19 on businesses is likely to be highly differentiated within industry segments.
- Local economies exposed to tourism will be hard hit by weaker incomes, higher unemployment, and uncertainty.

- Nationally, international tourism makes up 41 percent of total tourism expenditure and by region, Otago, Auckland, and West Coast have the highest proportions of international visitor expenditure.
- Manufacturing is the largest or second largest generator of production in many small provincial territorial authorities. According to Statistics New Zealand modelled territorial authority GDP figures, Kawerau, Carterton, South Taranaki District, and Mata-Piako Districts derived 41 percent, 40 percent, 25 percent and 25 percent of total GDP in 2018. Manufacturing is also a significant contributor to GDP in South Waikato, Timaru, and Hastings District.
- Agriculture is the largest industry by GDP for just over 40 percent of territorial authorities, including Waimate (51 percent of local GDP), Southland (38 percent), and Otorohanga (35 percent). The agriculture sector is expected to perform relatively well in the short- and long-term.
- High growth councils include Auckland, Hamilton, Tauranga, and Queenstown. Population growth from international migration will be heavily restricted over the next year. However, these councils also receive a relatively high number of domestic tourists each year, with net positive domestic migration in all districts except for Auckland during 2018. Returning New Zealanders and a continuation of domestic migration trends could support growth in these areas.

37. This analysis, along with the economic scenarios developed by The Treasury (released 14 April 2020[1]) have informed our assumptions around the GDP impact on local authorities of COVID-19 and fed into the development of three scenarios.

38. The stylised figure below depicts the negative impact on economic activity under the three scenarios described above. Scenario A shows an initial decline in activity, but a rapid recovery as alert levels are reduced. As indicated above, scenarios B and C each have some degree of Alert Level oscillation.

Figure 1: Stylised economic activity at different Alert Levels



[1] https://treasury.govt.nz/publications/tr/treasury-report-t2020-973-economic-scenarios-13-april-2020

Assumptions

39. As far as possible this report aligns financial impacts driven by economic activity using Treasury's assumptions of the levels of output across all of New Zealand under each Alert Level.

Table 3: Alert Levels and economic activity assumptions

Alert Level	Percent of output (midpoint)
4	60
3	75
2	87.5
1	92.5
0	100

Source: Treasury

40. Council expenditure and revenue items that we assume will scale in line with economic output include:

- subsidies and grants for operating purposes, except where specific sensitivities have been incorporated in the analysis (eg, the National Land Transport Programme);
- development contributions;
- other Income;
- interest and dividends from investments; and
- other operating expenditure.

Rates income (includes general and targeted rates and uniform annual general charges)

41. All modelling assumes the rating increases proposed by councils in the SOLGM Rating Intentions Survey for the 2020/21 financial year. For councils that did not participate in the survey, the average reduction in rating intentions for survey respondents was assumed to apply to those councils' proposed LTP rating intentions.

42. It is important to note that the proposed rating intentions are just considerations at this stage and may change between now and final adoption of each council's annual plan (likely to be late June for most councils).

LTP assumptions

43. We assume that councils' individual 2018 - 2028 LTP assumptions will remain relevant for:

- income from revaluations;
- employee costs;
- depreciation and amortisation;
- investment in council-controlled organisations (CCOs), council-controlled trading organisations (CCTOs) and other entities; and
- other assets.

Capital expenditure

44. Our analysis of council financial position assumes that councils will continue with the capital expenditure forecast in their 2018 – 2028 LTPs. It is highly likely that councils will consider reprioritising capital projects in order to better manage their recovery efforts and the financial impacts of COVID-19.

Petrol tax, fines, infringement fees and other

45. We assume that petrol tax, fines, infringement fees and other declines in proportion with NZTA's vehicle usage scenarios (presented later in this document).

Provision for rates non-collection

46. Our analysis assumes a non-collection assumption for rates in the range of 2 percent to 6 percent in the 2020/21 financial year, with the rates arrears progressively collected in the following two financial years.
47. Rates non-collection is counted as an increase in debt in 2020/21.

Grants and subsides

48. For the relevant sensitivity, grants and subsidies are assumed to decline proportionality with estimated reductions in the National Land Transport Fund (NLTF) net revenues.

Part 3: Short term - 2019/20 financial year

49. As outlined above SOLGM assisted with information gathering for this analysis by surveying councils about their estimates of short-term impacts of COVID-19 on revenues. The following is a summary of the key findings from the survey.

Rates revenue

50. Our initial report noted that many local authorities had sent, or were about to send, final 2019/20 rates instalment invoices to ratepayers. The impact of COVID-19 on rates revenues was not expected to be immediate or significant because the range of available collection options and enforcement powers would likely mean any ratepaying difficulties will manifest as payment delays rather than non-payment.

51. Most of the surveyed local authorities anticipate collection of all of the 2019/20 rates. Ten are forecasting some level of non-collection, though seven of the ten forecast collection of 99 percent or better. Only three have forecast levels of non-collection markedly above usual.

Fees and charges

52. The survey results confirm expectations that the closure of community facilities will result in a loss of revenues from fees and charges. Collectively, the surveyed local authorities anticipate an average decrease in revenue from fees and charges of around 12 percent.

53. Around a third are expecting declines in revenues of 15 percent or more. Four of these expect declines of more than 20 percent in revenue from fees and charges. The ten local authorities with the largest forecast losses are all territorial authorities but there is little commonality in factors such as size, location etc.

Interest and dividends from investments

54. A majority of the surveyed councils are expecting a reduced level of income from investments (dividends etc). Twenty of the thirty-three respondent councils forecast reductions in revenue from investments. Christchurch City and New Plymouth District are forecasting reductions of $26 million and $28 million respectively (the latter representing a change from a forecast receipt of $15 million to a loss of $13 million).

55. Five councils have forecast no change in investment incomes, and six others have forecast increases of 25 percent or more (though in many cases these are relatively small amounts).

56. While some losses appear very large when expressed as percentages, the actual amounts of forecast declines are small in the overall context of the council finances. For example, Hastings District forecasts its actual receipts from investment will be more than 80 percent lower than forecast in the annual plan. The amount involved is approximately $520,000 or around 0.6 percent of that council's rate take. In contrast, New Plymouth's loss is equivalent to 30 percent of its rate take.

Fuel tax, fines, infringement fees and other revenue sources

57. We expect a reduction in fuel tax (primarily affects Auckland Council through the Regional Fuel Tax – RFT), traffic and parking related fees due to the reduction in vehicle usage from Alert Levels 4 and 3.

58. Parking and traffic infringement revenue will reduce in line with reduced vehicle usage. We note that many councils have not been collecting any parking revenue during the initial Alert Level 4 period. This policy will further reduce parking income for councils during further Level 4 periods, if any.

Development and Financial contributions

59. While slightly more than a third of the thirty surveyed councils that can and do use development contributions (DCs) have forecast decreased revenues, most have forecast that revenues will hold steady or increase. The likely explanation for this counter-intuitive result is that, for many councils, development activities and DC income were running ahead of schedule and or well above LTP forecasts pre-COVID-19. Local authorities typically take a conservative approach with forecasting these revenues, recognising that the risk of any shortfall is an increase in rates or debt.

Impacts on capital expenditure

60. We anticipated that COVID-19 impacts would lead to some councils deciding to defer capital expenditure programmes for the remainder of 2019/20. The survey results indicate that, on average, councils now expect to expend around 73 percent of the planned capital budgets (approximately $674 million). Twenty-eight of the thirty-three councils expect to be below the annual plan budget, with 17 councils predicting capital expenditure less than 75 percent of budget (including five less than 50 percent).

61. These findings should be viewed with caution. There are a variety of reasons a local authority might not deliver all the planned capital works under 'business as usual' – these include availability of civil construction to do the work, inclement weather, delays in consenting. The Office of the Auditor-General's report on the 2017/18 audits noted that the sector's delivery against capital programmes has been improving in recent years, but in 2017/18 58 of 78 did not deliver all their planned capital expenditure.

62. The degree of underspend in capital budgets in Waikato and Selwyn Districts is more than $100 million. Hamilton likewise is expecting to underspend by around $79 million and Wellington is predicting a $64 million underspend (roughly $40 million of this was forecast before the Alert Level 4). Each of these are growth councils, and there may be significant ongoing impacts on wider objectives for housing and urban development.

63. Other councils likely to be significantly underspent include smaller provincial centres such as Timaru, Hastings and Marlborough Districts.[2] Councils did commonly note that the recent calling on councils to identify shovel ready projects would significantly influence their results.

64. It appears most have deferred some capital expenditure, and some cases markedly so, but it is unclear how much, if any, relates to COVID-19.

Operating Expenditure

65. Overall, the surveyed councils forecast staff costs will be within one percent of those budgeted in the annual plan. However, there are some councils predicting a significant variance from budget.

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[2] In February 2020, before COVID-19 impacts, Marlborough was already indicating that internal and external capacity constraints meant it was likely to spend only $14 million of its $87 million capital expenditure budget for 2019/20. See a media report about this at: https://www.stuff.co.nz/national/politics/local-democracy-reporting/119183211/council-spends-fraction-of-infrastructure-budget-due-to-lack-of-resources

66. Central Otago District predicts it will be 20 percent under annual plan and Otorohanga District predicts 10 percent. These are not necessarily COVID-19 impacts.

67. Likewise, there is currently little indication in the survey responses of sector-wide variance in the forecast expenditure on other direct costs from annual plan.

68. There is an indication of a small reduction in borrowing across the sector which is reflected in a moderate, 10 percent, reduction in finance costs.

Impact on debt levels.

69. There are several dynamics at play with the potential impacts on borrowing. There may be some borrowing reductions by councils that were intending to make significant reductions in capital expenditure, Others might borrow to offset reductions in revenues. The impact of prudential debt limits and the LGFA borrowing covenants would hold sway over all.

70. There is evidence of each of these dynamics at play in the survey results. On average the council responses indicate a collective expectation to borrow slightly less than forecast in annual plans. However, this average masks considerable variability in results – with a couple of councils forecasting they will borrow less than a third of that indicated in annual plans, while ten were forecasting higher borrowings.

71. As would be expected there is a correlation between those councils making significant reductions in capital expenditure and those reducing their borrowing. Six of the ten councils with the largest percentage reductions in debt are amongst those with the highest percentage in capital programmes. Hamilton City and Waimakariri District are also making large dollar reductions.

72. For some councils there may be a relationship between indications of borrowing more than annual plan forecast and anticipated revenue reductions. For example, New Plymouth District has forecast a substantial loss of investment revenues and some loss of development contributions revenues. Hastings District is also forecasting moderate revenue decreases across the board.

Part 4: Medium- and long-term (2020/21 and beyond)

Revenue forecast for the 2020/21 financial year

73. This updated analysis used two data sources to glean revenue forecasts for the 2020/21 financial year.

- As outlined earlier, an informal SOLGM survey that asked councils to provide data on their pre-COVID-19 plans for rates revenue and their best estimate, as of now, for the rating revenue they would strike in their upcoming Annual Plans.
- A model developed for this analysis to run various scenarios and sensitivity analyses. Based on the 2018 – 2028 LTPs, the model individualised each revenue line item, brought analysis to inform assumptions for each (ie, wider GDP impact) and forecast the revenue for each council.

Informal SOLGM survey results on rates revenue for the 2020/21 financial year

74. At the time of writing 37 local authorities had responded to the survey - 32 territorial authorities and 5 regions. The largest non-respondent councils included Auckland Council and Dunedin City Council. However, overall, the survey respondents appear to be reasonably representative of the sector as a whole.

75. In LTPs the 37 respondent councils forecast that they would receive a total rates income of $3.110 billion for the 2020/21 financial year. Prior to COVID-19 this amount would have increased to $3.152 billion. Based on their best post-COVID-19 estimates at the end of April 2020, the total rates income forecast lay between $3.022 billion (low rates income) and $3.079 billion (high rates income). These represent decreases of 4.1 and 2.3 percent respectively.

76. Under the low rates income estimate almost all the surveyed local authorities were expecting to make reductions in the level of rates income over those in the pre-COVID-19 situation. Three local authorities were intending to keep their rates income at pre-COVID-19 levels, 34 were intending to reduce the budgeted level of rates income. Of these 11 were intending reductions of at least five percent – including four of the five regional councils in the survey, four city councils and three district councils. Around two thirds of the surveyed councils were planning reductions below the amounts signalled in the LTP.

77. Under the high rating income estimate 32 of the 37 the surveyed local authorities were expecting to make reductions in the level of rates income over those in the pre-COVID-19 scenarios. Of these 8 were intending reductions of at least five percent – including four of the five regional councils in the survey.

78. It should be noted that local authorities, like central government, are undertaking their annual planning at a time when the uncertainty about the wider economic and social impact of COVID-19 is at its highest. Some councils had not started engaging the public on their 2020/21 annual plans when Alert Level 4 commenced and may change intentions further after engagement, and after elected member decision-making based on the results of that engagement. Even those councils that were well advanced with their annual plans still have many of these same process steps to complete.

79. Where they can, local authorities will first attempt to reduce spending in ways that do not require reductions to service levels, or in ways that could compromise the achievement of levels of service. The levels of reduction signalled above appear consistent with such a strategy. Higher levels of reduction would be more likely to require deferral of larger capital projects.

Modelling results on revenue line items for the 2020/21 financial year

80. The following table demonstrates the change in revenue and expenditure under the three financial scenarios for 2020/21. Under these scenarios, expenditure is kept constant to demonstrate the potential impact on debt, net surpluses. In reality, councils will be able to adjust their expenditure to offset some of the revenue shortfall.

81. A drop of at least 5 percent in operating and capital sources of funding (revenue) could be expected in 2020/21, compared to what was forecast in the 2018 – 2028 LTP. Operating sources of funding is estimated to fall between 6 and 7 percent in the 2020/21 financial year, while capital sources of funding falls by around just 3percent.

82. The drop is primarily driven by the rates default assumption of 2 to 6 percent and a 10 to 15 percent decline in GDP.

83. Under all three scenarios there is an assumed deficit of up to $1.2 billion.

Table 4: Total Local Government revenue and expenditure scenarios, 2020/21 financial year

Baseline (LTP)	Baseline (LTP) (000s)	Scenario A (000s)	Scenario B (000s)	Scenario C (000s)
Total source of operating and capital funding "revenue"	$15,455,139	$14,578,992	$14,447,048	$14,283,718
Total application of operating and capital funding "expenditure"	$15,455,135	$15,455,135	$15,455,135	$15,455,135
Net surplus (deficit)	$4	-$876,143	-$1,008,087	-$1,171,417
Revenue change from baseline		-5.7%	-6.5%	-7.6%

Source: DIA modelling of scenarios

National Land Transport Programme (NLTP) funding sensitivity

84. A significant proportion of revenue from subsidies and grants is the NLTP funding via the New Zealand Transport Agency (NZTA). A key uncertainty is how this reduced revenue will impact NLTP funding for councils.

85. NZTA is expecting to receive significantly less in revenue due to reduced collection of road user charges (RUC) and fuel excise duty (FED) from private and commercial vehicles.

86. To account for this uncertainty, a second sensitivity was run, assuming that revenue from NZTA decreases in proportion to NZTA's forecasted decline in revenue. Expenditure is reduced in proportion to the NZTA revenue decline.

- Including this assumption reduces revenue by 7 percent to 11 percent from LTP forecast revenue.
- In the worst-case scenario, the net deficit declines to $1.2 billion, due to the simultaneous decline in capital expenditure.

Table 5: Total Local Government revenue and expenditure scenarios, NLTP funding sensitivity

Baseline (LTP)	Baseline (LTP) (000s)	Scenario A (000s)	Scenario B (000s)	Scenario C (000s)
Total source of operating and capital funding	$15,455,139	$14,389,247	$14,014,972	$13,728,768
Total application of operating and capital funding	$15,455,135	$15,265,390	$15,054,440	$14,953,959
Net surplus (deficit)	$4	-$876,143	-$1,039,468	-$1,225,192
Change from baseline		-6.9%	-9.3%	-11%

Source: DIA modelling

Revenue drivers

87. Under the base assumption of no decline in NZTA funding from the LTP forecasts, the key drivers of the revenue reduction are rates revenue, fees and charges, and petrol tax, fines and infringement fees.

88. The tables below displays the top seven contributors to the decline in revenue. The second table indicates the relative importance of each item above to the overall decline in revenue – expressed as the percentage that an item contributes towards the change from LTP forecasts.

- Rates is the largest revenue source. Intended rates income (set by councils) is expected to decline by 2.9 percent across all scenarios. Despite this relatively small decline, the decrease in intended rates contributes between 17 percent and 23 percent of total variation from the LTP forecasts.
- Rates non-collected is assumed at 2 percent, 4 percent and 6 percent for scenario A, B, and C respectively. This assumption is also a strong contributor to the total decline in revenue – accounting for between 8 and 30 percent.
- Fees and charges are the second largest revenue category. An 11 percent decline across all scenarios contributes between 26 and 35 percent to total variation from the LTP forecasts. Approximately half of the revenue from fees and charges is derived from demand driven sources – such as building consent fees and community facilities.
- Petrol tax, fines, infringement fees and other falls by 16 to 26 percent across the three scenarios. It contributes 16 to 18 percent of the total revenue variation from the LTP forecasts.
- Development contributions and financial contributions are a relatively small revenue line item. A 6 to 8 percent decline in revenue equates to around 9 to 10 percent of the change from the LTP forecasts.

Table 6: Revenue change from the LTP forecasts and contribution to the total variation, by line item, 2020/21 financial year

Line item	Baseline (LTP) (000s)	Scenario A (000s)	Scenario B (000s)	Scenario C (000s)
Rates income	$6,916,413	-2.9%	-2.9%	-2.9%
Provision for rates non-payment	$0			
Fees and charges	$2,730,608	-11.3%	-11.3%	-11.3%
Subsidies & grants income	$1,871,635	0.0%	0.0%	0.0%
Petrol tax, fines, infringement fees & other	$829,657	-16.7%	-20.4%	-25.8%
Development & financial contributions	$538,577	-18.2%	-18.3%	-19.3%
Total operating revenue	$15,455,139	-5.7%	-6.5%	-7.6%

Source: DIA modelling of scenarios

Table 7: Contribution to the total variation in revenue change from the LTP forecasts, by line item, 2020/21 financial year

Line item	Scenario A	Scenario B	Scenario C
Rates income	22.8%	19.8%	17.1%
Provision for rates non-payment	7.5%	19.6%	28.2%
Fees and charges	35.1%	30.5%	26.2%
Subsidies & grants income	0.0%	0.0%	0.0%
Petrol tax, fines, infringement fees & other	15.8%	16.8%	18.2%
Development & financial contributions	11.2%	9.8%	8.9%
Other	7.5%	3.5%	1.4%

Source: DIA modelling

Scenario: If NZTA cuts funding proportionate to expected revenue reduction

89. A fall in grants and subsidies revenue in proportion to the expected reduction in NZTA revenue significantly increases the total decline in revenue. Under scenario C the reduction in grants and subsidies explains almost a third of the revenue variation from the LTP forecasts.

Table 8: Revenue change from the LTP forecasts and contribution to the total variation, by line item if NZTA cuts funding proportionate to expected revenue reduction, FY2020/21

Line item	Baseline (LTP) (000s)	Scenario A (000s)	Scenario B (000s)	Scenario C (000s)
Rates income	$6,916,413	-2.9%	-2.9%	-2.9%
Provision for rates non-payment	$0			
Fees and charges	$2,730,608	-11.3%	-11.3%	-11.3%
Subsidies & grants income	$1,871,635	-10%	-21%	-27%
Petrol tax, fines, infringement fees & other	$829,657	-16.7%	-20%	-26%
Development & financial contributions	$538,577	-18%	-18%	-19%
Total operating revenue	$15,455,139	-7%	-9%	-11%

Source: DIA modelling

Table 9: Contribution to the total variation in revenue change from the LTP forecasts, by line item, if NZTA cuts funding proportionate to expected revenue reduction, FY2020/21

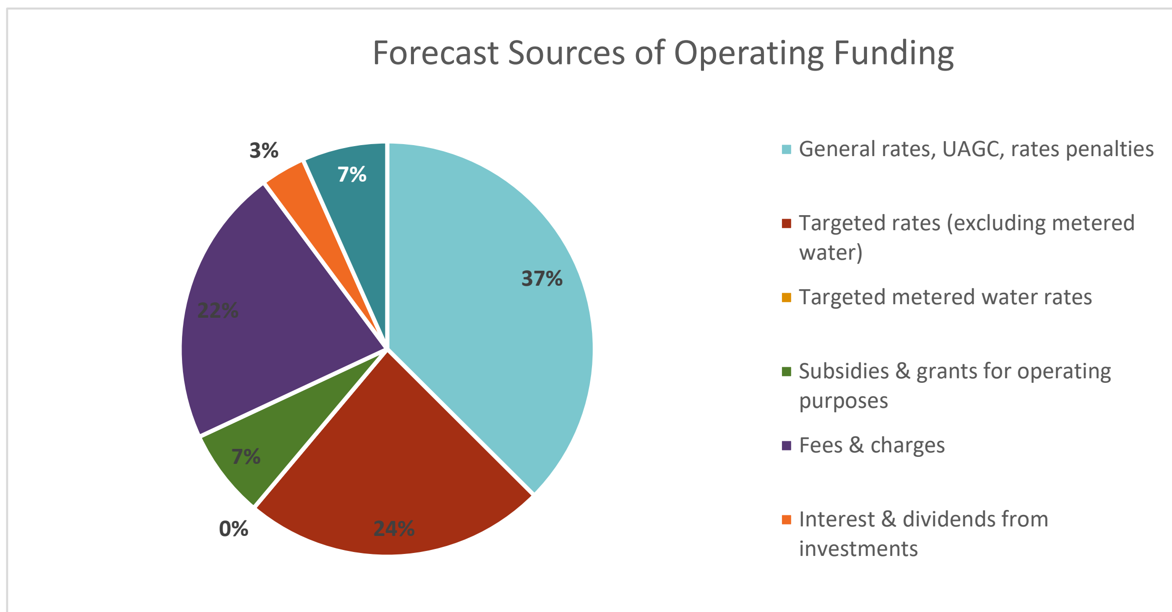
Line item	Scenario A	Scenario B	Scenario C
Rates income	18.8%	13.9%	11.6%
Provision for rates non-payment	6.2%	13.7%	19.1%
Fees and charges	28.8%	21.3%	17.8%
Subsidies & grants income	17.8%	27.8%	29.0%
Petrol tax, fines, infringement fees & other	13.0%	11.7%	12.4%
Development & financial contributions	9.2%	6.9%	6.0%
Other	6.2%	4.6%	4.1%

Source: DIA modelling

Further analysis and breakdown of significant revenue line items

90. As shown in figure 2 below, councils generate the vast majority of their revenue from rates, fees and charges and grants and subsidies.

Figure 2: Sources of operating funding: Forecast data from 2018-2028 LTPs



Source: DIA analysis of council LTPs for the 2019/20 financial year

Rates revenue

91. More significant impacts on rates collection may manifest in the 2020/21 year, as economic conditions post COVID-19 may make it difficult for some ratepayers to pay their rates on time. This is especially the case for residential ratepayers who lose their jobs and commercial ratepayers facing cashflow difficulties themselves or who have business tenants that are unable to pay their full rent on time or at all.

92. In an accounting sense, the deferred payment of rates does not reduce council revenue. Instead, deferred payment will simply impact cashflows unless councils apply a local rates remission policy on certain rates accounts or choose to 'write-off' unpaid rates.

93. Because rates fund essential community services and infrastructure projects (and ratepayers have been and will continue to be supported through other means) wide-scale rates remissions or write-offs seem unlikely. However, many councils will extend due dates, waive late payment penalties and work with individual ratepayers experiencing genuine hardship on a payment plan to clear rates arrears as quickly as possible.

94. As noted above, councils are currently undertaking their annual planning processes, and most have not set their rates for the 2020/21 financial year. Many councils recognise that there will be a growing level of hardship in their communities and are looking to reduce rates increases that might otherwise have gone ahead.

95. Lower rates levels are being funded by:

- use of council cash reserves;
- further borrowing;
- re-prioritisation of projects; and
- possibly, reducing some service levels.

96. The financial modelling shows that rates income could decline by around 2.9 percent due to council's lower rate collection intentions.

97. In addition, the analysis estimates that there could be between a $65 million and $330 million non-collection, based on a non-collection assumption of 2 to 6 percent in the 2020/21 financial year. However, these rates arrears are expected to be collected progressively in the 2021/22 and 2022/23 financial years.

Table 10: Rates income and provision for rates non-payment, FY2020/21

Line item	Baseline (LTP) (000s)	Scenario A (000s)	Scenario B (000s)	Scenario C (000s)
Rates income	$6,916,413	$6,716,311	$6,716,311	$6,716,311
Provision for rates non-payment	$0	-$65,973	-$197,918	-$329,867

Source: DIA Modelling

Fees and charges

98. Varying levels of economic activity at different COVID-19 Alert Levels will affect councils' revenue from fees and charges.

99. Across all sectors of the economy, we expect that outputs at the different Alert Levels will be as indicated in table 11 below.

Table 11: Economic output at different Alert Levels

Alert Level	Percent of output (midpoint)
4	60
3	75
2	87.5
1	92.5
0	100

Source: Treasury

100. Council fees and charges largely fall into two categories, namely:

- those affected by activity/demand levels, such as user charges for community facilities and fees for regulatory services such as resource and building consenting; and
- those that remain relatively constant over time, such as dog licensing fees.

101. The modelling shows a decline of 11 percent in the 2020/21 financial year, or approximately $300 million.

Table 12: Level and percentage change to fees and charges, FY2020/21

Line item	Baseline (LTP) (000s)	Scenario A-C (000s)
Fees and charges	$2,730,608	$2,423,415
% decline from baseline		-11.3%

Source: DIA Modelling

Subsidies and grants for operating purposes

Regional Councils expect reduced public transport fare revenue

102. Public transport fare revenue is expected to be much lower at all COVID-19 Alert Levels for some time. Longer-term public transport patronage will likely be impacted by changes in working practices as more people choose to work from home on a part-time or full-time basis. Higher levels of unemployment will also reduce patronage to some degree.

103. Social distancing requirements at Alert Levels 3 and 4 severely limit the capacity of buses and trains (capacity reductions as high as 80 percent due to the two-metre distancing requirement). The one metre social distancing requirement at Alert Level 2 is still very limiting and may only enable a five percent capacity gain (ie, 25 percent capacity at Alert Level 2).

104. We assume the following levels of public transport patronage when compared to normal pe-COVID-19 patronage levels.

Table 13: Assumptions of public transport patronage at different Alert Levels

Alert Level	Percent of normal patronage
4	2.5
3	20 – 23
2	43
1	80
0	95

Source: DIA with NZTA

105. Assuming that the zero fares in Alert levels 3 and 4 continue until 30 June 2021, the estimated impact on regional council fare revenues under each scenario is:

Table 14: Estimated impact on regional council fare revenue under each scenario

Region	Fare Revenue Loss - 2020 ($M)			Fare Revenue Loss - 2021 ($M)		
	Scenario A	Scenario B	Scenario C	Scenario A	Scenario B	Scenario C
Auckland	65.3	65.3	65.3	260.1	260.1	260.2
Bay of Plenty	4.4	4.4	4.4	17.4	17.4	17.4
Canterbury	6.0	6.0	6.0	24.0	24.0	24.1
Gisborne	0.1	0.1	0.1	0.2	0.2	0.2
Hawke's Bay	0.5	0.5	0.5	1.9	1.9	1.9
Manawatu-Wanganui	0.9	0.9	0.9	3.5	3.5	3.5
Nelson-Tasman-Marlborough	0.2	0.2	0.2	0.9	0.9	0.9
Northland	0.5	0.5	0.5	2.1	2.1	2.1
Otago	2.9	2.9	2.9	11.5	11.5	11.5

Southland	0.2	0.2	0.2	0.6	0.6	0.6
Taranaki	0.4	0.4	0.4	1.6	1.6	1.6
Waikato	2.6	2.6	2.6	10.2	10.2	10.2
Wellington	19.7	19.7	19.7	78.4	78.4	78.4
West Coast	0.0	0.0	0.0	0.0	0.0	0.0

Source: DIA analysis based on patronage assumptions and 2018/19 actual public transport revenue.

Public transport subsidy revenue risks

106. Regional councils potentially face a double impact on public transport revenues as a result of estimated reductions in the NLTF net revenues (ie, due to reduced income from RUC and FED).

107. Based on our scenarios, NLTF revenues may be impacted as outlined in the table below.

Table 15: Estimated impact on NLTF revenues under each scenario

Quarter Starting	Percent Change Scenario A	Percent Change Scenario B	Percent Change Scenario C
Jan 2020	-1.4	-3.4	-3.4
Apr 2020	-30.9	-45.0	-45.0
Jul 2020	-12.3	-21.6	-40.5
Oct 2020	-11.7	-33.1	-35.3
Jan 2021	-11.5	-23.3	-23.7
Apr 2021	-5.0	-7.6	-7.7
Jul 2021	-4.3	-5.3	-5.5
Oct 2021	-3.7	-4.8	-5.2
Jan 2022	-3.3	-4.6	-5.0
Apr 2022	-2.1	-3.3	-3.7

Source: Ministry of Transport

108. While the issue has been highlighted, at this early stage of the response, we are not aware of any decisions having been made about whether or how the NLTF revenue shortfall might be addressed.

109. Accordingly, for the purposes of this analysis, we have considered the impact of the following two possible Government policy responses:

    - Either, the Crown makes up the shortfall in NLTF revenue and there is no subsequent reduction in public transport subsidies; or
    - Public transport subsidies are proportionately reduced in line with the reduction in NLTF net revenue.

110. Under the first of these possible responses, regional councils will retain the existing levels of subsidy and will be primarily impacted by reduced passenger fare revenue.

111. Subsidies could reduce by the following amounts under the second scenario if losses in NLTF revenue are proportionately spread across local government:

Table 16: Potential reduction in subsidies under each scenario

Region	2020/21 ($M)			2021/22 ($M)		
	Scenario A	Scenario B	Scenario C	Scenario A	Scenario B	Scenario C
Auckland	28.02	42.04	42.04	35.31	74.81	93.22
Bay of Plenty	1.55	2.32	2.32	1.95	4.13	5.15
Canterbury	2.11	3.17	3.17	2.66	5.64	7.03
Gisborne	0.03	0.05	0.05	0.04	0.09	0.12
Hawke's Bay	0.19	0.29	0.29	0.24	0.51	0.64
Manawatu-Wanganui	0.35	0.52	0.52	0.43	0.92	1.15
Nelson-Tasman-Marlborough	0.09	0.13	0.13	0.11	0.24	0.29
Northland	0.22	0.33	0.33	0.28	0.59	0.73
Otago	1.03	1.54	1.54	1.29	2.74	3.42
Southland	0.08	0.12	0.12	0.10	0.21	0.26
Taranaki	0.15	0.23	0.23	0.19	0.41	0.51
Waikato	1.06	1.60	1.60	1.34	2.84	3.54
Wellington	6.91	10.37	10.37	8.71	18.45	22.99
West Coast	0.00	0.01	0.01	0.00	0.01	0.01

Source: DIA analysis based on Ministry of Transport estimates of NLTF revenue and 2018/19 actual public transport subsidies.

112. The impact of lower NZTA subsidies on total local council revenue is estimated to be a drop of between $200 million and $500 million.

Table 17: Level and percentage change to subsidies and grants income, FY2020/21

Line item	Baseline (LTP) (000s)	Scenario A (000s)	Scenario B (000s)	Scenario C (000s)
Subsidies & grants income	$1,871,635	$1,681,890	$1,470,940	$1,370,459
% change from baseline		-10%	-21%	-27%

Source: DIA modelling

Interest and dividends from investments

113. As mentioned in our first report, six councils have had investment income greater than 12.5 percent of their rating revenue. Because of the very different investment profiles, we have not been able to forecast the impact of COVID-19 on each council (ie, beyond what councils are estimating themselves).

114. Broadly, we expect the following impacts on different types of council-owned investments over the next three years.

Table 18: Estimated impact on different investment types over the next three years

Investment type	Expected impact
Airport companies	No dividends in 2020, with substantial dividend reductions over pre-COVID-19 expectations in the following two years.[3]
Port companies	No dividends in 2020, but dividends should return to normal levels by 2022 assuming international trade is not significantly impacted.[4]
Civil infrastructure companies	No dividends in 2020 due to reduced productivity under lock down, but dividends should return to normal levels in subsequent years due to stimulus.
Term deposits	Average bank term deposit interest rates have fallen from 3.38 percent in July 2018 to 2.39 percent[5]. This is a 29 percent reduction in interest revenue.
Electricity distribution businesses	Minimal change to dividends due to the sectors use of customised and default price path regulation. Potential drop in dividend expectations after next price path reset if risk free rate remains at current low levels.
Property investments	There is a heightened risk of rental income stagnation and lower occupancy rates. No dividends are expected due to many councils offering rent relief and/or rent abatement. We expect some level of non-payment of rent by the commercial sector.
Managed funds	Managed funds across the board have reduced in value. By way of example, in the last three months Mercer's managed funds[6] have performed in the following manner: • Mercer Conservative Portfolio -3.45 percent • Mercer Moderate Portfolio -5.6 percent • Mercer Balanced Portfolio -9.5 percent • Mercer Growth Portfolio -13.18 percent • Mercer High Growth Portfolio -15.64 percent • Mercer Shares Portfolio -18.11 percent • Mercer Real Assets Portfolio -16.42 percent We expect that managed funds will recover over the long run.

Source: DIA analysis with sources as per footnote

Fuel tax, fines, infringement fees and other revenue sources

115. We expect a reduction in fuel tax (primarily affects Auckland Council through the Regional Fuel Tax – RFT), traffic and parking related fees due to the reduction in vehicle usage.

116. We expect that parking and traffic infringement revenue will reduce in line with reduced vehicle usage (summarised in table 19 below). We note that many councils have not been

[3] Source: DIA analysis of global airport company dividend expectations from https://simplywall.st/.

[4] Source: DIA analysis of global port company dividend expectations from https://simplywall.st/.

[5] Source: Interest.co.nz.

[6] Mercer manages New Plymouth District Council's Perpetual Investment Fund.

collecting any parking revenue during the initial Alert Level 4 period. This policy will further reduce parking income for councils during further Alert Level 4 periods, if any.

Table 19: Impact on vehicle usage under each scenario

	Impact on Light Vehicle Travel			Impact on Heavy Vehicle Travel		
Quarter Starting	**A**	**B**	**C**	**A**	**B**	**C**
1/04/2020	53%	46%	46%	71%	69%	69%
1/07/2020	72%	72%	51%	89%	89%	71%
1/10/2020	72%	61%	58%	89%	73%	73%
1/01/2021	72%	70%	69%	89%	89%	88%
1/04/2021	93%	93%	93%	91%	90%	90%
1/07/2021	98%	98%	98%	92%	91%	90%
1/10/2021	98%	98%	98%	93%	91%	90%
1/01/2022	98%	98%	97%	94%	92%	90%
1/04/2022	98%	98%	98%	95%	92%	91%
1/07/2022	98%	98%	98%	95%	93%	91%
1/10/2022	99%	98%	98%	96%	93%	92%
1/01/2023	99%	98%	98%	96%	94%	93%
1/04/2023	99%	98%	98%	96%	94%	93%
1/07/2023	99%	99%	98%	97%	95%	93%
1/10/2023	99%	99%	98%	97%	95%	94%

Source: DIA/Ministry of Transport/NZTA

Development and Financial contributions

117. While non-essential building work ceased during the Level 4 Alert and most will not return to pre-alert levels of activity until after New Zealand reaches Alert Level 2, DCs may already have been paid for some of the projects put on hold during Alert Level 4.

118. Only territorial authorities can charge DCs and some councils choose not to use DCs. The triggers for liability for a development contribution (granting of a resource or building consent or authority for a service connection) all occur before construction starts.[7]

119. Council policies and practice around DCs for building consents (and certificates of acceptance) will vary widely. At one end of the scale some will require the DC to be paid immediately on invoicing or on 20th of the month following, while others will not require payment of a DC triggered by a building consent until a code compliance certificate (CCC) is sought – which can be up to 2 years after a consent is granted, or longer with an extension of time for the consent.

[7] Although Auckland Council did not response to this survey, we note that in Auckland Watercare Services Limited collects infrastructure growth charges as part of their service contract rather than DCs. Some councils collect financial contributions as a condition of resource consents as an alternative to using DCs.

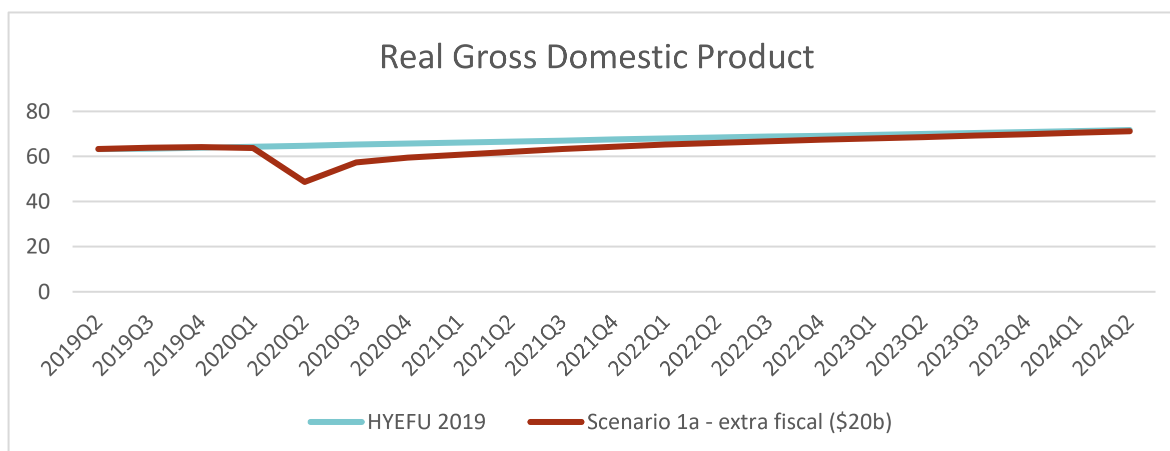
120. Resource consents for subdivisions are where the greatest variability can be expected. A resource consent will usually remain valid for up to 5 years and provided the consented works start within the 5-year period it can go on for years in stages (often 10-15 years and possibly longer). In some cases, the DCs may not need to be paid until certification under RMA s.224 (restrictions on deposit of survey plan), which can be at any point within that long timeframe for different stages of a subdivision.

121. When compared to our baseline of forecast revenue in the 2018-2028 LTP, our modelling shows an 18 percent decrease in revenue from development and financial contributions in the 2020/21 financial year, 16 percent in the 2021/22 financial year and 16 percent in the 2022/23 financial year.

122. The real, longer term impacts on development and financial contributions will not be evident until the COVID-19 impacts on the availability of finance for development and developer cash flows are clear. Some councils expect sustained impacts on economic activity, and this will lead to lower than expected development contributions. By way of example, Queenstown Lakes District Council expects a 20 percent reduction in development contributions across the entire 2020/21 financial year due to the down turn in that district's economy.

123. The graph below (Figure 3) shows an estimate of the effects of COVID-19 on real GDP over time.

Figure 3: Estimate of the effects of COVID-19 on real GDP over time.



Source: Statistics New Zealand, Treasury.

Impacts on capital expenditure

124. In the 2018/19 financial year councils reported capital expenditure of just over $5.7 billion. Expenditure is reported under three main areas, for growth and increased demand, to improve levels of service, and for the renewal and replacement of existing assets. Overall the most common use for capital expenditure is replacement of existing assets (42 percent), followed by improvements to levels of service (37 percent), and growth (21 percent).

125. Councils also forecast capital expenditure in their LTPs. Currently, the peak forecast year for capital expenditure is 2020/21 (well over $5.8 billion).

126. For the 2018/19 year, actual expenditure, across all 78 territorial and regional councils, was 84 percent of the LTP forecasts. Reasons for this variance include:

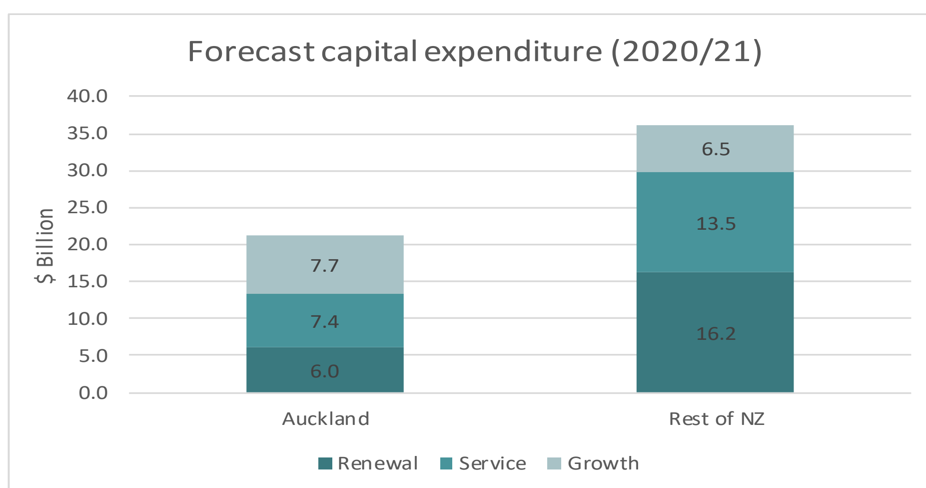
- Some projects may require resource consents and/or land acquisition. Council's will budget for these processes to go smoothly, since they would not want to hold up a consented project where all land had been acquired. In practice there will be delays that result in these projects not being completed to budgeted times frames;

- All projects will include a contingency allowance for unforeseen costs. In practice, some of that contingency will likely be unspent, resulting in some level of under-expenditure while completing scheduled work; and
- There may simply be limits on the available capacity in the contracting sector to do the work, especially when the economy is running well. Relatively little council capital work is done by in-house staff, so the availability of private sector resource is a constraint over which councils have little control.

127. In general, the variance is greatest for growth-related capital expenditure and renewals is lowest. This reflects the impact of some of the uncertainties indicated above.

128. In 2018/19 the Auckland Council spent 41 percent of the total capital expenditure by local authorities. Forecasts indicate it will remain dominant with an average of 39 percent for the first five years of the current LTPs. Compared to all other councils Auckland is forecasting a much higher proportion of capital expenditure on growth (36 percent), with a correspondingly lower percentage on renewals (18 percent).

Figure 4

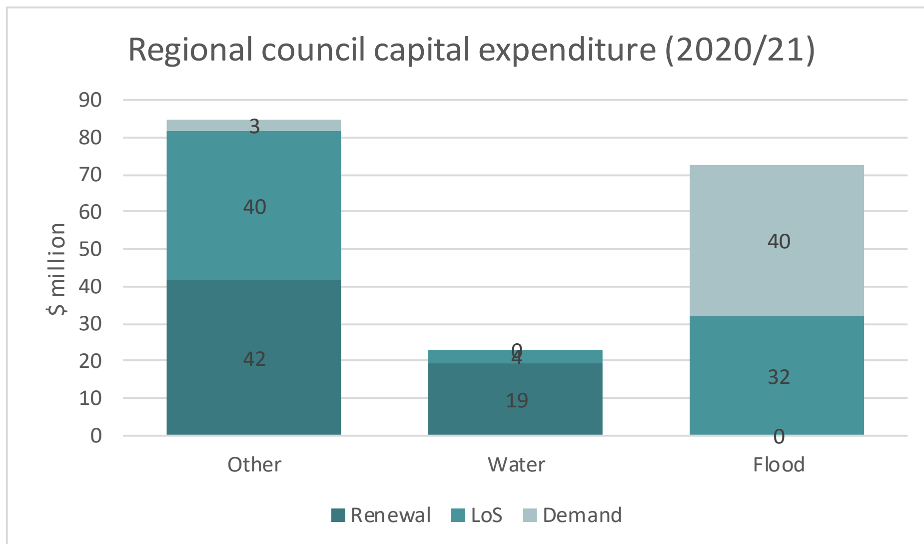


Source: DIA analysis of LTPs

129. The total, combined capital expenditure of regional councils[8] is less than 4 percent of total expenditure by all councils. Just under half of this regional council expenditure is forecast to be spent on infrastructure (mainly flood protection with some water supply works from Wellington Regional Council). A number of regional councils indicated in their LTPs that they intended to increase spending on flood protection. This is seen in the increase in levels of service-related capital for this activity.

[8] Excludes unitary authorities and Auckland

Figure 5



Source: DIA analysis of LTPs

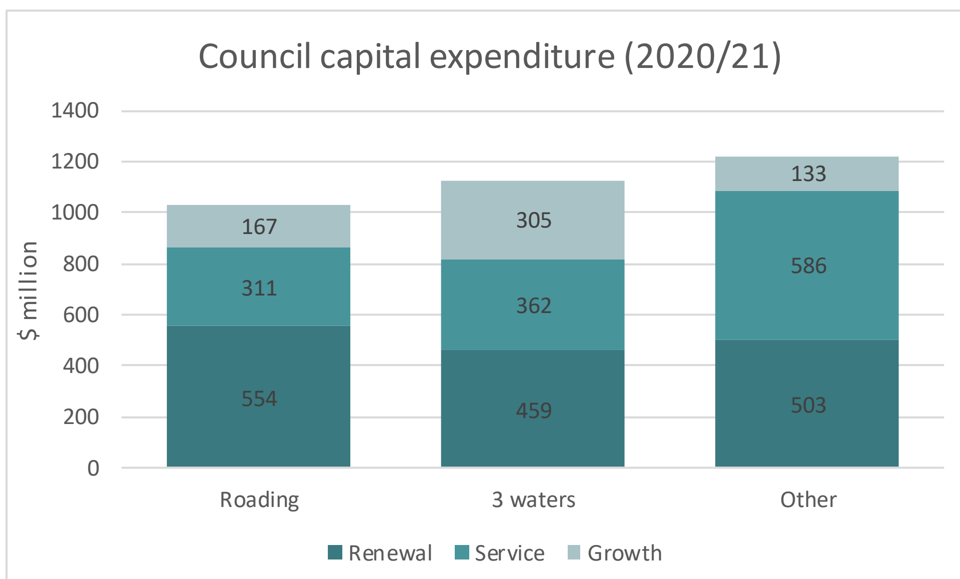
130. Most regional councils have strong balance sheets, with minimal external debt and significant investment in port operations.

131. Capital expenditure in 2018/19 for the remaining 66 councils (excluding regional councils and Auckland) ranged from almost $408 million for Christchurch City Council, to $3 million for Kawerau District Council. The median was $22 million.

132. Councils must provide funding impact statements that include details of capital expenditure for roading, water, wastewater, stormwater and flood protection infrastructure activities. The remaining ‘other’ capital expenditure includes any remaining activities.

Most (67 percent) forecast capital expenditure on 2020/21 will be spent on the infrastructural activities. Of this, the greatest percentage (47 percent) will be spent on renewals. Over the next four years roading and three waters activities are both forecast to be a little over $4 billion (each). Roading has a far greater percentage of capital allocated for renewals (52 percent) compared to 3 waters (41 percent). In contrast three waters has a greater percentage forecast for improved levels of service (33 percent) and growth (29 percent).

Figure 6



133. ‘Other’ capital expenditure shows significant expenditure on improved levels of service in 2020 and 2021 financial years. While the amount decreases in 2022 and 2023 this remains a significant area for capital expenditure. Growth related capital expenditure also decreases over time.

134. There are several trends apparent within the three waters. Water supply services have a significant expenditure in growth and levels of service in 2020 and 2021, dropping away over time. Changes to levels of service are likely to be a result of councils needing to respond to the changes brought about by the Havelock North contamination event. Wastewater has a significantly higher proportion of capital for improved levels of service, reflecting increased environmental compliance. Stormwater has a significant percentage of expenditure marked for improved levels of service, this is also likely to be for improved compliance with fresh water quality standards.

135. It is likely that growth-related capital expenditure would be the easiest to delay (for both infrastructural and ‘other’ activities). For all three waters activities there could be significant risks if improvements to levels of service was deferred. It may be easier to defer some spending on improved levels of service for ‘other’ capital, although circumstances would vary between councils.

136. While it might be possible to defer some renewals expenditure, this runs the risk of pushing some councils into a cycle where some assets are at greater risk of failure, leading to higher longer-term costs.

Impact on debt levels

137. We assume that net debt levels will be higher across all councils than forecast in LTPs.

138. Generally, the higher debt levels relate to lower than expected revenues, and a higher than expected level of late or deferred rate payments. In an accounting sense, late rate payments are still treated as revenue by councils and the ratepayers owe money to the councils until the debt is paid, or written off in some rare situations

139. Several councils will exceed debt to revenue limits **if** they do not act to maintain revenue, and/or reduce operating and capital expenditure.

140. The impacts on debt to revenue thresholds over the next three financial years across the sector are shown in the table below:

Table 20: Impact on net debt/revenue thresholds by scenario over the next three financial years

Type	Scenario A			Scenarios B and C		
	Over LGFA threshold	**80% LGFA** threshold	**Under LGFA** threshold	Over LGFA threshold	**80% LGFA** threshold	**Under LGFA** threshold
Metropolitan	5	-	5	5	-	5
Provincial	3	5	19	4	4	19
Regional	-	-	11	-	-	11
Rural	-	2	22	-	2	22
Unitary	-	-	4	-	-	4
Total	**8**	**7**	**61**	**9**	**6**	**61**

Source: DIA modelling

141. Several high-growth councils are expected to exceed or get close to their LGFA debt to revenue thresholds under these assumptions. We note that many councils have more conservative debt to revenue restrictions in their financial management policies and it is highly likely that several councils will exceed their internal thresholds even if they keep within the LGFA limits.

142. Unrated councils (who are generally the smaller rural councils) may be able to increase their LFGA debt to revenue threshold by getting an external credit rating. This lifts the LGFA threshold from 175 percent to 250 percent. External credit ratings will also lower the cost of borrowing for these councils by at least 10 basis points. The cost of an external credit ratings is approximately $50,000 per year.

143. Alternatively, unrated councils could request that the LFGA Board increase their debt to revenue threshold above 175 percent and up to 250 percent. This LGFA Board decision would not require LGFA shareholder approval. We understand that no unrated council has approached the LGFA Board for any bespoke financial covenants to date.

144. No regional councils are expected to exceed their LGFA thresholds (these are a mixture of rated and unrated councils). Under scenarios B and C, just over half of regional councils will exceed 80 percent of the LGFA threshold despite strong balance sheets. This is driven by assumptions of high proportions of rates being collected over a longer period.

145. We note that considerable work is underway in these councils to reprioritise operating and capital expenditure. Local government capital expenditure budgets are often underspent by approximately 20 percent. This may mean that councils have lower debt levels we have assumed.

146. Overall the most common use for capital expenditure is replacement of existing assets (42 percent), followed by improvements to levels of service (37 percent), and growth (21 percent). We expect that councils will defer the replacement of assets for a period and potentially reduce the priority of capital expenditure to improve service levels. The deferral of asset replacement may increase the infrastructure resilience risks and increase long term costs for councils.

147. Councils that have high existing debt levels and do not have significant planned future capital expenditure may face greater difficulty managing their debt to revenue levels as they have limited ability to deprioritise capital expenditure.

148. Compared to the past, interest rates are exceptionally low for new debt. This means that councils can comfortably manage all other LGFA financial covenants.

149. Councils will have some management options to keep within the debt-revenue covenants such as maintaining planned rates increases, reducing operating costs and deferring capital expenditure.

Auckland Council

150. Auckland Council has published its own analysis of the possible effects of the COVID 19 outbreak on the council. Given the large scale of this council and some alignment of the Council’s analysis with the risk indications in our first report, we include this brief summation here for noting.

151. The primary risk for the Auckland Council is that lower revenue levels mean that the council’s debt to revenue ratio policy may be breached. Council officials do not expect the absolute levels of debt to be any greater than previously forecast but, depending on the length and

severity of disruptions to council operations, cash operating revenue for the Council group may be $450 to $650 million lower than currently budgeted for 2020/21.

152. Over the last five years, the Council has delivered on average a capital expenditure programme of $1.6 billion a year. If disruption lasts for six months, it expects to be able to deliver capital expenditure of around $2.3 billion in each of the current and next financial years. Longer periods of disruption would reduce the programme that could be delivered. The programme could be voluntarily reduced to as little as $1 billion to stay safely within debt limits

Implications for recovery

153. While we remain at Alert Level 3 and considerable uncertainties remain, the implications for recovery are difficult to predict. However, it seems clear that recovery planning will, among other things, need to account for:

- council revenue reductions of varying, but significant degrees throughout New Zealand;
- the constraints of debt limits, the relationship with revenue reductions and how councils will respond to resolve these challenges;
- likely very significant impacts on councils where the local economy is substantially based on tourism activities; and
- how capital expenditure programmes may change as a result of COVID-19 impacts on growth pressures and councils' reprioritisation to enable revenue to be applied to sustaining other levels of service.

154. The Response Unit partners are now considering the transition to a longer-term recovery programme. As that programme takes shape over coming weeks, these issues will continue to be considered and addressed.

Further analysis and reports

155. The Response Unit has no immediate plans to complete further analyses or to produce additional financial implications reports. However, we expect that, in time, the recovery programme will identify areas where some follow-up and further analysis will assist longer-term planning and advice.

Appendix 1: Economic geography/context

Analysis by Territorial authority

1. The table below indicates the proportion of GDP that is expected to have been heavily impacted by COVID-19 in the short and long term, by a selected number of territorial authorities. This analysis takes into account ability to operate under Alert Level 4 (ie the percent of sector deemed an essential services), as well as potential interruption to supply chains, reduced consumer demand, working capital pressure, exposure to tourism, and Government support.

Table 21: Percentage of Territorial authority GDP in industries that are highly affected by COVID-19 in short and long term (top 20 ordered by short term)

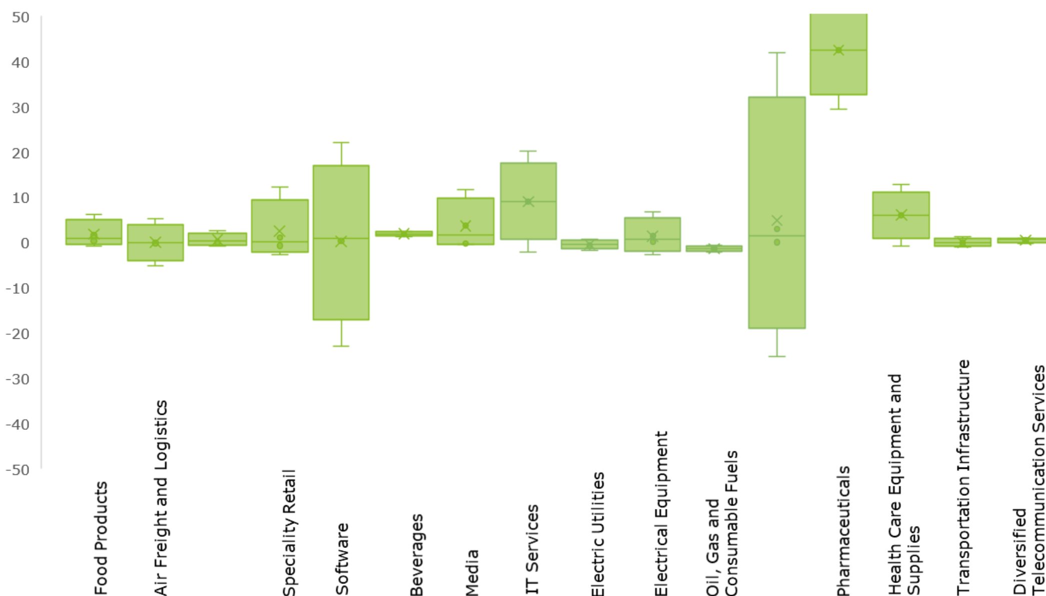
Territorial authority	Largest sector	Second largest sector	Percent of economy in highly affected sectors in short term	Percent of economy in highly affected sectors in long term
Kawerau District	Manufacturing	Construction	59	2
Carterton District	Manufacturing	Rental, Hiring and Real Estate Services	56	7
Upper Hutt City	Manufacturing	Construction	40	5
Matamata-Piako District	Manufacturing	Agriculture	39	4
Timaru District	Manufacturing	Forestry, Fishing, Mining, Electricity, Gas, Water and Waste Services	38	9
Clutha District	Agriculture	Manufacturing	36	5
Westland District	Agriculture	Manufacturing	35	11
Lower Hutt City	Manufacturing	Construction	35	5
Queenstown-Lakes District	Rental, Hiring and Real Estate Services	Construction	35	14
Kaikoura District	Agriculture	Forestry, Fishing, Mining, Electricity, Gas, Water and Waste Services	35	14
Marlborough District	Manufacturing	Agriculture	34	6
Porirua City	Manufacturing	Health Care and Social Assistance	34	4
South Taranaki District	Manufacturing	Agriculture	32	1
Christchurch City	Manufacturing	Professional, Scientific and Technical Services	32	7
Waimakariri District	Construction	Forestry, Fishing, Mining, Electricity, Gas, Water and Waste Services	31	3

Tasman District	Manufacturing	Agriculture	31	5
Southland District	Agriculture	Manufacturing	31	10
Kapiti Coast District	Construction	Health Care and Social Assistance	31	5
South Wairarapa District	Agriculture	Manufacturing	30	5

Authors analysis based on Deloitte, Statistics New Zealand

2. The impact of COVID-19 on businesses is likely to be highly differentiated within industry segments. To demonstrate the impact to date from an industry perspective Deloitte undertook analysis of movements in the multiple of Enterprise values over EBITDA over the two weeks to 20 April 2020 relative to the same period a year earlier – presented in the graph below (Figure 7).

Figure 7



Source: Deloitte, Capital IQ

Key drivers for groups of councils and financial channel impacted

Tourism exposed Territorial Authorities

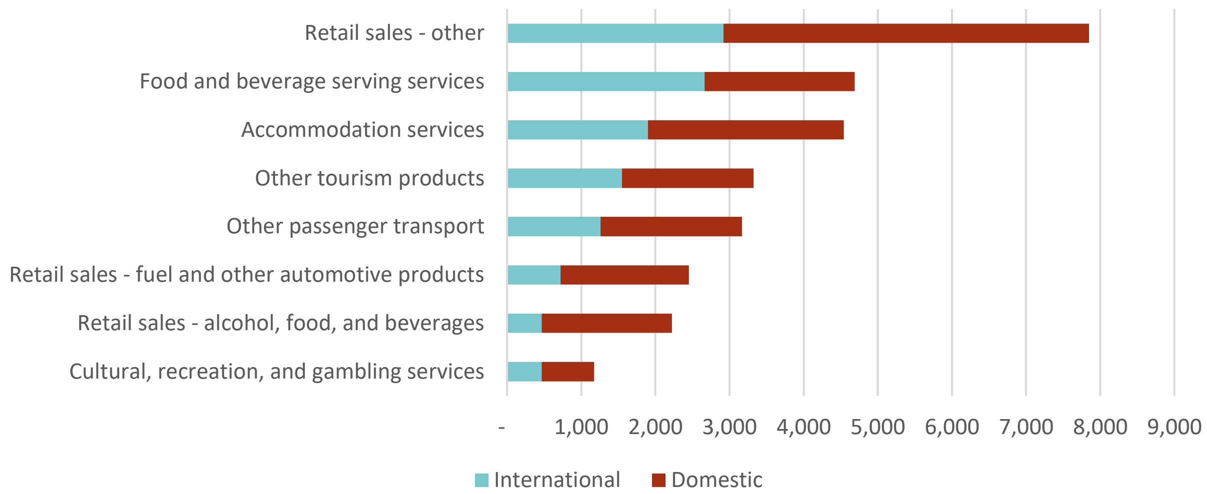
3. Local economies exposed to tourism will be hard hit by weaker incomes, higher unemployment, and uncertainty.

4. Sectors capturing tourism include retail trade, food services, accommodation, passenger, transport, and other recreation services. The graph below shows expenditure by international and domestic tourists by product in the 2019 calendar year. Retail sales accounted for 27 percent of expenditure in 2019, while accommodation services and food and beverage services each accounted for 15 percent of tourism related expenditure.

5. In the longer term, ongoing restrictions on international particularly impacts these businesses in territorial authorise deriving significant revenue from tourism. Although domestic tourism

can resume under Alert Level 1 and 2, Territorial Authorities with a high proportion of international spending may face ongoing revenue problems.

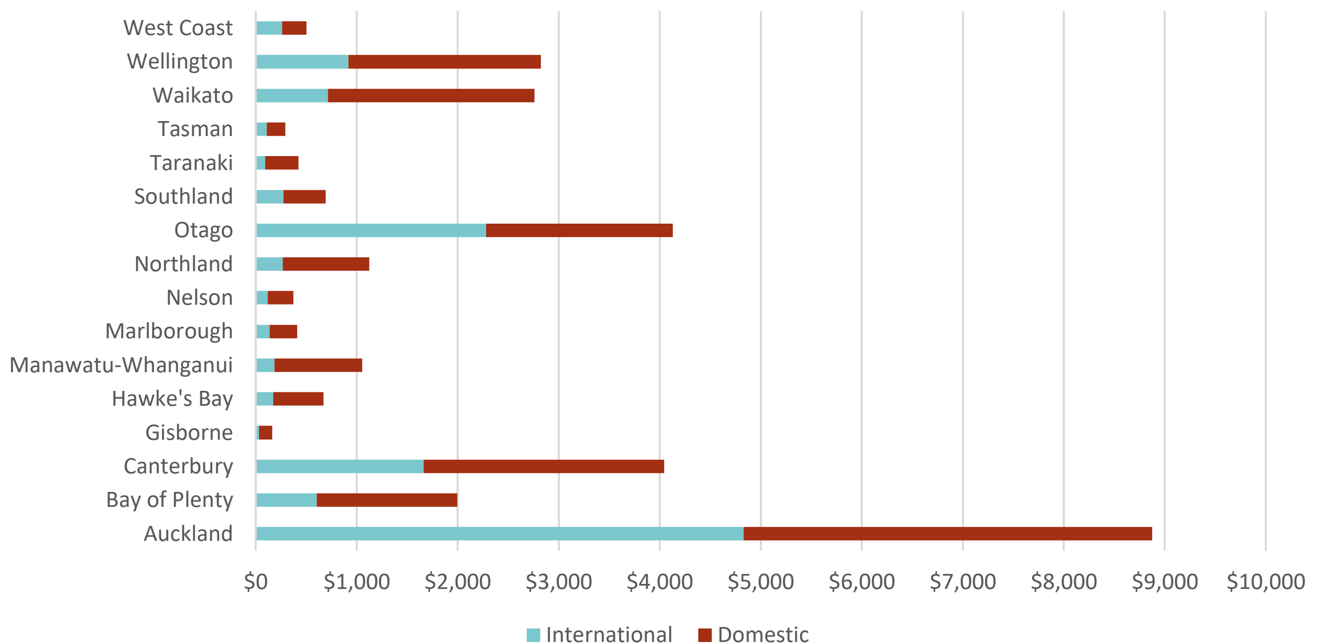
Figure 8 International and domestic tourism expenditure, year to December 2019



Source: International visitor survey, Ministry of Business, Innovation and Employment

6. Nationally, international tourism makes up 41 percent of total tourism expenditure and by region, Otago, Auckland, and West Coast have the highest proportions of international visitor expenditure, as indicated by the graph below.

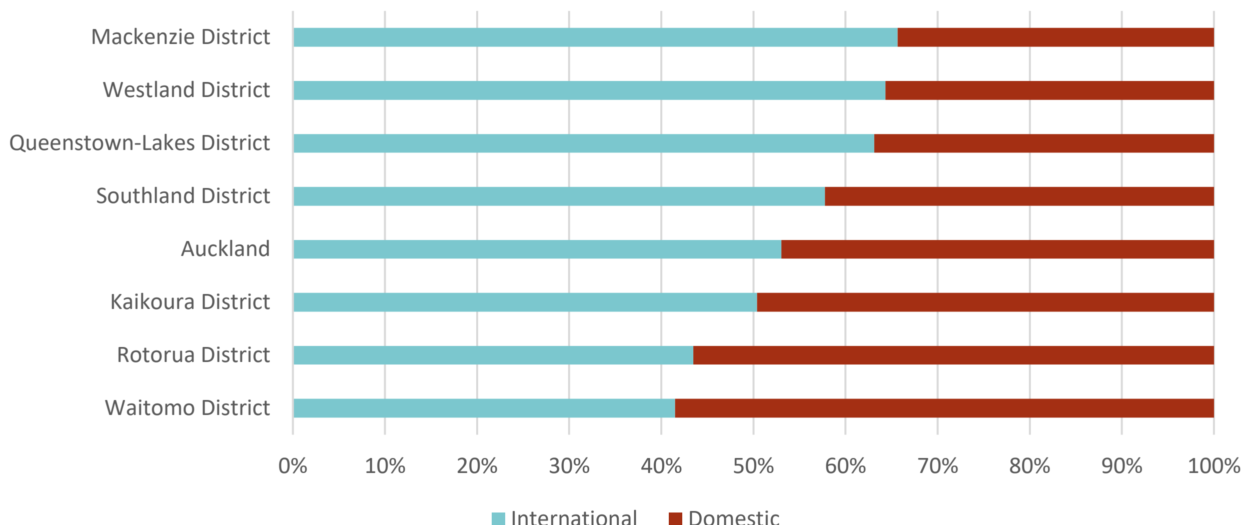
Figure 9: International and domestic tourism expenditure by Region, year to December 2019



Source: International visitor survey, Ministry of Business, Innovation and Employment

7. Mackenzie District, Westland District, and Queenstown-Lakes District each derive almost two-thirds of tourism revenue from international visitors.

Figure 10: The proportion of international and domestic tourism expenditure, TAs above the national average for percent of international expenditure

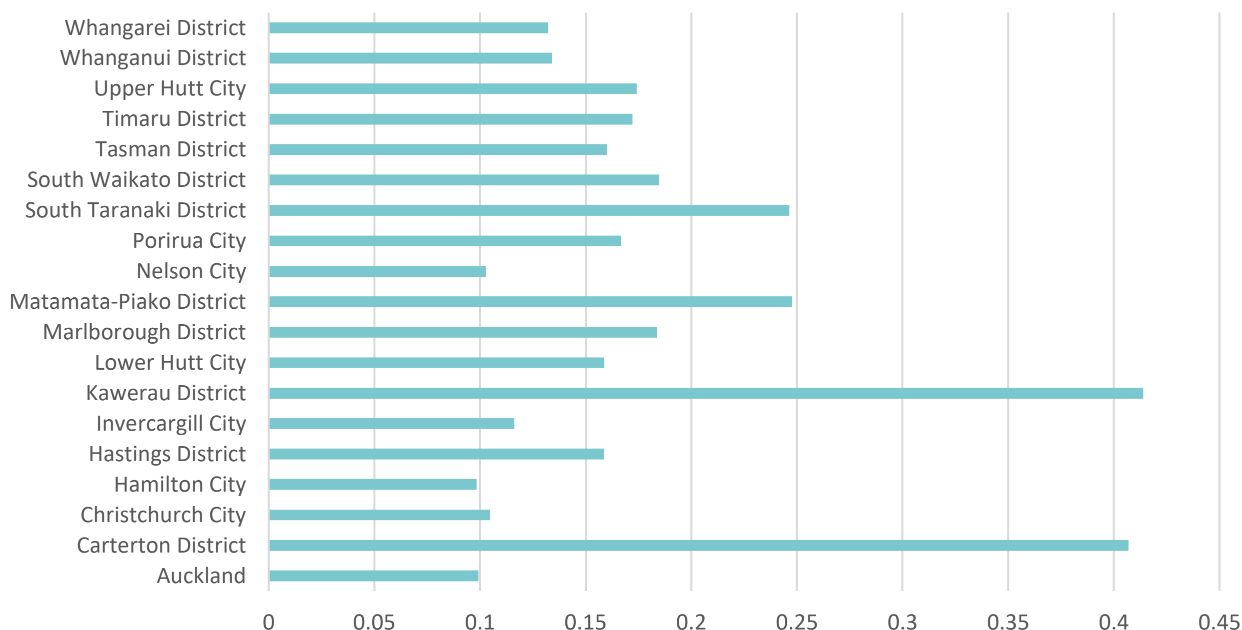


Source: International visitor survey, Ministry of Business, Innovation and Employment

Territorial Authorities with high shares of manufacturing GDP

8. Manufacturing is the largest or second largest generator of production in many small provincial Territorial Authorities. According to Statistics New Zealand Modelled Territorial Authority GDP figures, Kawerau, Carterton, South Taranaki District, and Mata-Piako Districts derived 41 percent, 40 percent, 25 percent and 25 percent of total GDP in 2018. Manufacturing is also a significant contributor to GDP in South Waikato, Timaru, and Hastings District.

Figure 11 % of GDP derived from manufacturing sector



Source: Modelled Territorial Authority GDP, Ministry of Businesses, Innovation, and Employment

9. Territorial Authorities with a high proportion of manufacturing sector GDP could be disproportionately affected in the short term. With the expectation of food and essential item producers, many manufacturing firms have been unable to operate under Level 4. Some manufacturers will have faced supply chain pressure. The long term impact will vary between types of manufacturing firms, depending on the degree of behavioural shift from consumers and long term effects on employment and wealth (and therefore demand).

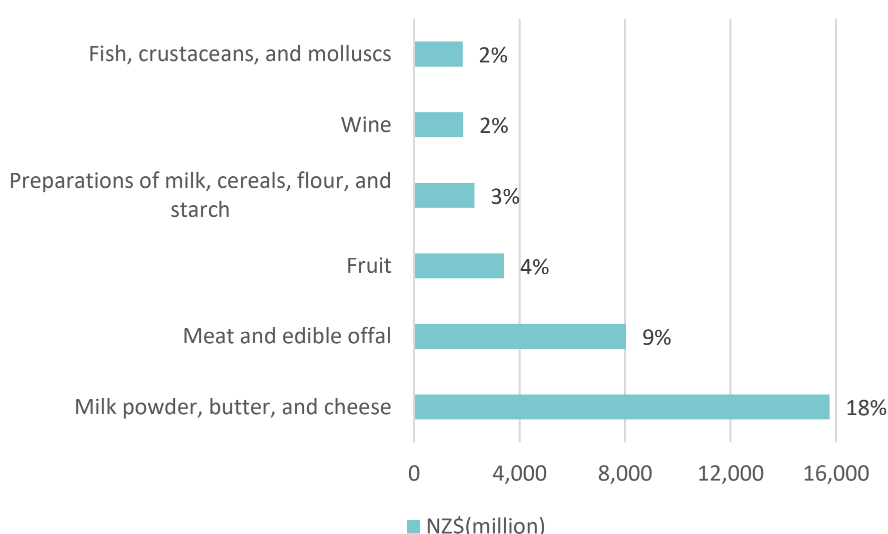
Territorial Authorities with high shares of agriculture GDP

10. Agriculture is the largest industry by GDP for just over 40 percent of territorial authorities, including Waimate (51 percent of local GDP), Southland (38 percent), and Otorohanga (35 percent).

11. The agriculture sector is expected to perform relatively well in the short and long term. Farming has been able to continue during Alert Level 4.

    - Dairy prices have fallen and milk volumes are expected to trail last year for the final three months of the season.
    - Lamb returns have stabilised after a recent fall. Lamb was diverted to the Middle East and Europe whilst the China market was in shutdown, generally worked well. China is looking positive again for sales of lamb and mutton. However, the wool market remains weak as brokers are no longer accepting stock due to the country wide lockdown.
    - The horticulture sector can operate under lockdown, but strict rules limits production. Crops are in good condition, therefore, the challenge will be getting all the fruit picked and processed. Another challenge is getting the produce onto ships in a timely manner as ports are congested with non-essential items that are not being cleared.
    - Forestry is not deemed an essential service which could hamper the industry and slowing exports will drastically cut incomes for exporters.

Figure 12 Level of international food exports and % of total exports, year to December 2019



Source: Statistics New Zealand

High growth councils

12. High growth councils include Auckland, Hamilton, Tauranga, and Queenstown.

13. Population growth from international migration will be heavily restricted over the next year. However, these councils also receive a relatively high number of domestic tourists each year, with net positive domestic migration in all Districts expect for Auckland during 2018. Returning New Zealanders and a continuation of domestic migration trends could support growth in these areas.

14. The high growth council's economies are not highly concentrated in sectors which could be heavily impacted by COVID-19 in the short or long term, with the exception of Queenstown-Lakes District.

    - After manufacturing, Auckland's largest industries are professional, scientific and technical services and financial and insurance services. The impact in the short term on these businesses will be low as most employees will be able to work from home.
    - Manufacturing and healthcare and social assistance both make up around 10 percent of economic activity in Hamilton city.
    - Tauranga's largest industries are Rental, Hiring and Real Estate Services and Construction. Both these industries have operated with limited capacity in Level 4 but are able to operate in Level 3. Low house price confidence and a permanent reduction in income may weaken demand in the medium to long term, particularly if house prices begin to decline as they have in Australia.
    - Queenstown's largest industries are also Rental, Hiring and Real Estate Services and Construction. In addition, the district is exposed to the tourism industry, limiting recovery in the long term.

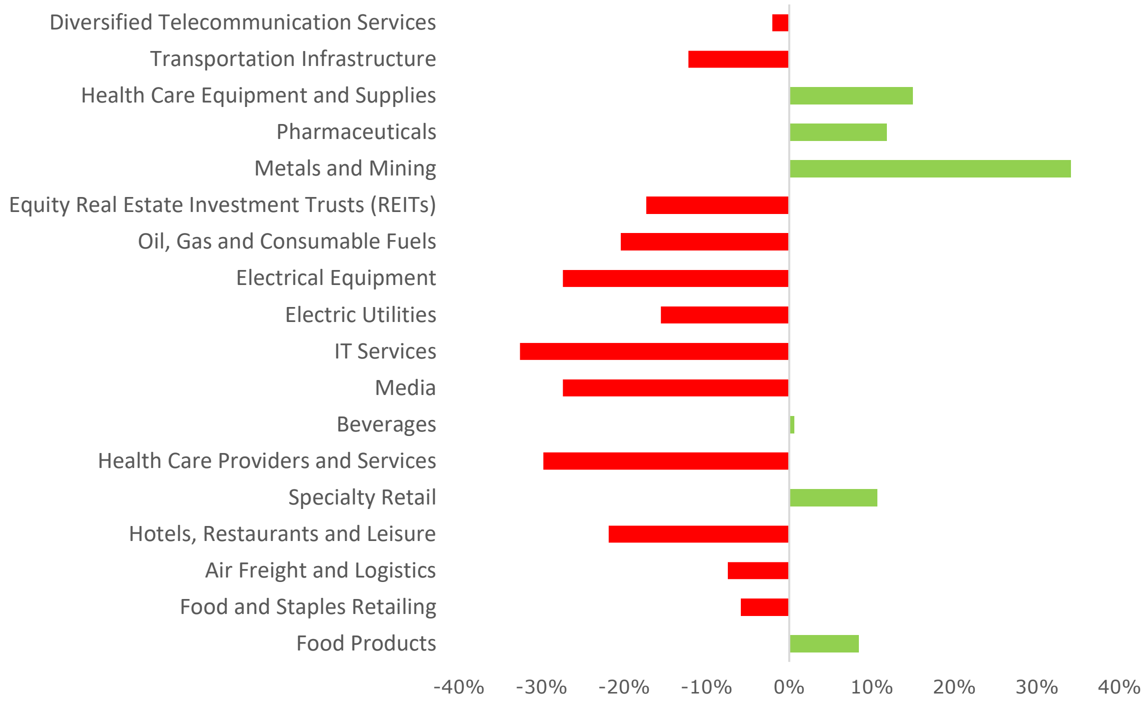
Councils with high investment dividends

15. Councils who derive a large proportion of revenue from investment dividends will be exposed to market movements.

16. The graph below indicates the change in enterprise value of businesses on the NZX in the four weeks to April 2020. This analysis is only a snapshot of the short-term impact of COVID-19 on listed businesses. However, councils whose investment portfolios are heavily exposed to industries expected to suffer loss in value may be at risk of lower than expected dividend revenue.

17. In the four weeks to April 2020, the value of transportation infrastructure dropped by around 12 percent and Air Freight and logistics fell by 7.5 percent. The value of hotels, restaurants and leisure businesses fell by almost 30 percent. In contrast, health care equipment and supplies and pharmaceuticals rose by 15 percent and 12 percent, respectively over the same period.

Figure 13: Percentage change in enterprise value - 20 Feb 2020 to 20 April 2020



Source: Deloitte based on Capital IQ