Emergency Budget - Mayoral Proposal

July 2020

The challenge

1. Auckland Council's Emergency Budget is the result of the global COVID-19 pandemic and its impact on our council's revenue.

2. The government's response to the pandemic, closing our borders and locking down our society during level four, was undoubtedly the right one. It saved thousands of lives, stopped our hospital system being overwhelmed and has allowed the near normal resumption of life within New Zealand much earlier than in most other countries.

3. However, the cost of lockdown, border closure and the impact of international recession economically is, and will continue to be, severe. For Auckland Council, it means a potential loss of income in the current financial year of around $475 million. Although less severe than originally estimated because of a faster return to level one, its budgetary impact is still profound.

4. Subsequent to the draft Emergency Budget going out for consultation, Auckland's historic drought has meant it is now necessary to build up the city's water infrastructure to ensure we mitigate severe water restrictions. The cost of this comes to approximately $239 million ($224 million in capital and $15 million in operating expenditure).

5. It has presented our council, in the words of one of our longest standing councillors, with its greatest ever challenge and the toughest decisions it has ever had to make.

6. While the Local Government (Auckland Council) Act 2009 (LGACA) requires the mayor to put forward each year's budget proposal, we have adopted a collective and collaborative approach in determining the shape of this year's Emergency Budget. Councillors, together with Local Boards and the Independent Māori Statutory Board (IMSB), have worked hard to balance the measures needed to tackle the emergency situation created by COVID-19.

7. I want to thank all councillors for their professional and measured approach to working through the options. In particular, I want to thank the Chair and Deputy Chair of the Finance and Performance Committee, Desley Simpson and Shane Henderson, for their huge efforts and Deputy Mayor Bill Cashmore for attending all the webinars during the Have Your Say consultations.

The response

<u>Debt</u>

8. With the substantial loss of income, Council has in return had to dramatically reduce its expenditure. Council normally borrows to meet capital cost of infrastructure because that infrastructure provides for the needs of future generations and it is appropriate therefore to spread the cost over generations.

9. It is generally not appropriate to borrow to cover day to day operational expenditure. Indeed the Local Government Act 2002 (LGA) requires councils to have a balanced budget by setting

operational revenue at a sufficient level to meet operational expenditure. However, it does allow councils to resolve that it is prudent in certain circumstances, in light of the matters set out in section 100(2)(a) to (d) of the LGA, not to balance the budget and to borrow to meet operational needs. Given the circumstances created by COVID-19, Council will borrow this year at a level which exceeds its debt to revenue limit set out in financial policies and will not balance the budget because that is prudent and necessary.

10. With high population growth and the need to borrow to build infrastructure to cope with this growth, Auckland was already close to its debt to revenue policy threshold. Keeping borrowing below this threshold is important for Auckland to retain its AA credit rating, which is just one notch below the government's.

11. Losing one notch in credit rating would push up interest rates, with an estimated cost of approximately $130 million in interest payments over a decade. Losing two notches would create around $300 million in extra interest cost. It would also reduce access by council to borrowing opportunities.

12. To keep our credit rating, it is therefore important that exceeding the debt to revenue threshold is limited in degree and in time. Credit rating agencies are understood to be likely to allow Auckland Council to exceed its 270 per cent debt to revenue ratio up to a level of around 290 per cent. This tolerance is subject to Council having a credible plan and strong commitment to bringing debt back to the threshold level within a relatively short period of time.

13. Council's Emergency Budget aims to borrow for only one year above the ratio to avoid much more drastic cuts to services and infrastructure investment, which would impact on and slow economic recovery.

<u>Rates</u>

14. To compensate for the loss of $475 million in revenue, Council would need the equivalent of a 28 per cent increase in general rates in addition to the 3.5 per cent planned. Such an increase has not been contemplated. The impact on ratepayers would be severe at a time when, because of COVID-19, many households may face a decline in their income.

15. To the contrary, Council has consulted on and, received overwhelming public support, for a proposal to extend its rates postponement policy to offer those facing serious financial problems the opportunity to postpone their payment of rates. Around $50 million has been set aside to cover the postponement this year. These rates will be recovered later when those households are in a position to more readily meet the cost of their rates.

16. Council considered the possibility of lowering rate increases from the 3.5 per cent set out in 2018 as part of its 10-year Budget (Long-term Plan). Indeed, it consulted on whether this rate increase could be lowered to 2.5 per cent for this financial year. In individual submissions the level of support for 2.5 per cent was marginally higher than 3.5 per cent, with support for the former more marked in an independent quantitative survey.

17. However, additional costs faced by Council due to the urgent need to strengthen the city's water supply in the face of its worst ever drought makes any reduction in planned rate levels unrealistic and imprudent.

18. Watercare has indicated that urgent capital works to increase water supply and reduce the likelihood of severe water restrictions being imposed next summer require additional capital expenditure of around $224 million in this year which has not been budgeted for. It represents bringing forward investment which would have normally been required in future years. There is also additional operating expenditure of $15 million, associated with electricity, chemicals, and enhanced leak and pressure management.

19. This information was not available at the time Council went out to consultation on the rate increase levels.

20. This unbudgeted expenditure requires additional borrowing that would push our debt to revenue ratio beyond 290 per cent. It is unavoidable expenditure and will require additional revenue through general rates and additional water charges to service debt without posing additional risks.

21. The difference in cost to ratepayers paying the average rate between a 2.5 per cent and 3.5 per cent rate increase is around 47 cents a week extra for the higher rate, but will make a marked difference in Council's ability to meet the cost of the water infrastructure required without having to slash spending on other infrastructure and services to a greater degree.

22. Moreover, all Local Boards with elected representatives from right across Auckland region, support a 3.5 per cent increase in the general rate in their feedback to the Governing Body. This level of support for a rate increase, according to a senior Local Board Chair, is unprecedented.

<u>Services</u>

23. The loss of revenue caused by COVID-19 will require reduced expenditure on services and the staff employed to provide Council services. Already over 600 contingency workers (temps and contracted workers) have left Council and around 500 full-time-equivalent permanent staff on top of this will lose their jobs. This is a tough and difficult outcome for people who have served Council well but with the impact of COVID-19, Council must become a leaner and smaller organisation.

24. Councillors have worked hard to find service cuts that preserve as much as possible the key services needed by Aucklanders in areas such as transport, water quality and environmental protection, waste and recycling services, parks, playgrounds and libraries and support for sporting and cultural activities.

25. In reducing service expenditure, Council has strived to protect the most vulnerable, such as the homeless, and to extend the living wage to cleaners contracted by Council.

26. We have also protected new expenditure required to cut Council's greenhouse emissions by up to 20 per cent in line with our commitment to reduce our impact on climate change. However, the proposed increase in child fare subsidy for public transport will need to be deferred.

27. Operating expenditure in this year's budget will be $4.4 billion.

Investment in infrastructure

28. While Council has had to defer spending on some infrastructure projects because of the huge cut in its income, it has endeavoured to keep as many projects going as possible. This is both because of the city's urgent need for improved transport, housing and environmental infrastructure, and to help stimulate economic recovery, preserve jobs and keep a pipeline of work available for construction.

29. The capital programme for 2020/2021 is proposed to be $2.3 billion before adding $224 million additional investment by Watercare in response to the current drought. This is less than the $2.7 billion proposed in the pre-COVID budget but substantially more than the $1.6 billion average expenditure over the last five years.

Asset Recycling

30. A target of $224 million for asset recycling is ambitious and a critical pillar of the Emergency Budget. Without it, other levers will have to be pulled further, which means more reductions in investment and services and more borrowing. We know these other levers are at their respective limits as well.

31. It is necessary to improve the current process to make it possible to achieve the $224m target in a timely manner. We need to consider Local Board feedback but also recognise the holding cost and the opportunity cost of surplus properties. If properties are not used to deliver council services and do not have identified and funded future service needs, they should be disposed of, to support capital investment of higher strategic priority.

Conclusion

32. Key recommendations in this proposal are summarised below for consideration by the Finance and Performance Committee.

    a) an average general rate increase of 3.5 per cent.
    b) an increase to the Uniform Annual General Charge of 3.5 per cent.
    c) continuation of Long-term Differential Strategy.
    d) no changes to Regional Fuel Tax, Water Quality Targeted Rate, Natural Environment Targeted Rate.
    e) that it is prudent to not balance the budget for 2020/2021 financial year.

33. This Emergency Budget is the most difficult annual budget ever faced by councillors. These have not been easy decisions to make. Nevertheless, as governors of this city, we have had to make these hard calls.

34. I would like to thank the people of Auckland for the record level of engagement and submissions. I would like to acknowledge councillors, particularly the Chair and Deputy Chair of Finance and Performance Committee and the Deputy Mayor, Local Board members and IMSB members for their leadership, collaboration and willingness to meet the challenges Council faces and to make the hard decisions.

35. I also wish to thank mana whenua for their input, and our co-governance partners for their contribution and assistance from their funding towards the Emergency Budget. Through the process, we have been able to sustain our commitment to improving Māori outcomes.

36. I would like to acknowledge our staff who have been professional, highly competent and hardworking. They have provided elected members with quality advice and supported us through a challenging decision-making process.

37. We will adopt the Emergency Budget on 30 July. However, we need to remain cautious and vigilant in the ensuing 11 months as the financial year 2020/2021 unfolds with many uncertainties relating to COVID-19. We need to monitor our finances closely and be prepared to adapt quickly to any future changes in our financial position.

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