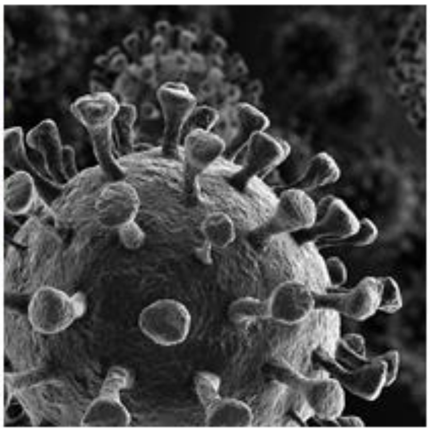
Local Government Sector

COVID-19 Financial Implications

Report 1 – Initial Analysis






Local Government COVID-19 Response Unit
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14 April 2020

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Foreword

1. As noted in the Treasury economic scenarios report released on 14 April 2020, the COVID-19 pandemic is a rare event that will have profound impacts on economic and financial systems globally and in New Zealand. The local government sector is not immune to such impacts.
2. The purpose of this initial financial analysis is to inform the ongoing central and local government response to the pandemic and to contribute to early thinking about the development of recovery plans at national, regional and local levels.
3. This analysis will help to identify:
    - how councils, collectively and individually, and their communities are being impacted now;
    - possible, but largely uncertain, future financial implications for councils;
    - barriers to reinstating and ramping up council services during the recovery;
    - opportunities for central and local government to work together on initiatives and projects that support community well-being and economic recovery.
4. The information we have confirms that situations and impacts will vary considerably around New Zealand, but all councils will be impacted to a significant degree.
5. The issues faced by each council and the solutions they will develop will also differ and be dependent on the circumstances, known preferences of their communities and central government initiatives at local and regional levels.
6. Final choices about local solutions will depend on the final Alert Level scenarios and central government decisions about stimulus packages. These uncertainties, yet to be fully addressed, will likely be significant factors in subsequent analyses.
7. This analysis has been produced from information already held by the Department of Internal Affairs (DIA), Local Government New Zealand (LGNZ), the Society of Local Government Managers (SOLGM), the Local Government Funding Agency (LGFA) and further information provided by councils in response to requests from these organisations.
8. Some of the information relates to forecasts undertaken before the COVID-19 pandemic (for example, 2018-2028 Long Term Plans). These forecasts provide the counterfactual against which the financial impacts of the COVID-19 pandemic can be assessed. There are important information gaps that will need to be filled and a large number of unknowns to consider.
9. There will no doubt be other information that councils and other organisations can provide that will enhance our shared understanding of the financial impacts of COVID-19 on the local government sector. Councils are still compiling the impact of the Response and Alert Level 4 on their financial situation and are still developing scenarios and forecasts for the next financial year, 2020-21. We encourage councils and other organisations to provide this information to us along with any feedback on this first report.
10. This first and initial analysis will be updated as issues emerge, and new information is received. The next report, due in around two-weeks' time will include further information on what councils tell us are expected impacts in the fourth-quarter of the current financial year and assumptions and scenarios to inform council and central government longer-term impact analyses.

11. For the interim, we will continue to provide practical advice and guidance in response to requests from the sector.
12. Compiling and producing this report has been a team effort with contributions from LGNZ, SOLGM, Local Government Funding Agency (LGFA), the Treasury and DIA. We are also very grateful to the councils and staff who supported this effort by quickly responding to information requests and willingly giving us their time during follow-up discussions.
13. We hope you will find something of value in the following pages as you continue your own efforts to understand and address the impacts of the pandemic.
14. Stay safe and well.

Snapshot

15. It appears that all councils expect a significant reduction in non-rate revenue in the fourth-quarter of 2019/20 and well into 2020/21.

16. The sudden onset of the COVID-19 pandemic and control measures means that the impact on the business sector is more pronounced than in a conventional recession. Council's with a high proportion of business rates are likely, in the short-term, to face greater collection difficulties than others. Of the 45 council's data we have access to, around one in five derive 25 percent or more of their rates income from businesses.

17. In council districts with a high degree of non-essential service industries, the impacts of COVID-19 mean that a greater proportion of households and businesses may face financial hardship. These councils will likely see greater reductions in revenue from fees and charges and impact on rate collections in the short-term.

18. Councils and businesses in districts heavily reliant on revenue derived from tourism activities are expected to be under significant financial stress for an extended period.

19. Many councils were planning significant rate rises in 2020/21 and beyond to fund essential infrastructure upgrades, and expansions to meet growth demands. These rate rises are being reconsidered due to potential ratepayer hardship arising from COVID-19. Any reduction in planned rates revenue will have long-term or multi-year implications such as large future rate increases and/or further reduced spending to balance the books and catch up.

20. The combined effect of lower-than-planned rates and other revenue reductions means councils are likely to reduce some operational expenditure and capital expenditure, which will create job losses directly or indirectly. Longer-term, reduced investment in infrastructure is likely to lower productivity and reduce the availability of serviced land needed for housing.

21. Councils typically spend twice as much on suppliers (including contractors) as staff (37 percent compared to 19 percent) and will likely look to reduce this expenditure. This will have both direct and indirect impacts on their communities.

22. Most councils are unlikely to meet the 30 percent revenue reduction criteria for the Government wage subsidy themselves, but some council subsidiaries may (e.g., Trusts running zoos, art galleries, museums etc). This income may not offset all of the costs of retaining affected staff during the period of the subsidy.

23. Our very limited analysis of council's borrowing capacity is that the majority of councils have sufficient debt headroom to respond to COVID-19 impacts through to the end of the 2020/21 financial year. Regional councils are in the strongest position. However, revenue reductions will reduce the headroom for all councils. Most significantly, there are several councils already managing higher debt levels (primarily high growth districts which are home to most of the population) that have very little spare borrowing capacity and may reduce borrowings to mitigate the risk of breaching LGFA debt covenants.

24. We expect that councillors will want to focus efforts on community and wellbeing and that capital expenditure plans could reduce. Depending upon council priorities, this could result in reductions in capital expenditure to make land available for development, to improve levels of service (such as reducing wastewater overflows to waterways) or to replace existing assets reaching the end of their useful lives.

Summary of expected financial impacts of COVID-19 on the local government sector

25. COVID-19 will impact councils' revenue, expenditure, borrowings and liquidity in the short and medium-term. Table 1 summarises the expected overall financial impacts at a collective level. Individual councils will experience these differently.

Table 1: Summary of Financial Impacts

Impact Category	Summary Financial Impact to 30 June 2020	Summary Financial Impact next financial year (2020/21)
Revenue	Loss of operating revenue from: • Community facility closures (public libraries, community halls, swimming pools, stadiums, etc.); • Development contributions, financial contributions, and consenting fees; • Business license fees as a result of business closures; and • Loss of dividends and investment income. Few councils will meet the 30 percent revenue reduction criterion of the Employer Wage Subsidy Scheme, although some Council Controlled Organisations may. A higher than normal percentage of fourth-quarter rates will be received late. This will be the result of council rate postponement or inability to pay on time. Business ratepayers may have the highest level of distress.	Loss of operating revenue from: • Ongoing social distancing or other health protection constraints on the operation of community facilities (if any); • Development contributions, financial contributions, and consenting fees; • Business license fees as a result of business closures; • Loss of dividends and investment income; and • Lower rates increases than previously planned. Higher than normal levels of rates defaults or late payments will affect cashflows. Some residential ratepayers affected by unemployment and business ratepayers impacted by business closures or large income reductions due to sector-specific impacts or lower overall economic activity will fail to pay rates on time.
Operating Expenditure	Relatively fixed expenditure such as depreciation and permanent staff costs are unlikely to be impacted in the short-term. Some reductions in operating expenditure may occur as a result of: • Redundancies where (particularly casual and part-time) staff cannot be redeployed;	Some reductions in operating expenditure may occur as a result of: • Redundancies where (particularly casual and part-time) staff cannot be redeployed; and • Not funding community events that cannot proceed because of restrictions on large gatherings. Offsetting these reductions councils may:

	• Non-essential contract work not being undertaken in the Alert Level 4 period (although some contractors may still be paid to ensure their long-term viability to service councils); and • Not funding community events that cannot proceed because of restrictions on large gatherings.	• face pressure to provide additional funding to community organisations in the sport and performing arts sectors that have lost funding from usual sources like gaming trusts or commercial sponsorships; and • provide additional financial support to Council-Controlled Organisations to maintain solvency.
Capital expenditure	Noting that some councils expect to continue with current long-term infrastructure projects, some reductions in capital expenditure may occur due to: • Non-essential projects not being undertaken in the Alert Level 4 period; and • Deferred projects as a result of lower operating revenue and borrowing limits.	Noting that some councils expect to continue with current long-term infrastructure projects, some reductions in capital expenditure may occur due to: • Lower forecast revenue to fund projects; and • Deferred projects as a result of lower operating revenue and borrowing limits.
Borrowings	The local government debt market confidence has improved in the last two weeks given support from the Reserve Bank and central government. Despite this, borrowing costs are higher than before the COVID-19 market volatility. Changes in borrowings will vary by council and relate to the amount of: • Unplanned borrowing to provide for operating income shortfalls; • Uncommitted capital projects that are stopped; and • Delayed capital projects as a result of the Level-4 lockdown.	Changes in borrowings will vary by council and relate to the amount of: • Borrowing to provide for operating income shortfalls; and • Uncommitted capital projects that are stopped.

Background

Local Government COVID-19 Response Unit

26. This initial analysis and report has been driven out of the Local Government COVID-19 Response Unit, which is a joint initiative of DIA, LGNZ, SOLGM and the National Emergency Management Agency (NEMA).

27. 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.

28. The Unit aims to:

    28.1 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.

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

    28.3 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.

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

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

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

Finance Workstream

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

    30.1 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).

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

    30.3 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.

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

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

Indicative impacts of economic activity on councils

32. Reductions in economic activity will drive some council revenue reductions. Estimates of the economic impact of COVID-19 vary considerably and will remain uncertain for at least several weeks.

33. Treasury have modelled five scenarios that assume no additional fiscal support measures beyond the approximate $20 billion of direct support that have already been announced1. Treasury have also considered the economic outlook if the world economy is weaker and takes longer to recover.

34. Key results from Treasury modelling include:

    34.1 Falls in annual GDP are highest in the year to March 2021, and vary from a decline of around 13 percent in Scenario 1, the least restrictive of the scenarios considered, to closer to one third in the worst case scenario which involves tight restrictions throughout the year;

    34.2 Peaks in the unemployment rate vary from around 13 percent in Scenario 1 to nearly 26 percent in worst case scenario 3; and

    34.3 Inflation remains below the 2.0 percent mid-point of the target range throughout the forecast period, and monetary conditions are also supportive.

35. Councils that have large numbers of non-essential service businesses in their district are more likely to face delayed collection from both commercial and residential property rates. This could have implications for cash flow in the current and next financial year. Some industries, such as tourism, will likely see a more sustained downturn than others.

Reduced tourism over a prolonged period will affect districts differently

36. Tourism trade is a significant feature of the New Zealand economy, accounting for approximately 10 percent of GDP. Strict travel restrictions have virtually eliminated international tourism exports. Reduced international tourism has been evident since the beginning of the year. Tourism encompasses parts of accommodation, food, and retail, along with several other supporting sectors.

37. The significant tourism reduction will reduce revenue for some councils or council-controlled organisations that operate tourism facilities (refer to section "*Many territorial authorities have a high degree of dependence on fees and charges revenue*"). A higher number of distressed tourism businesses may also reduce the collection of business rates (refer to section "*Difficulties in collecting rates revenue*").

[1] https://treasury.govt.nz/system/files/2020-04/c19-4265378-t2020-973-economic-scenarios-v2.pdf

38. Some councils (e.g. Queenstown Lakes, Hurunui, Napier) have facilities that are highly dependent upon tourism, both domestic and international, so maybe more severely impacted depending upon the pace at which that industry recovers.

39. The number of annual guest nights in 2019 by territorial authority per capita is indicative of how reliant on the tourism industry a council is. At 0.6 guest nights per capita, the Mackenzie District (i.e. Tekapo) likely derives a relatively significant proportion of revenue from tourists and tourism businesses. In the Queenstown-Lakes District, there are 0.5 guest nights per person. Westland District and Kaikoura District are also likely highly exposed to the tourism sector, with 0.2 and 0.1 guest nights per person (see Figure 1).

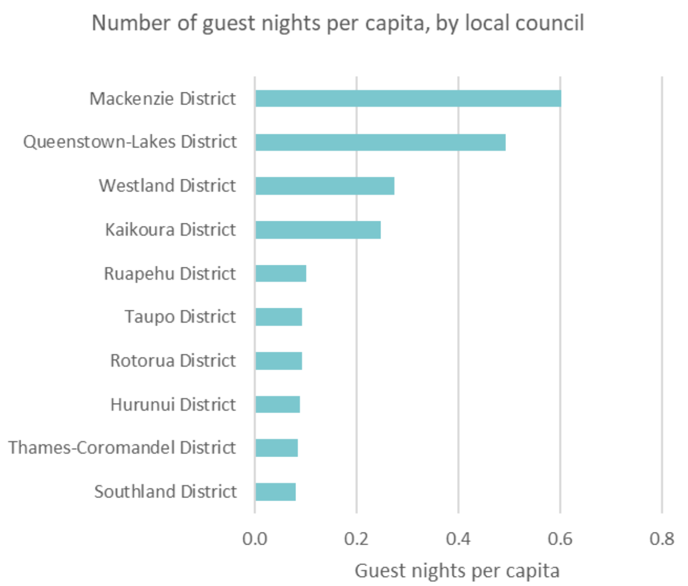

Figure 1: Guest nights per capita

Source: Response Unit Analysis of Statistics New Zealand data

Short term forecasts of economic activity under Alert Level 4

40. In council districts with a high degree of non-essential service industries, the impacts of COVID-19 mean that some households and businesses may face financial hardship. This will likely reduce council revenue from fees and charges and impact on rate collections in the short-term. However, the revenue impact may not be significant in the 2020/2021 year.

41. Essential services include healthcare and social assistance, finance and insurance, and agriculture, forestry and fishing. Only 25-30 percent of accommodation and food, construction, education and training industries are deemed essential services (see

42. Figure 2).

43. Areas with a higher proportion of non-essential industries are at greater risk of an economic downturn associated with business disruption from the Alert Level 4 lockdown. For example:

    43.1 In Queenstown-Lakes District, we estimate close to 60 percent of the economy is in a non-essential service. Rental, hiring and real estate services is the largest sector, accounting for 10 percent of GDP in 2019. Around 40 percent of this sector is deemed to be essential. Construction and accommodation make up 6.4 percent and 5.8 percent of GDP respectively, but each have less than a quarter of essential services.

43.2 Christchurch City Council also has a high proportion of non-essential services. However, many in the professional, scientific, and technical services (10 percent of GDP in 2019) are able to work from home. Construction and manufacturing make up collectively 11 percent of the economy and are heavily restricted in their ability to work during Alert Level 4. They will also likely be restricted to a significant degree during any Level 3 period.

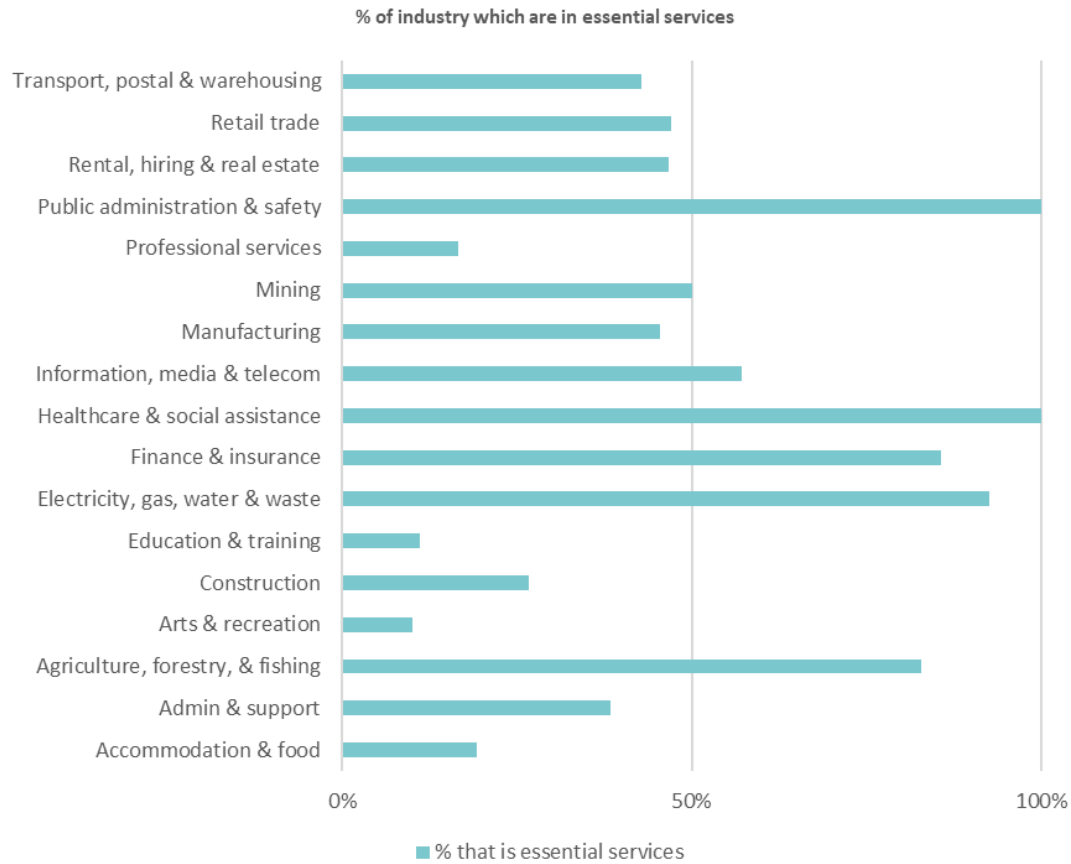

Figure 2: Essential services by industry

Source: Response Unit Analysis of Statistics New Zealand

Table 2: Estimated proportion of GDP that is attributable to non-essential services

Estimated proportion of GDP that is attributable to non-essential services – top 20	2019
Auckland	51%
Carterton District	50%
Christchurch City	52%
Dunedin City	49%

Hamilton City	49%
Invercargill City	46%
Kapiti Coast District	49%
Kawerau District	50%
Lower Hutt City	50%
Matamata-Piako District	46%
Napier City	50%
Nelson City	48%
New Zealand	**47%**
Palmerston North City	47%
Porirua City	50%
Queenstown-Lakes District	58%
Tasman District	46%
Tauranga City	50%
Waimakariri District	48%
Waipa District	47%

Source: Analysis of data from Statistics New Zealand, ANZ Bank and Deloitte.

Fourth-quarter impact – 2019/20 financial year

44. The Alert Level 4 lockdown took effect on Thursday 27 March. We are still collecting data from councils on the implications of the COVID-19 response on their fourth-quarter accounts. Based on some of the data collected to date and discussions with individual councils, we expect the following implications.

Revenue

45. A significant decrease in revenue for all councils, with a few approaching or exceeding the 30 percent criterion for the Government's wage subsidy support package, driven by:

    45.1 Closures of community facilities and the resultant loss of income, for example public libraries, community halls, swimming pools, stadium;

    45.2 Drop off in development contributions, financial contributions, and consenting fees and charges as non-essential building work is stopped; and

    45.3 Loss of dividends and investment income, noting Auckland Council was expecting dividends of $63m this financial year[2] and New Plymouth was budgeting for $15m[3] (10 percent of total income) from its' investment fund.

46. The impact on rates revenue is expected to be less immediate with the last instalment invoices for the financial year still being issued over the next few weeks. However, on-time rates collection is likely to be impacted. This will vary across councils and will largely depend on the underlying economic base of ratepayers (e.g. areas with high exposure to tourism or retail will likely see a higher proportion of late payments or defaults).

47. The most significant impact is likely to be on commercial/business sector payments due to business closures and reduced business incomes.

48. Although unrelated to the COVID-19 pandemic, some councils have the compounding effect of challenging local economic conditions due to severe drought conditions. This may further impact the ability to pay rates, fees and charges in some communities.

Operating Expenditure

49. Overall, operating expenditure reductions are likely to be substantially less than losses in operating revenue (i.e. insufficient to offset the revenue loss). There may be some short-term reduction in staffing costs, especially casual and part-time staff who cannot be easily redeployed to emergency and other activities.

50. Redundancies are expected to occur in user pays areas of council business. Decisions on redundancies are highly dependent on when non-essential business activities can resume. As an example, the Auckland Council announced on 7 April its intention to cut 1,100 jobs immediately.[4]

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[2] Auckland Council Annual Plan 2019/20.

[3] New Plymouth District Council Annual Plan 2019/20.

[4] https://www.stuff.co.nz/auckland/120879172/coronavirus-auckland-council-cuts-1100-temporary-and-contract-staff.

51. Table 3, planned cash outgoings for the 2019/20 financial year, shows that payments to suppliers are almost twice the amount of payments to staff:

Table 3: Planned Cash Outgoings for 2019/20

Expense type	$ M	Percent
Payments to staff[5]	2,792	19%
Payments to suppliers	4,964	34%
Finance costs	959	7%
Other operating funding applications	157	1%
Capital expenditure	5,819	40%
Total	14,691	100%

Source: DIA analysis of 2018 - 2028 Long-Term Plans

52. We note that most councils, while significantly impacted by COVID-19, are unlikely to meet the 30 percent revenue reduction criterion for the Employer Wage Subsidy Scheme. Some council-controlled organisations or smaller councils with a high proportion of revenue during the relevant period from fees and charges and income sources other than rates may be eligible.

53. Operating expenditure is likely to reduce where non-essential contract work is on hold. However, councils may be providing financial support to critical contractors so that there are viable businesses available when councils can resume normal operations. This is likely to be more of an issue for predominantly rural councils.

54. The reduction in borrowings for capital expenditure will reduce interest payments for next and the following financial years. However, low borrowing costs mean the impact of this is small compared to the forecast revenue reductions.

Capital Expenditure

55. Capital expenditure trends are not yet clear, but it is highly likely that capital expenditure will be well down. This is due to all non-essential work being stopped during Alert Level-4. Some councils have also informed us that they will not complete planned capital expenditure due to an expected reduction in operating revenue.

56. Councils with shareholdings in other businesses such as airports may face a double impact of lost dividends and a call on capital to keep the airports solvent (especially for the regional or provincial airports). Solvency payments could take the form of additional capital investment, or operating grants.

57. It is unknown if there will be any need to recapitalise council-controlled organisations during this current financial year.

[5] Long Term Plan data combines payments to staff and suppliers together. This and the figure for payment to suppliers has been estimated by assuming the ratio is the same as reported in Local Authority Financial Statistics for 2018 from Statistics New Zealand.

Borrowing

58. There are likely to be three factors in play for borrowings:

    58.1 Increased borrowings to cover reductions in revenue;

    58.2 Lower borrowings reflecting the stop or slow down in uncommitted capital expenditure. For example, Tauranga City Council is expecting borrowings this financial year to be $64 million less; and

    58.3 The available financial capacity to borrow given the LGFA financial and debt covenants in place for councils.

Impacts in the 2020/21 financial year

59. We have carried out an initial, high-level analysis of councils' 2020/21 financial forecasts and other advice received directly from councils to identify groups of councils that may have financial risks in the coming financial year.

60. We have focused on the following risks:

    60.1 Lost fees and charges revenue, not reflected by corresponding cuts in costs;

    60.2 Lost development contributions revenue;

    60.3 Lost investment income;

    60.4 Subsidiaries requiring recapitalisation;

    60.5 Limited capacity to borrow;

    60.6 Difficulties in collecting rates revenue; and

    60.7 Pressure to fund community and business recovery efforts.

61. We also note several councils are planning for, or needing to make, infrastructure catch up investments. It is unlikely that all councils will be able to maintain all pre-COVID-19 levels of investment until revenue levels are restored. This will require trade-offs on what investment is prioritised and could place at-risk infrastructure projects related to:

    61.1 General population and housing growth pressures;

    61.2 Three waters;

    61.3 National Policy Statement on Freshwater; and

    61.4 National Policy Statement on Urban Development Capacity.

62. We have analysed regional councils separately from territorial authorities as they have quite different balance sheet capacity to deal with adverse events.

Territorial authorities

Many territorial authorities have a high degree of dependence on fees and charges revenue

63. Councils collect fees and charges broadly in two contexts – the use of council services (such as swimming pool entry fees, venue hire and parking meter revenue) and charges for regulatory

services (such as building and resource consenting fees, food premises licensing, and dog registration fees).

64. The degree to which councils rely on fees and charges as a source of income varies considerably. However, we expect many councils will see significantly reduced fees and charges revenue next year for the following reasons:

64.1 Reduced income from council services impacted by the length of time venues such as swimming pools and community facilities stay closed, and by the degree to which vulnerable groups and the public in general avoid using facilities even when formal closures are removed.

64.2 Building and subdivision activity is likely to slow considerably, depending on requirements under different Alert Levels (see below). This may also be compounded by a reduction in business license fees, e.g. food premises, if sufficient businesses close and immediate replacements do not open.

65. Councils may partially compensate for lost services revenue by laying off casual and part-time staff (e.g. swimming pool attendants, library book shelvers), but are likely to be reluctant to lay off the professional staff that run these services, even if they are closed for significant periods. Reduced staffing expenditure is likely only to occur when councils are operating under more restrictive Alert Levels.

66. As Table 4 shows, there are 16 councils where budgeted fees income exceeds 25 percent of budgeted rates income.

Table 4: Dependence on fees income

Budgeted Fees income as a proportion of budgeted rates income	2020
Auckland (Group)	75.6%
Dunedin City	40.8%
Grey District	25.9%
Hastings District	29.7%
Hurunui District	92.0%
Hutt City	36.7%
Invercargill City	29.1%
Napier City	37.8%
New Plymouth District	29.3%
Queenstown-Lakes District	49.4%
Selwyn District	27.9%
Tauranga City	33.0%
Timaru District	33.4%
Upper Hutt City	25.8%
Waimakariri District	25.3%
Wellington City	45.9%

Source: DIA analysis of 2018/28 long-term plans.

As shown in Table 5, Auckland Council faces significant exposure to reduced fees and charges revenue. Reductions in this revenue will need to be met with reduced operating expenditure, increased borrowings, or increased rates.

Table 5: Auckland Council Fees and Charges

Type of fees and charges	$M
Water and wastewater	504
Sale of goods or services	357
Port operations	230
Consents, licenses and permits	195
Infringements and fines	47
Total fees and charges	**1,333**

Source: Email from Auckland Council.

Growth councils will likely suffer a significant reduction in development contributions revenue

67. Nine councils were projecting development contributions revenue of between 12 and 25 percent of annual rates income next year. These are shown in Table 6.

Table 6: Dependence on development contributions income

2020 Budgeted development contributions income as a proportion of budgeted rates income	Percent
Auckland (Group)	15.3%
Hamilton City	13.1%
Queenstown-Lakes District	23.7%
Selwyn District	25.2%
Tasman District	13.3%
Tauranga City	17.1%
Waimakariri District	20.2%
Waipa District	17.9%
Western Bay of Plenty District	13.8%

Source: DIA analysis of 2018/28 long-term plans.

68. The short-term effect of lower development contributions will likely be deferral of capital expenditure to accommodate growth. If that is insufficient to manage debt levels, these councils might also seek to defer investment intended to improve levels of service, such as reducing wastewater overflows or improving the resilience of water supplies.

69. ASB forecast a 30 percent reduction in residential investment as a result of Alert Level 4[6]. Many councils are predicting a reduction in building consent, and some (such as Hamilton[7]) are providing full refunds for building and resource consents that are withdrawn as a result of COVID-19.

70. An analysis of the impact on development contributions in nine growth councils during the Global Financial Crisis shows a substantial reduction in actual development contributions compared to the forecasts. It is uncertain as to whether a similar trend will occur in response to COVID-19 as the drivers are quite different. It is likely that COVID-19 will have a much wider-reaching economic impact than the Global Financial Crisis which had a particular impact on the finance and property development sector.

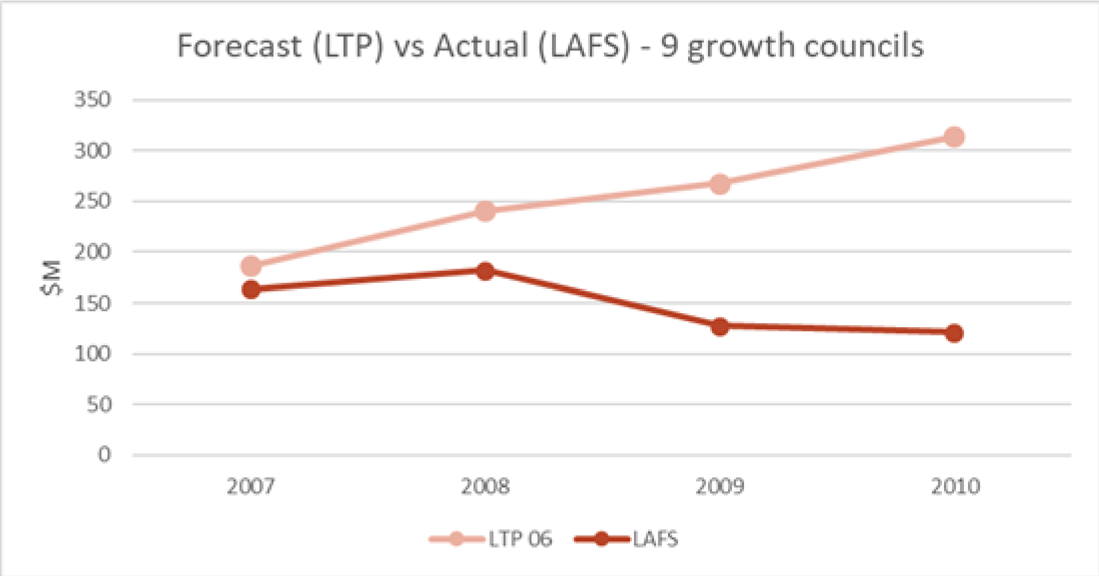

Figure 3: Forecast and Actual development contributions during the Global Financial Crisis

Source: Budgeted figures come from DIA analysis of 2006 long-term plans. Actual figures come from Local Authority Financial Statistics, Statistics New Zealand.

71. In the longer term, if growth does not recover reasonably quickly, the affected councils may need to pass some of the cost of investment to ratepayers. We saw this happen with the Western Bay of Plenty District Council after the Global Financial Crisis.

Some councils rely on investment income for significant funding

72. Local authority investment income comes from a variety of sources. These include investment portfolios, ownership of trading companies like ports, airports, electricity lines companies and civil contracting companies. Six territorial authorities have projected investment income of more than 10 percent of rates.

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[6] https://www.goodreturns.co.nz/article/976516585/covid-19-will-impact-on-building-activity.html.

[7] https://www.hamilton.govt.nz/our-city/covid-19/recovery-package/Pages/default.aspx

Table 7: Dependence on investment income

2020 Budgeted investment income as a proportion of budgeted rates income	Percent
Buller District	12.4%
Christchurch City	15.7%
Invercargill City	15.2%
New Plymouth District	18.8%
Selwyn District	12.0%
South Taranaki District	20.0%

Source: DIA analysis of 2018/20 long-term plans.

73. The first two, have large investment portfolios that they maintained after the disposal of electricity companies many years ago. We anticipate the value of these portfolios will have dropped substantially, possibly in line with world share market movements.

Some council subsidiaries may require recapitalisation

74. Many councils have subsidiaries that are likely to suffer significant losses of income. We've been told that, in some cases (e.g. provincial airports), the loss of income is so significant that new capital will be needed to maintain the solvency of the subsidiary. Other examples are sports stadiums and community venues that are managed through council-controlled organisations. We are seeking further information to better understand this risk.

75. In some cases, councils have issued uncalled capital to subsidiaries. If subsidiaries are unable to meet their financial obligations that capital may be called. Councils would not be able to default on that obligation. In the case of Christchurch City Council, total uncalled capital among its subsidiaries is $1.5 billion (increased in September 2019, up from $1.3 billion at 30 June 2019)[8].

Limited capacity to borrow

76. All councils with substantial borrowing are members of the LGFA. They must comply with LGFA debt covenants, of which the binding criteria is the debt to revenue ratio. Debt cannot exceed 250 percent of revenue for credit-rated councils, and for an unrated council it cannot exceed 175 percent. There are 30 credit-rated councils. The Board of the LGFA may grant an unrated council a bespoke ratio higher than 175 percent, but no ratio higher than 250 percent can be achieved without shareholder approval. Auckland Council has a gross revenue to debt ratio of 270 percent with Standard and Poors. Breaching this ratio would likely to see Auckland Council's credit rating cut from AA to AA-. Historically, Auckland Council has had an objective of retaining its AA Standard and Poors credit rating.

[8] Email from LGFA.

77. Broadly, there are two groups of councils with high debt – high growth councils with substantial capital investment programmes and other councils with historic challenges that have left them with high debt such as Waitomo District.

78. All these councils would be pushed closer to their debt covenant cap in the event of:

    78.1 a reduction in income from other sources;

    78.2 them holding rates increases below previous forecast levels; and

    78.3 any borrowing for unforeseen purposes, such as to meet operating costs in 2020/21, or to recapitalise subsidiaries.

79. The overall impact is likely to be a reduction in the ability of councils to fund existing planned work, or to bring forward "shovel ready" projects to help stimulate the economy.

80. In the case of high growth councils, these problems could be compounded by the loss of development contributions income.

81. On average, councils may not be at risk of breaching their LGFA debt covenants as shown below in Figure 4.

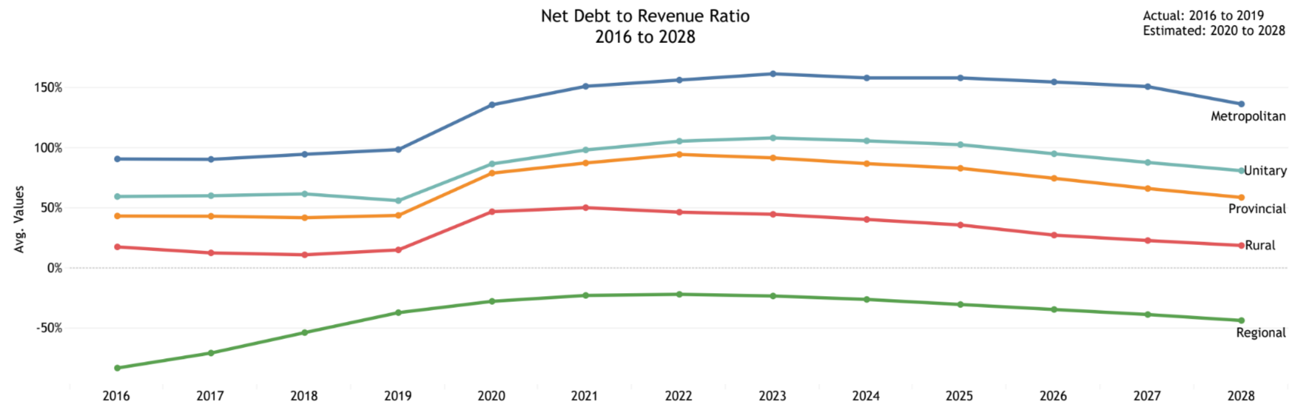


Figure 4: Average Net Debt to Revenue Ratios

82. However, Table 8 shows forecast debt to revenue ratios the end of the 2020/21 financial year[9] which indicates that some individual councils were already planning to have high debt to revenue ratios even before the reduction in revenue caused by COVID-19.

Table 8: Debt to revenue ratios

Projected Net debt to revenue ratios at 30 June 2021	Percent
Auckland Council	220.5%
Christchurch City Council	184.1%
Gore District Council	113.9%
Hamilton City Council	222.3%
Hastings District Council	122.1%
Hauraki District Council	120.8%
Horowhenua District Council	177.2%

[9] These forecasts were developed prior to the COVID-19 response.

Hutt City Council	117.8%
Kapiti Coast District Council	125.0%
Manawatu District Council	149.8%
Masterton District Council	119.1%
Palmerston North City Council	154.5%
Porirua City Council	116.9%
Queenstown Lakes District Council	176.2%
Rotorua District Council	172.3%
Stratford District Council	105.1%
Tauranga City Council	216.5%
Timaru District Council	112.0%
Upper Hutt City Council	106.1%
Waikato District Council	124.9%
Waimakariri District Council	206.6%
Waipa District Council	136.8%
Waitomo District Council	134.5%
Wellington City Council	155.0%
Western Bay of Plenty District Council	115.5%
Whanganui District Council	117.0%
Whangarei District Council	131.3%

Source: Source: LGFA analysis.

83. Hamilton, Auckland and Tauranga are the most at risk of reaching debt ceilings. For every $1 of budgeted revenue they do not receive, their debt cap falls by $2.50. Factors that would influence this include rates increases lower than initially planned and falls in revenue from council services. Tauranga and Auckland, both have a high dependence on fees and charges revenue, so are vulnerable to falling income from that source.

84. For other councils, while it is unlikely they would reach their debt ceilings, reducing planned rates increases, borrowing now to recapitalise subsidiaries or to meet operating costs would limit their future ability to fund future infrastructure investment. Examples include Christchurch, Queenstown-Lakes and Rotorua which own, in part or in whole, airport companies. Queenstown-Lakes and Rotorua also have a high exposure to the tourism industry.

85. The Response Unit has undertaken a sensitivity analysis of debt to revenue ratios (assuming a reduction in revenue of 15 and 20 percent). See appendix 2. This sensitivity analysis highlights:

85.1 Auckland Council potentially breaches the debt covenants this financial year under both scenarios[10].

85.2 Hamilton City and Tauranga City would breach the debt covenants by the end of next financial year.

85.3 By the end of 2024 financial year, five councils would potentially breach debt covenants in the 20 percent revenue reduction scenario.

86. We note that it is unlikely that a sustained 15 or 20 percent revenue reduction will occur as Treasury expects economic growth to resume from the 2020 or 2021 years.

87. Our summary of the limited capacity to borrow analysis is that the majority of councils have sufficient debt headroom to respond to COVID-19 impacts through to the end of the 2020/21 financial year. Regional councils are in the strongest position. However, revenue reductions will reduce the headroom for all councils. Most significantly, there are several councils already managing higher debt levels (primarily high growth districts which are home to most of the population) that have very little spare borrowing capacity and may reduce borrowings to mitigate the risk of breaching LGFA debt covenants.

Difficulties in collecting rates revenue

88. Councils are grappling with the effect of the sudden change in economic conditions on likely rates revenue. There are two separate factors at work. Rates collections will inevitably fall in the short-term as distressed households and businesses fail to make payments by the due date. However, unless remitted, this is more of a timing problem as rates arrears are recoverable in the longer-term.

89. If there are difficulties in collecting a high proportion of rates, this will have a cashflow impact on councils. Councils could offer short term postponements and work with ratepayers to recover those rates over time. Non-payment of rates will only result in a permanent loss of revenue if the council writes off the rates, which is extremely rare.

90. The sudden onset of the lockdown means that the impact on the business sector is more pronounced than in a "conventional" recession. Councils with a high exposure to business rates are likely, in the short-term, to face more considerable collection difficulties than others. Councils may be viewed by businesses as being "soft creditors" with priority given to paying other creditors ahead of councils. National data on the makeup of council rating bases is unavailable.

91. We have carried out an informal survey through SOLGM to identify which councils are most exposed to business rates. At the time of writing, we had data for 45 councils, and therefore some notable councils are missing from this analysis[11]. Nine councils derive 25 percent or more of their rates income from businesses and may be vulnerable to cashflow difficulties as a result. We expect that Wellington City Council and the Greater Wellington Regional Council will be proportionately less impacted than other councils due to the number of properties occupied by Crown agencies.

[10] Auckland Council is considering options to mitigate this result and has already announced a reduction in staffing numbers.

[11] Hamilton, New Plymouth. Queenstown-Lakes and Timaru are major centres that did not respond to the survey.

Table 9: Business rates income as a proportion of total rates

Council	percent
Auckland Council	32%
Buller District Council	20%
Christchurch City Council	26%
Dunedin City Council	30%
Greater Wellington Regional Council	33%
Hutt City Council	24%
Mackenzie District Council	25%
Napier City Council	21%
Nelson City Council	24%
Palmerston North City Council	30%
Rotorua-Lakes	34%
Taupo District Council	23%
Wellington City Council	44%
Whanganui District Council	21%
Whangarei District Council	28%

Source: SOLGM Survey of Rating Officers.

92. Appendix 1 provides further breakdown on the percentage of business rate income by council type.

Pressure to fund community and business recovery efforts

93. Councils will come under increased pressure from their communities to financially support businesses, sporting and other community groups in the medium term.

94. Community and sporting organisations are facing challenging financial situations with the loss of revenue from sales, fundraising opportunities, subscriptions and grants (particularly from gaming trusts). Central government is providing some support to sporting and community groups such as:

    94.1 Community and Preparedness Grant Fund;

    94.2 Creative New Zealand Emergency Response Package;

    94.3 The Employer Wage Subsidy Scheme (which is also available to NGOs);

    94.4 A Whānau Māori Community and Mārae package; and

    94.5 Sport NZ confirming investment levels to all National Partners and Regional Sports Trusts.

95. Councils expect that further requests for funding are inevitable.

96. Economic development agencies are likely to face increased cost pressures to ensure the survival of businesses that are important for employment and local economies. Central government is providing significant support to businesses through:

96.1 The Employer Wage Subsidy Scheme;

96.2 Redundancy support;

96.3 The Business Finance Guarantee Scheme;

96.4 Business cash flow and tax measures; and

96.5 Support for Māori communities and businesses.

97. There is an opportunity for central and local government to work closely together to ensure that businesses can access government and private sector funding support.

Conclusion for territorial authorities

98. The effects on territorial authorities are likely to be highly varied, but the competing pressures to keep rates down, combined with the loss of revenue from other sources and the desire to maintain employment and expenditure in local communities will impact all territorial authorities to some degree.

99. Several councils are already indicating an intention to consider a 0 percent rate increase in the 2020/21 financial year, while others will delay or reduce planned increases. This has significant longer-term implications. For example, Wellington City Council was planning a 9.4 percent rise in 2020/21 and is now proposing options of either 4.95 percent and 2.15 percent increases.[12]. This will likely result in significant rates increases in subsequent years if the council retains its spending forecasts.

100. Downward pressure on council revenue streams could become evident for those councils with a high proportion of industries with non-essential services and those who are exposed to the tourism sector. For example, Queenstown-Lakes District Council is heavily reliant on accommodation and rental hiring and real estate services. If these businesses are unable to operate for an extended period, there may be implications on council cash flows from non-payment or late payment of business rates.

101. However, some will be affected more substantially than others, and they are likely to be those identified in this report.

Regional councils

102. Regional councils, like territorial authorities, vary quite a lot in their financial characteristics. However, they tend not to have large infrastructure investments, so have quite different balance sheets. Many also own significant port assets, and some have, directly or indirectly, significant investment property portfolios. However, all have low debt and could borrow for operating costs in the short term if they did not wish to increase rate revenue.

Some regional councils are highly dependent on fees and charges income

103. Reliance on fees and charges income is highly variable across regional councils (see Table 10). The main issue is the public transport funding model and the impact of lower fare revenue on major regional councils (and Auckland Council). We understand that for the balance of this

[12] https://www.nzherald.co.nz/nz/news/article.cfm?c_id=1&objectid=12324005.

financial year, NZTA is making up shortfalls in fare revenue. It is not clear how this may play out in the 2020/21 financial year, noting that the NZTA's primary source of revenues (fuel tax and road user charges) is expected to be reduced.

Table 10: Regional council – fees and charges dependence

2020 Budgeted fees and charges as a proportion of budgeted rates income	Percent
Bay of Plenty Regional	21.6%
Canterbury Regional	33.7%
Hawke's Bay Regional	40.3%
Manawatu-Wanganui Regional	20.2%
Northland Regional	14.9%
Otago Regional	13.1%
Southland Regional	56.0%
Taranaki Regional	93.2%
Waikato Regional	22.4%
Wellington Regional	74.6%
West Coast Regional	100.4%

Source: DIA analysis of 2018/28 long-term plans.

Some regional councils also have a high dependence on investment income

104. Many port companies are owned by regional councils, and some have a high reliance on port company dividends to fund their operations.

Table 11: Regional councils – investment income dependence

2020 Budgeted investment revenue as a proportion of budgeted rates revenue	Percent
Bay of Plenty Regional	70.5%
Canterbury Regional	0.7%
Hawke's Bay Regional	55.7%
Manawatu-Wanganui Regional	6.0%
Northland Regional	28.7%
Otago Regional	36.2%
Southland Regional	24.8%
Taranaki Regional	89.2%
Waikato Regional	6.6%
Wellington Regional	3.6%
West Coast Regional	23.1%

Source: DIA analysis of 2018/28 long-term plans

105. The key issue here is the medium-term effect of the COVID-19 outbreak on port company revenues. It can be expected that revenue from cruise ships will be depressed for some time but impacts on physical trade are harder to determine.

Conclusion regional councils

106. Issues with regional councils are likely to be very case-specific. Particular issues that may need to be followed up include:

    106.1 The effect of the planned redevelopment of the Port of Napier on Hawkes Bay Regional Council;

    106.2 The effect of the planned redevelopment of Yarrow Stadium on Taranaki Regional Council; and

    106.3 The impact of Wellington Stadium disruptions on Wellington Regional Council.

Further analysis and reports

107. While this initial analysis has produced some useful food for thought at a sector-wide level and some indications of local and regional issues, it is important to note that significant uncertainties remain. In some areas, that uncertainty will be sustained for several weeks or many months.

108. As indicated in the foreword to this report, further analysis of the financial implications will be undertaken over coming weeks as more data is gathered, and certainty increases about Alert Level scenarios, economic activity, ongoing central government stimulus packages and the likely role of councils in national recovery efforts.

109. Further data is currently being sought from councils on financial impacts in the fourth-quarter of 2019/20. Many councils are still identifying these impacts.

110. The Local Government COVID-19 Response Unit is also undertaking further analysis of the impact on regional economic activity. This will provide more significant insights into the impact on business rates, license fees, and other sources of business-related council revenues.

111. Our analysis will be updated progressively as new and updated information comes to hand. This work will continue to be undertaken in close consultation with councils and central government agencies such as Ministry of Business Innovation and Employment, Ministry of Housing and Urban Development, Ministry of Transport, the Treasury, New Zealand Transport Agency, and NEMA.

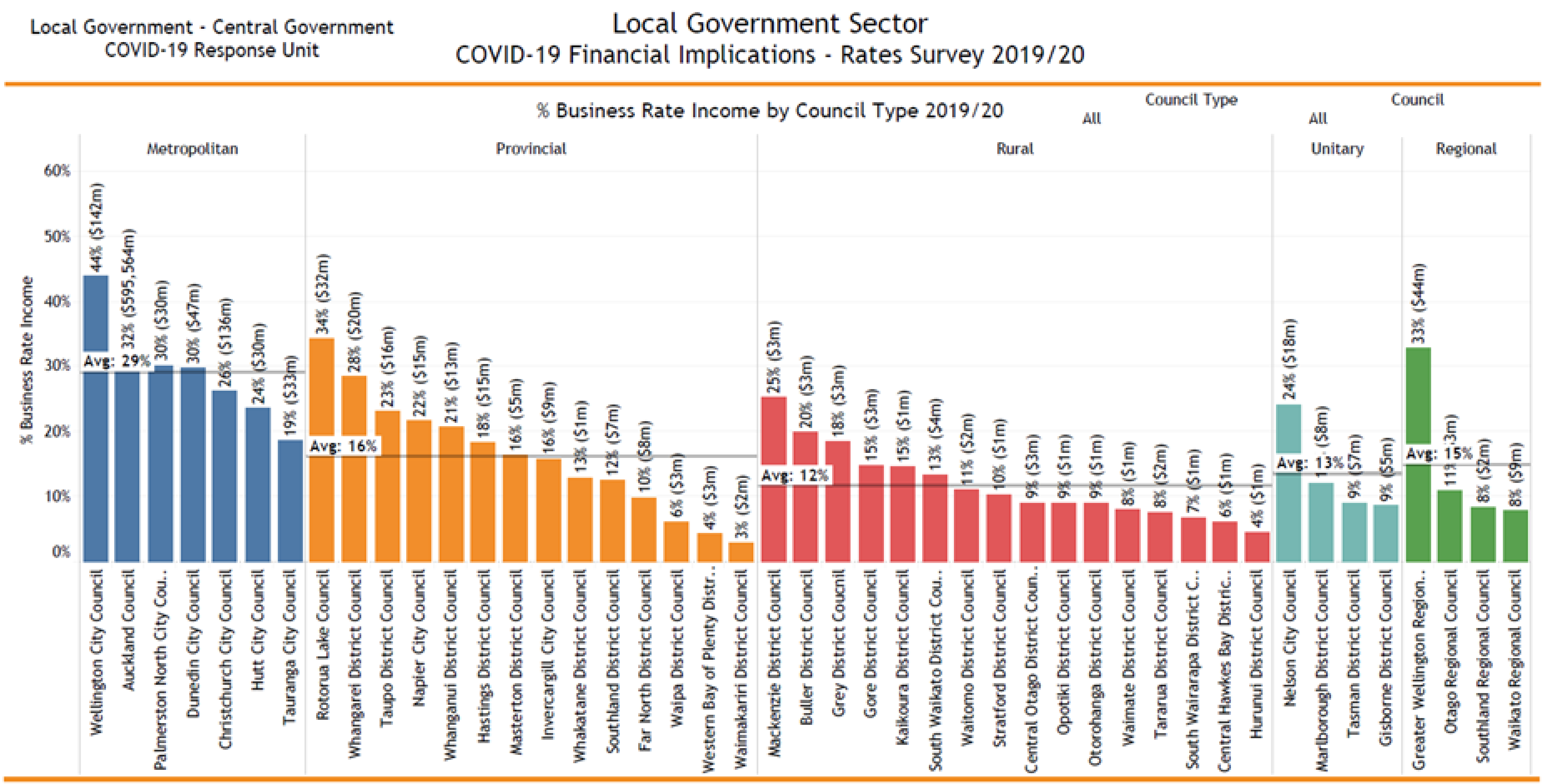
Data

112. The data and information used in this provisional analysis has come from several sources, as outlined in the table below:

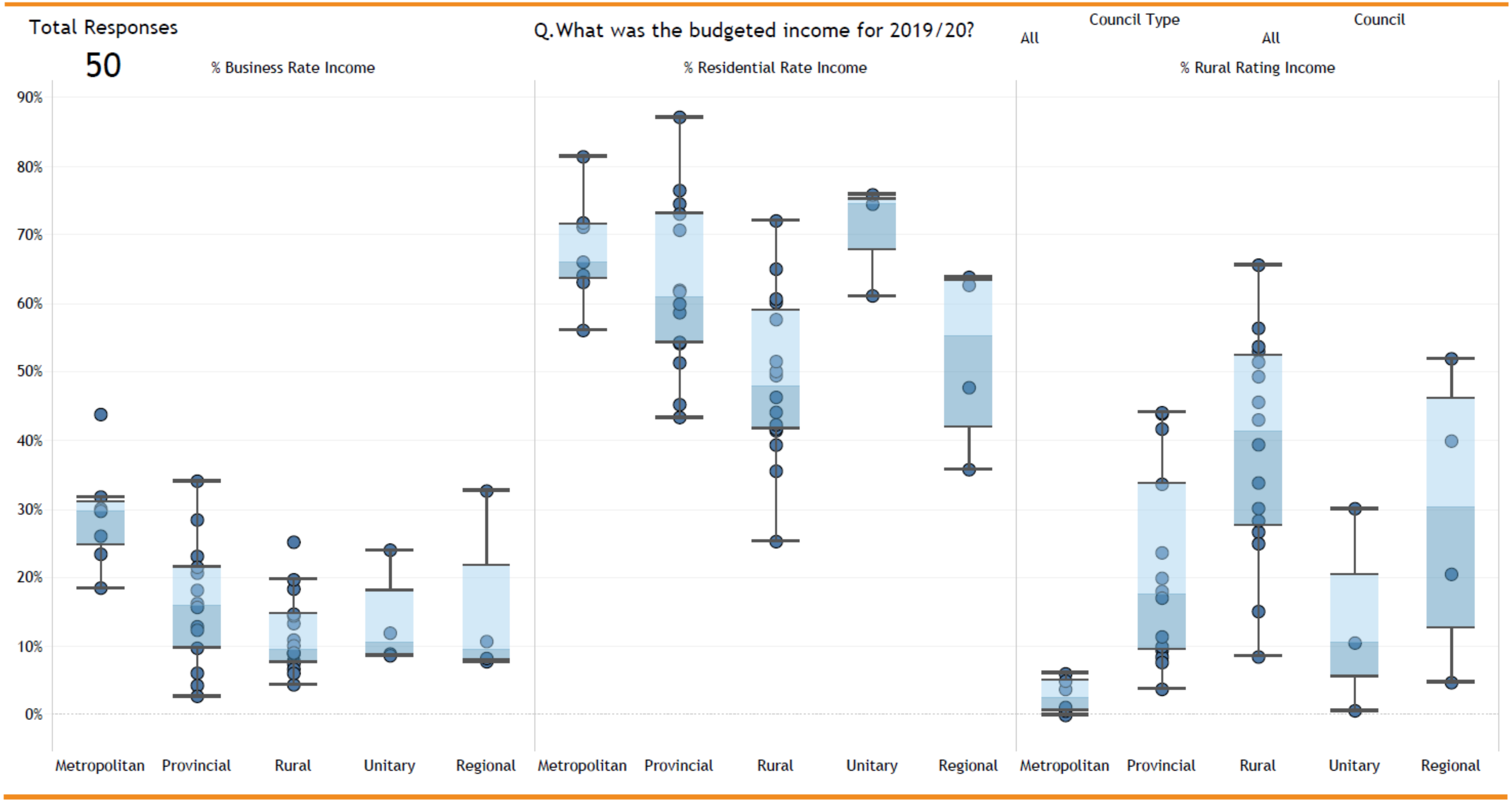
Table 12 Data sources and limitations

Data	Notes and limitations
Councils Long Term Plans 2018 – 2028 and Annual Plans 2019-2020.	Councils are required to publish these plans and Annual Reports. DIA collates information from these and this data has been used to underpin much of the analysis in this report.
Local authority financial statistics	Statistics New Zealand. This is an annual financial survey based on local authority financial reports. The most recent data is for the financial year ended 30 June 2018.
Informal SOLGM Survey	Only 45 councils provided comparable data, so gaps exist. For example, Hamilton, New Plymouth, Queenstown-Lakes and Timaru were unavailable at the time of writing. Councils defined "business rates" themselves so the data should be used to compare councils' possible vulnerability to loss of business rates (or otherwise). Data cleansing processes identified some unusable data which resulted in some council data not being included.
Provisional information from councils	Provisional Information from council finance leaders. Some information has not yet been considered by council and is not confirmed.
LGFA forecasts	These forecasts are based on the 201/-2028 Long Term Plans, which were created before the COVID-19 situation. The underlying forecasting assumptions may no longer be correct.
Media articles	We have not been able to confirm the primary data referred to in media articles.
Statistics New Zealand – Commercial Accommodation Monitor (CAM)	Data is based on a survey which does not capture the full extent of tourism in a local council such as spending, day visitors, or visitors staying in Airbnb.
Statistics New Zealand – Census 2018	Official Tier 1 data.
MBIE – Modelled Territorial Authority Gross Domestic Product (MTAGDP)	Experimental dataset.
% of essential services	Early estimates based on analysis of 54 industry groups, subject to change.

Appendix 1: Percentage of business rate income by Council type



Source: SOLGM survey.



Total Responses
50
Q.What was the budgeted income for 2019/20?
All
Council Type
All
Council
% Business Rate Income
% Residential Rate Income
% Rural Rating Income
90%
80%
70%
60%
50%
40%
30%
20%
10%
0%
Metropolitan
Provincial
Rural
Unitary
Regional
Metropolitan
Provincial
Rural
Unitary
Regional
Metropolitan
Provincial
Rural
Unitary
Regional

Appendix 2: Sensitivity analysis of debt to revenue–revenue reduction scenarios

Councils with Debt to Revenue Ratios of Greater than 175 percent

	LTP debt to revenue data					Scenario: 15% Revenue Reduction					Scenario: 20% Revenue Reduction				
	2020	**2021**	**2022**	**2023**	**2024**	**2020**	**2021**	**2022**	**2023**	**2024**	**2020**	**2021**	**2022**	**2023**	**2024**
Auckland Council	214%	221%	222%	227%	222%	252%	259%	261%	267%	261%	268%	276%	278%	283%	277%
Christchurch City Council	172%	184%	190%	198%	205%	202%	217%	224%	233%	241%	215%	230%	238%	248%	256%
Hamilton City Council	187%	220%	218%	216%	219%	220%	259%	256%	254%	257%	234%	276%	272%	270%	273%
Horowhenua District Council	166%	177%	182%	176%	182%	195%	208%	214%	207%	214%	208%	221%	228%	220%	228%
Kapiti Coast District Council	202%	125%	202%	198%	145%	238%	147%	238%	233%	170%	252%	156%	253%	248%	181%
Manawatu District Council	141%	150%	142%	135%	124%	166%	176%	167%	158%	146%	177%	187%	178%	168%	155%
Opotiki District Council	71%	84%	86%	174%	170%	84%	98%	101%	205%	201%	89%	105%	108%	218%	213%
Queenstown Lakes District Council	132%	175%	188%	189%	195%	155%	206%	221%	222%	229%	164%	219%	234%	236%	244%
Rotorua District Council	158%	172%	192%	185%	178%	186%	203%	225%	218%	210%	198%	215%	239%	232%	223%
Tasman District Council	158%	161%	157%	147%	138%	186%	189%	184%	172%	162%	198%	201%	196%	183%	172%
Tauranga City Council	181%	215%	223%	227%	226%	213%	253%	262%	267%	266%	226%	269%	278%	284%	282%
Waimakariri District Council	201%	207%	192%	180%	168%	237%	243%	226%	212%	197%	252%	258%	240%	225%	210%
Waipa District Council	107%	137%	186%	186%	171%	125%	161%	218%	218%	201%	133%	171%	232%	232%	214%
Non-rated cap	175%	175%	175%	175%	175%	175%	175%	175%	175%	175%	175%	175%	175%	175%	175%
LGFA debt covenant	250%	250%	250%	250%	250%	250%	250%	250%	250%	250%	250%	250%	250%	250%	250%

Source: LGFA data, DIA data and author's calculations

The analysis in the above table is speculative. It should only be used as a guide to understand which councils have the most significant debt constraints through the COVID-19 pandemic response and recovery. It maps expenditure and borrowing profiles from 2018-2028 long-term plan data against a 15% and 20% decrease in revenue (excluding development contributions, revaluations and vested assets) for each year between 2020 and 2024.

Several decisions are likely to be made by councils as part of their annual planning to respond to COVID-19, which may have a significant impact on the above analysis.