

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

***THAT 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.***

***AND THAT 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*

***THAT 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***

*Kemphorne/Thomas*

*Carried*

*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.

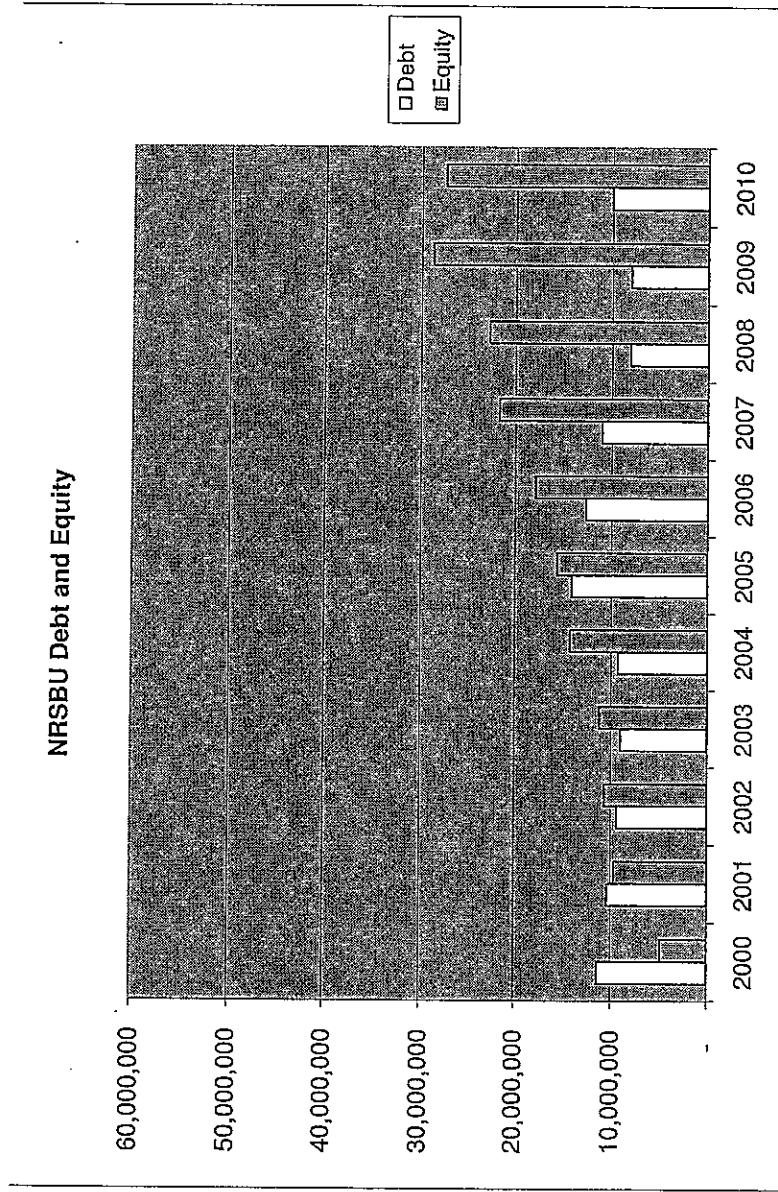
Appendix B: 10 year Projection of Debt and Equity without Owners' Distribution.

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.

Nelson Regional Sewerage Business Unit History of Debt and Equity

	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
Equity	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	27,467,421
Debt	11,375,000	10,400,000	9,400,000	9,000,000	9,300,000	14,000,000	12,600,000	11,000,000	8,050,000	8,000,000	10,000,000
Debt + Equity	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	37,467,421
Debt/Equity Ratio	70/30	52/48	47/53	45/55	40/60	47/53	43/57	34/67	26/74	22/78	27/73

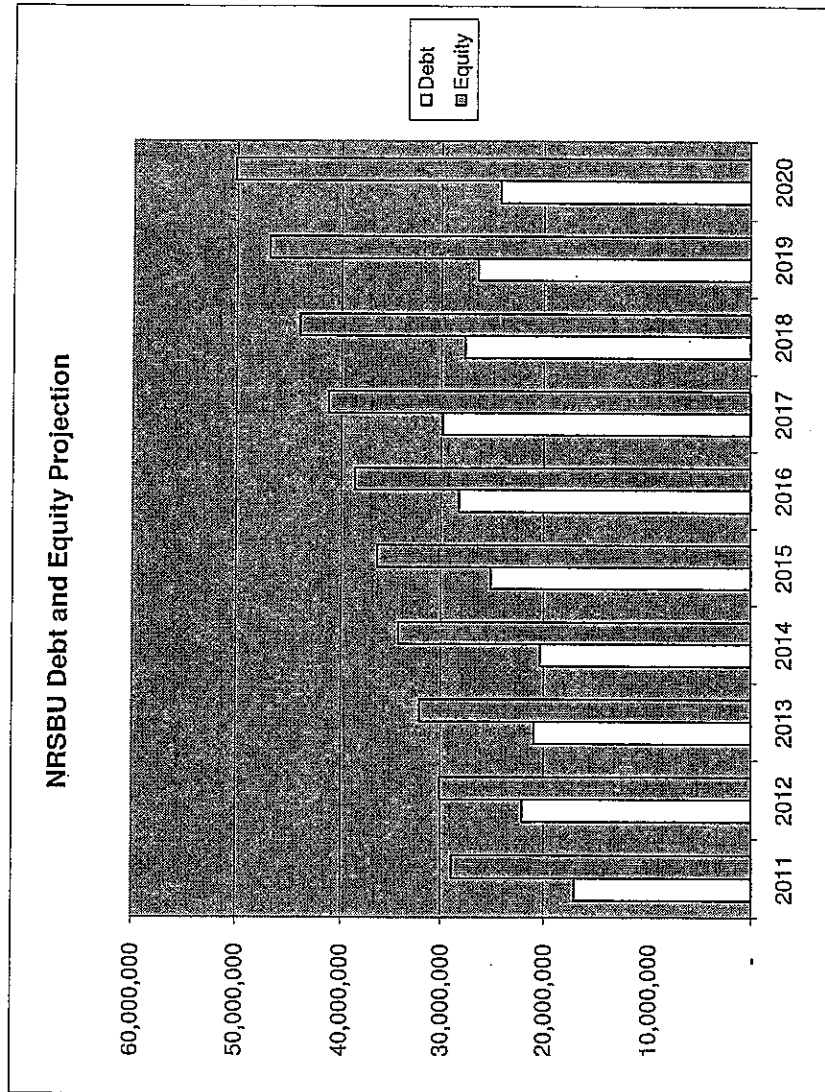


### Nelson Regional Sewerage Business Unit Debt and Equity Projection without Owners Distribution

**Assumptions**

1. No payment of surplus to shareholders
2. No allowance for revaluations

	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Equity	27,467,421	28,956,221	30,112,221	32,150,221	34,296,221	36,390,221	38,683,221	41,252,221	44,037,221	46,996,221	50,144,221
Debt	10,000,000	17,071,859	22,103,155	20,928,967	20,353,229	25,137,802	28,302,848	29,871,391	27,685,638	26,360,360	24,282,014
Debt + Equity	37,467,421	46,028,080	52,215,376	53,079,189	54,649,451	61,528,023	66,986,069	71,123,613	71,722,860	73,356,582	74,426,236
Debt/Equity Ratio	27/63	42/58	39/61	39/61	37/63	41/59	43/57	42/58	39/61	36/64	33/67



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

**Assumptions**

1. Operating surplus returned to shareholders
2. No allowance for revaluations

	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Equity	27,467,421	27,467,421	27,467,421	27,467,421	27,467,421	27,467,421	27,467,421	27,467,421	27,467,421	27,467,421	27,467,421
Debt	10,000,000	17,071,859	22,103,155	20,928,967	20,353,229	25,137,802	28,302,848	29,871,391	27,685,638	26,360,360	24,282,014
Debt + Equity	37,467,421	44,539,280	49,570,576	48,396,889	47,820,651	52,605,223	55,770,269	57,338,813	55,153,060	53,827,782	51,749,436
Debt/Equity Ratio	28/62	45/55	43/57	43/57	43/57	48/52	51/49	52/48	50/50	49/51	47/53

