Nelson Regional Sewerage Business Unit

8 February 2011

REPORT 1033037

Proposal to Distribute Future Business Unit Surpluses

1. Purpose of Report

1.1. To align the budgets in the 2011/12 Business Plan with the objective of repaying debt over 30 years to ensure the principle of intergenerational equity is maintained.

2. Recommendations

<u>THAT</u> the NRSBU establishes a principle that future operating surpluses be returned to the Shareholders provided that there is provision to repay loans over 30 years.

<u>AND THAT</u> the revised 2011/12 Business Plan which includes the proposed distribution of surpluses be approved.

3. Background

3.1. The Joint Shareholders Group considered this issue at their meeting of 1 March 2010. The Minutes record the following:-

"Nelson Regional Sewerage Business Unit Surplus Income

Report No 880820, agenda pages 6-8 refers

The Chairperson of the Business Unit gave a background to the report. The Joint Committee expressed the view that it was appropriate that any surplus come to the two owners.

Recommendation to the Nelson City Council and the Tasman District Council

<u>THAT</u> for this financial year the excess surplus above what was budgeted for from the Nelson Regional Sewerage Business Unit be returned to the two council shareholders in equal proportions

Kempthorne/Thomas

<u>Carried</u>

There was some discussion regarding the debt/equity ratio of the Business Unit. It was agreed that within the next review of the Memorandum of Understanding, the Councils should give a direction to the Business Unit

Board on what debt/equity ratio is seen as appropriate for the Business Unit."

- 3.2. When the NRSBU was established in 2000 the debt to equity ratio stood at 70/30 with \$11.4m debt and \$4.8m equity. Over the last 10 years priority has been given to reducing the level of debt with almost all surpluses being used to repay debt. At June 2010 the Debt to Equity ratio was 27/73. See Appendix A for a history of debt and equity levels.
- 3.3. Put simply, surpluses have been generated from the return on Equity and the difference between the interest which NRSBU pays on loans and the rate of return which is charged to customers.

4. Discussion

Proposed Use of Surpluses

- 4.1. Appendix B contains a ten year financial forecast where all surpluses continue to be used to repay debt. A review of projected investment requirements, debt levels and surpluses shows that by continuing to utilise surpluses to repay debt the Business Unit is reducing debt levels to a point where the principle of intergenerational equity is compromised by unfairly burdening current ratepayers with accelerated debt repayments. This would result in future generations utilising high value assets which have been paid for by current ratepayers.
- 4.2. Appendix C contains a revised ten year financial forecast where all surpluses are returned to the shareholders. Under this scenario it can be seen that debt is projected to peak at \$30m in 2017 (with a Debt to Equity ratio of 52/48) and then reduce back to \$24m by 2020 (Ratio 47/53). This is considered to be sustainable.
- 4.3. As can be seen from Appendix D, funds from depreciation are anticipated to be more than sufficient to pay for renewals as well as repaying debt over 30 years as required by the Business Plan objectives.

Impact on Council Owners

- 4.4. The significant increase in contributions in 2012/13 as a result of the replacement pipeline upgrade, are largely borne by the two Councils. Appendix D shows the forecast NRSBU total contributor costs, the cost to each Council, as well as each Council's share of the Owners' Distribution over the next 10 years.
- 4.5. The increased contributions to TDC and NCC can be largely offset by distributing operating surpluses, thus enabling Councils to avoid significant rates increases associated with increases in their NRSBU contributions.

5. Conclusion

- 5.1. The proposal to return future surpluses to shareholders is consistent with the requirements for:
 - Fiscal responsibility under the Local Government Act
 - Intergenerational equity

- The NRSBU 2011/12 Business Plan Objectives

Contact officer: Andrew Bishop, Management Accountant, Nelson City Council.

Attachments

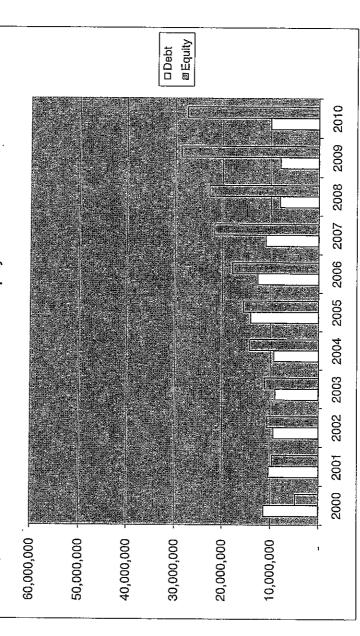
Appendix A: History of Debt and Equity.

Appendix B: 10 year Projection of Debt and Equity without Owners' Distribution. Appendix C: 10 year Projection of Debt and Equity with Owners' Distribution. Appendix D: 10 year forecast of Total contributions, Council contributions, and distributions to owners.

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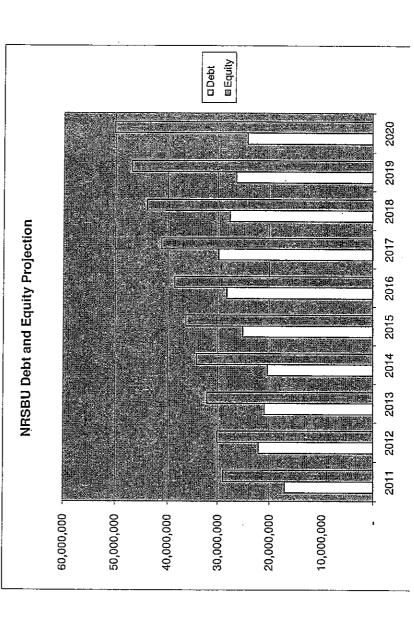
Nelson Regional Sewerage Business Unit History of Debt and Equity

2010		27/73					
2009	28,789,659 8,000,000 36,789,659	22/78					
2008	22,787,319 8,050,000 30,837,319	26/74					
NZIFRS 2007	21,685,511 11,000,000 32,685,511	34/67					
NZGAAP 2006	17,843,978 12,600,000 30,443,978	43/57					
2005	15,501,159 14,000,000 29,501,159	47/53		and Equity			
2004	14,148,266 9,300,000 23,448,266	40/60		VRSBU Debt			
2003	11,209,271 9,000,000 20,209,271	45/55					
2002	10,645,638 9,400,000 20,045,638	47/53			. 00	00	
2001	9,683,039 10,400,000 20,083,039	52/48			60,000,00	50,000,00	
2000	4,818,517 11,375,000 16,193,517	70/30					
	Equity Debt Debt + Equity	Debt/Equity Ratio					
	NZIFRS 2002 2003 2004 2005 2006 2007 2008 2009	2000 2001 2002 2003 2004 2005 2006 2007 2008 2009 4,818,517 9,683,039 10,645,638 11,209,271 14,148,266 15,501,159 17,843,978 21,685,511 22,787,319 28,789,659 11,375,000 10,400,000 9,400,000 9,000,000 14,000,000 12,600,000 11,000,000 8,050,000 8,000,000 16,193,517 20,083,039 20,045,638 20,209,271 23,448,266 29,501,159 30,443,978 32,685,511 30,837,319 36,789,659	2000 2001 2002 2003 2004 2005 2006 2007 2008 2009 4,818,517 9,683,039 10,645,638 11,209,271 14,148,266 15,501,159 17,843,978 21,685,511 22,787,319 28,789,659 11,375,000 10,400,000 9,000,000 9,300,000 14,000,000 12,600,000 11,000,000 8,050,000 8,000,000 16,193,517 20,083,039 20,045,638 20,209,271 23,448,266 29,501,159 30,443,978 32,685,511 30,837,319 36,789,659 70/30 52/48 47/53 46/60 47/53 46/60 29,501,159 32,685,511 30,837,319 36,789,659	2000 2001 2002 2003 2004 2005 2006 2007 2008 2009 4,818,517 9,683,039 10,645,638 11,209,271 14,148,266 15,501,159 17,843,978 21,685,511 22,787,319 28,789,659 11,375,000 10,400,000 9,400,000 9,300,000 14,000,000 12,600,000 11,000,000 8,000,000 16,193,517 20,083,039 20,045,638 20,209,271 23,448,266 29,501,159 30,443,978 32,685,511 30,837,319 36,789,659 70/30 52/48 47/53 46/60 47/53 43/57 34/67 26/74 22/78	2000 2001 2002 2004 2005 2005 2007 2008 2009 4,818,517 9,683,039 10,645,638 11,209,271 14,148,266 15,501,159 17,843,978 21,685,511 22,787,319 28,789,659 11,375,000 10,400,000 9,400,000 9,300,000 14,000,000 17,000,000 8,050,000 8,050,000 16,193,517 20,083,039 20,045,638 20,209,271 23,448,266 29,501,159 30,443,978 32,685,511 30,837,319 36,789,659 70/30 52/48 47/53 46/60 47/53 43/57 34/67 26/74 22/78 NRSBU Debt and Equity	2000 2001 2002 2004 2005 2006 2007 2008 2009 4,818,517 9,683,039 10,645,638 11,209,271 14,148,266 15,501,159 17,843,978 21,685,511 22,787,319 28,789,659 11,375,000 10,400,000 9,400,000 9,300,000 14,000,000 17,600,000 8,050,000	2000 2001 2002 2003 2004 2005 2005 2007 2008 2009 4,818,517 9,683,039 10,645,638 11,209,271 14,148,266 15,501,159 17,843,978 21,685,511 22,787,319 28,789,659 11,375,000 10,400,000 9,400,000 9,300,000 14,000,000 12,600,000 11,000,000 8,050,000 16,193,517 20,083,039 20,045,638 20,209,271 23,448,266 29,501,159 30,443,978 21,685,511 30,837,319 36,789,659 70/30 52/48 47/53 45/55 40/60 47/53 43/57 34/67 26/74 22/78 60,000,000 50,000,000 10,000,000 <td< th=""></td<>



Nelson Regional Sewerage Business Unit Debt and Equity Projection without Owners Distribution

Assumptions 1. No payment of surplus to shareholders 2. No allowance for revaluations	surplus to share	holders									
	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Equity Debt Debt + Equity	27,467,421 10,000,000 37,467,421	27,467,421 28,956,221 30,112,221 10,000,000 17,071,859 22,103,155 37,467,421 46,028,080 52,215,376	30,112,221 22,103,155 52,215,376	32,150,221 20,928,967 53,079,189		34,296,221 36,390,221 20,353,229 25,137,802 54,649,451 61,528,023	36,390,221 38,683,221 25,137,802 28,302,848 61,528,023 66,986,069	41,252,221 44,037,221 29,871,391 27,685,638 71,123,613 71,722,860	44,037,221 27,685,638 71,722,860	46,996,221 26,360,360 73,356,582	50,144,221 24,282,014 74,426,236
Debt/Equity Ratio		27/63	42/58	39/61	37/63	41/59	43/57	42/58	39/61	36/64	33/67

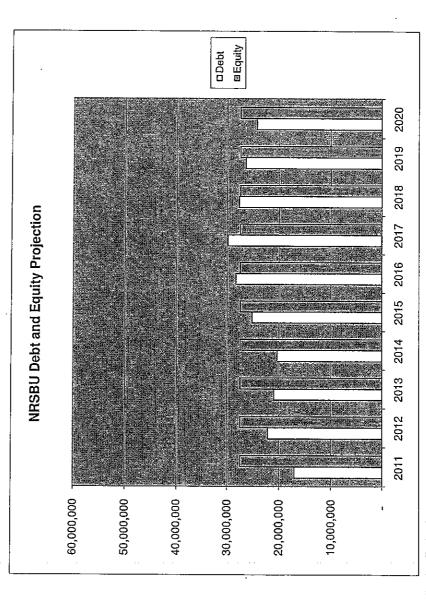


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Nelson Regional Sewerage Business Unit of Debt and Equity Projection with Owners Distribution

Assumptions
1. Operating surplus returned to shareholders

2020	27,467,421 24,282,014	49,436	47/53
ิ		51,7	47
2019	27,467,421 26,360,360	53,827,782	49/51
2018		55,153,060	50/50
2017	27,467,421 29,871,391	57,338,813	52/48
2016	27,467,421 27,467,421 28,302,848 29,871,391	55,770,269	51/49
2015	1	52,605,223	48/52
2014	27,467,421	47,820,651	43/57
2013	27,467,421 20,928,967	40,330,333	43/57
2012	22,103,155	49,070,070	45/55
2011	1 27,467,421 27,467,4 0 17,071,859 22,103,1	44,555,650	28/62
revaluations 2010	27,467,421 10,000,000	# 13t. 10t. 10	
 No allowance for revaluations 2010 	Equity Debt		Debt/Equity Ratio



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3,464,000 4,086,000

4,133,000 3,504,000

4,165,000 3,531,000

3,583,000 4,226,000

4,177,000

4,006,000 3,397,000

3,430,000 3,376,000 2,909,000 2,863,000

3,458,000 2,933,000

2,921,000 2,478,000

2,726,000 2,312,000

Tasman District

1,030,000

1,032,000

1,033,000

1,037,000

920,000

857,000

921,000 825,000

933,000

530,000

744,000

Owners Distribution to each Council

10 Year Forecast of Contributions and Distributions Nelson Regional Sewerage Business Unit

	Projection	į				Fo	Forecast				
	10/11	11/12	12/13	13/14	14/15	15/16	16/17	17/18	18/19	19/20	16/06
Income									77.07	17/20	40121
Contributors	6,902	7,396	8,498	8,429	8,297	9.843	10.264	10 384	10.233	10.155	lason
Interest			-			_	-	-	-	10,172	10,040
Other Recoveries	224	195	195	195	195	195	195	195	195	195	195
Total Income	7,127	7,592	8,694	8,625	8,493	10,039	10,460	10,580	10,429	10,351	10,236
Expenditure											
Operations & Maintenance	3,175	3,521	3,510	3,521	3,428	4,363	4,413	4,382	4,380	4.392	4.418
Interest	812	1,315	1,437	1,382	-	1,796	1,840	1 758	1,616	1,528	1,392
Insurance	25	25	25	25	25	25	য়	25	25	25	25
Depreciation	1,626	1,671	1,856	1,856	1,856	2,142	2,342	2,342	2,342	2,342	2,342
Total Operating Cost	5,638	6,532	6,828	6,784	6,843	8,326	8,620	8,507	8,363	8,287	8,177
Surplus/Deficit	1,489	1,060	1,866	1,841	1,650	1,713	1,840	2,073	2,066	2,064	2,059
Use of Funds			•			-					•
Loan Repayment	1,575	1,299	1,174	1,226	1,715	1,835	1,261	2,186	1,355	2,078	1,489
Kenewais	51	372	682	630	141	307	3,911	156	1,017	264	2,275
Owners Distribution	1,489	1,060	1,866	1,841	1,650	1,713	1,840	2,073	2,066	2,064	2,059
Upgrades	8,647	6,330	0	650	6,500	2,000	0	0	0	0	0
	11,762	9,061	3,722	4,347	10,006	8,855	7,012	4,415	4,438	4,406	5,823
Sources of Funds Surplus/Deficit	1.489	1.060	1.866	1.841	1.650	1 713	840	2 073	2 066	790 6	- 050 6
Depreciation	1,626	1,671	1,856	1,856	1,856	2,142	2,342	2,342	2,342	2,342	2,342
New Loans	8,647	6,330	0	650	6,500	2,000	2,830	0	30	0	1,422
	11,762	9,061	3,722	4,347	10,006	8,855	7,012	4,415	4,438	4,406	5,823
Contributions Nelson City	2,726,000	2,921,000	3,458,000	3,430,000	3,376,000	4,006,000	4,177,000	4,226,000	4,165,000	4,133,000	4,086,000

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