

# HURUNUI DISTRICT COUNCIL

## POLICY

### INTERNAL FINANCING



<b>Adopted:</b>	Council meeting 28 June 2018
<b>Replaces:</b>	Internal Financing Policy 25 June 2015
<b>Review date:</b>	<b>2021</b>

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#### Introduction

Council has developed a system of internal financing for various activities within the organisation. The system is designed to provide funding for communities to meet the cost of capital expenditure rather than setting its rates at a level to cover the entire cost in the year that it is incurred. The system allows communities to spread the cost of such capital expenditure over a longer period than just one year.

The system is used instead of the Council specifically setting its rates to cover the cost of depreciation on some of its assets - mainly community assets, such as halls, pools and medical centres.

The internal financing system is applicable those activities that are funded by a Targeted Rate, which requires the Council to ensure that the funds generated from rates are only applied to that activity, or there is reasons to separately account for an activity. As a result, the internal financing system is applied to the following:

- Ward Amenities
- Roadside Construction
- Household Refuse Collection
- Water Supplies
- Sewerage Schemes
- Stormwater and Drainage Schemes
- Medical Centres
- Foreshore Protection Schemes
- Special Funds including Development Contribution Funds
- Hanmer Springs Thermal Pools and Spa

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#### Mechanics of the System

Each activity has a capital balance, which in essence is an individual bank account for that activity. Receipts from that activity – Rates, Fees & Charges, and Development Contributions etc. – are deposited into that account. Payments for that activity – Employment Costs, Direct Operating Expenditure, Council Overheads etc. and Capital Expenditure – are withdrawn from that account. The result is that at any stage, that bank account may be in funds or it could be overdrawn.

Like most bank accounts, if there are funds in the account from that activity, then the Council will pay interest to that activity. Conversely, if the bank account is overdrawn, then that activity will be charged interest.

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**Debt Repayment and Depreciation Funding**

There is also a need for those activities whose bank accounts are overdrawn to make provision to get out of overdraft. This is most likely done by setting rates at a level to not only pay the annual operating costs and interest charge, but to also fund additional amounts that will offset the overdraft. The Council's policy is that debt should be repaid over 20 years (or such term Council deems appropriate in particular circumstances). Communities will need to consider that requirement when recommending any rate increases to Council for the Long Term Plan or Annual Plans.

For Three Waters Assets (Water, Sewer and Stormwater) and the Hanmer Springs Thermal Pools and Spa Assets there is the requirement for the activity to fully fund depreciation, although this may be staged depending on compliance with Council's approved rate increase limits. The cash generated by increasing rates to cover the cost of depreciation will be used to repay debt within the internal financing structure.

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**Increasing the Account**

As a way of increasing the account so communities are in a position to cover some or all of the cost of major capital projects in the future, the communities are encouraged to continue setting its rates at a level to cover the annual operating cost but also additional amounts (as a deemed affordable) which will increase the balance of the account. As a result, there will be a number of activities whose bank accounts will increase over time, with the knowledge that those funds will be utilised on capital expenditure. This will be particularly prevalent for those activities on which depreciation is funded.

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**Interest Component**

To ensure consistency throughout the entire organisation, with the exception of the Hanmer Springs Thermal Reserve, the interest rates have been set as follows:

- Interest rate on Overdrawn Activity Accounts is charged interest at 100 basis points (1%) above the interest rate that Council is charged for any external debt.
- Interest rate on Activity Accounts in funds received interest at the interest rate that the Council receives on its call accounts.
- As the Hanmer Springs Thermal Pools and Spa activity is of a commercial nature, there is an increased level of risk involved and as such, the interest rate charged has been increased to reflect this level of risk. The rate charged for any debt drawn down by the Hanmer Springs Thermal Pools and Spa is set at 200 basis points (2%) above the Council's external cost of capital.

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**Use of Interest**

All interest derived from internal financing is accumulated by the Council's treasury function. Costs associated with treasury, such as any external interest, external advice, and Council overheads, are paid from the interest derived with the overall surplus from the treasury function used actively to offset the District Rate requirement.

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END OF POLICY