UTTERLY UNIQUELY
UPPER HUTT CITY
UPPER HUTT CITY COUNCIL

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28 FEB 2000

FILE No.		0/3/8/1
TO NOTE	INIT	DATE
D Benham		
M.Kennedy		
TO ACTION		

The Wellington Regional Council
PO Box 1 l-646
WELLINGTON

Attention: ***Mr D Benham,***
Divisional Manager Utility Services

Mr M Kennedy,
Strategy & Asset Manager

File: 329/1/3
MH/LAM
lam/MSO/Feb.21 wrc

Contact:
Marilla Hood

24 February 2000

Dear Sirs

WELLINGTON REGIONAL COUNCIL WATER GROUP
LONG TERM FINANCIAL STRATEGY

Upper Hutt City Council thanks you for the opportunity to comment on the Water Group Long Term Financial Strategy.

At our Council's meeting last evening, I was asked to forward to you a copy of Mr Wallach's report on this matter. It is attached for your information.

Council also conveyed that it would expect the Wellington Regional Council to annually review the levy reduction to see if it could be bettered, rather than just sustained.

Again, we appreciate the opportunity to comment, and if you have any enquiries on Council's submission, please do not hesitate to contact Mr Wallach, Director of Operations.

Yours faithfully

M Hood

Marilla Hood
MANAGEMENT SERVICES OFFICER

47653

CHAIRMAN AND MEMBERS
POLICY and FINANCE COMMITTEE (February 2000)

Item: A.9
File: 329/ 1/3
LKW:JMS
reports:lachlan - wrc

9 February 2000

WELLINGTON REGIONAL COUNCIL WATER GROUP – LONG TERM FINANCIAL STRATEGY – INVITATION TO COMMENT

PURPOSE

To respond to the Wellington Regional Council's invitation to comment on the development of the Water Groups long term financial strategy in relation to future water levies.

BACKGROUND

The Wellington Regional Council Water Group has produced a proposed long term financial strategy (copy attached) and has invited comments from the four cities in the Wellington metropolitan area. The long term financial strategy will effect the bulk water supply levies payable in the future by the four cities. Comments will enable the WRC to consider the views of the four Cities on the long term financial strategy in its draft Annual Plan for 2000/2001. There will be further opportunity for Council to comment as part of the consultation over the WRC draft Annual Plan.

Wellington Regional Council officers have suggested to the Utility Services Committee of the Regional Council that a levy reduction of up to 4% is sustainable for 2000/01 and subsequent years.

The Wellington Regional Council has asked for comment on future water levies and debt levels having particular regard to the following issues:

- Provision of a quality water supply in accordance with changing standards.
- Providing the required quantity of water to meet the future demand.
- Stability in the levy so that any changes between years is minor.
- Ensuring there is no deferred maintenance.
- Funding future capital works.

- Providing for inter-generational equity.
- Prudent interest rate risk management.
- Compliance with the Local Government Amendment Act No. 3 1996 with regard to fully funding depreciation.

DISCUSSION

Provision of a quality water supply in accordance with changing standards:

The bulk water supply should comply with the current New Zealand Drinking Water Standards. The Te Marua Water Treatment Plant is already graded A and Council should support funding for the other treatment plants in the system to be upgraded to the same standard. However, where it is only a possibility that turbidity requirements may change and a standard may be set for supematant water, allowance should not be made in the long term financial strategy for additional expenditure.

Providing the required quantity of water to meet future demand.

The main driver for development of a new water source would be an increase in population. The Wellington Regional Council report presents two population growth scenarios, i.e. a high projection and a mid projection. The mid projection growth will not create a water supply problem in the next 20 years whereas the high growth scenario predicts a shortfall around 2020. Present indicators seem to suggest that a mid growth projection is more realistic. Population increases would also probably happen gradually over a period of years, which should give ample warning of the need to proceed with an additional water source. At this stage use of the high growth projection as the basis for modelling would seem to be unnecessarily conservative and it would be more appropriate for future demand needs to be based on the mid projection for population growth.

Based upon the high growth projection the proposed long term financial strategy includes provision of $4M to develop a new source about 2020. Given the unlikely occurrence of the high growth projection and the periodic review of the long term financial strategy the incorporation of a $4M provision appears unnecessary at this point.

Whilst the use of a mid growth projection may not indicate a need for new sources within the planning period, nevertheless, as part of a responsible asset management plan consumption forecasts, continuing investigations and preliminary planning for new water sources should continue.

Stability in the levy so that any changes between years is minor:

Any reduction in the levy as a result of increased efficiencies would be acceptable. However, unlike the City reticulation networks where the replacement of assets is continuous, the bulk water system comprises a relatively small number of highly valued assets. This could lead to significant fluctuations in the level of capital expenditure required. To reduce the impact of this on the four Cities we would expect to be provided with long term levy projections based upon prudent asset management requirements. We would expect the Wellington Regional Council to use funding mechanisms (excluding the use of reserves) which smoothed the funding peaks.

Ensuring there is no deferred maintenance:

It is not necessary to have no deferred maintenance. Provided it is not of an urgent nature a quantum of deferred maintenance is acceptable to smooth expenditure provided that the long term financial plan ensures that the work is completed within a period that does not place the asset at risk.

Funding future capital works:

Generally the Wellington Regional Council funds capital expenditure from the annual depreciation. This is the same mechanism used by Upper Hutt City Council. However, the Wellington Regional Council also put into reserve each year $885,000.00 to cover capital expenditure that is of a refurbishment nature. Council should not support the use of such a reserve. It raises inter-generational equity questions but also the work that it is being used to fund should be capable of being programmed within an Asset Management Plan and hence funded from the depreciation charges each year as for the other capital works.

Providing for inter-generational equity:

Providing for inter-generational equity is intended to ensure that the costs of providing services are spread reasonably uniformly over the generations receiving those services. It is a particular issue with services provided by infrastructures with very long lives. In theory, debt should mirror the life of the asset. However, in the Wellington Regional Council case this is not feasible, as the average life is at least 50 years for some assets. The Wellington Regional Council is using 30 years for the repayment of debt and considering their assets this is reasonable. Upper Hutt City Council uses 18 years as an average for debt repayment in its own long term financial strategy.

However, the Wellington Regional Council also has a preference to repay all debt some years before a major new debt loading is required so as to reduce the impact of servicing the new debt. They consider that this more fairly spreads the burden across the generations.

Firstly, it is questionable whether this does fairly spread the burden across the generations. If debt was reduced to zero prior to a major capital expenditure being required, then the current generation could be paying for all the existing infrastructure plus a share of future infrastructure whereas the driver for the additional expenditure e.g. increased population would only pay a share of the new capital.

Secondly, the philosophy of repaying all debts some years before a major new debt loading is required is based upon the unlikely high population growth scenario. The impacts on inter-generational equity through repayment of all debt under the medium population growth scenario must be considered.

Where sustainable savings in operational costs can be achieved these should be reflected in lower costs the four Cities rather than an accelerated debt repayment.

Prudent interest rate risk management:

The Wellington Regional Council report discusses the impact of increased interest rates on high levels of debt. If interest rates rise then a larger levy may be required to meet increased interest costs but alternatively the debt repayment period could be extended and thus not require a levy increase. If they lowered the debt levels to reduce the exposure to interest rate increases this could impose a greater burden on the current generation.

The risk from interest rate fluctuations over the time frame being looked at appears to be adequately covered by the Wellington Regional Council. Interest rates will always have peaks and troughs and for that reason, the chart within the Wellington Regional Council report showing debts scenarios as interest rate of 9.5% is probably an acceptable scenario.

Compliance with the Local Government Amendment Act No. 3 - 1996 with regarding to fully funding depreciation:

Audit opinion given to this Council is that it is not necessary to fully fund depreciation provided it can be shown that the funding being provided is sufficient to maintain the assets within their life cycle.

Wellington Regional Council is currently fully funding depreciation. If a significant amount of that funding is going towards debt reduction then the justification and benefits need to be reviewed.

CONSULTATION:

Council is responding to a request from the Wellington Regional Council to comment upon wholesale water prices and their proposed long term financial strategy.

LEGAL CONSIDERATIONS:

No legal considerations have been identified.

FINANCIAL CONSIDERATIONS:

The report prepared by the Wellington Regional Council suggests that a 4% reduction in the bulk water levy is sustainable. Having reviewed the Wellington Regional Council's report and considered the drivers that can effect the trade off between levy and debt repayments a reduction in the bulk water levy of 4% for 2000/2001 and sustained for the future would seem realistic although the strategy should continually be reviewed to see if this can be bettered and operational savings included. The mid growth scenario should also be modelled to see if the 4% can be bettered. The final amount of the bulk water levy depends on usage however; a 4% reduction would indicate a saving to Upper Hutt City Council of about $lOO,OOO.OO.

SUMMARY

The Wellington Regional Council has invited comment from the four Cities in the Wellington metropolitan area on their proposed long term financial strategy for the water group. The long term financial strategy has been considered in relation to a number of drivers and the conclusion is that under a high growth scenario a 4% reduction in the levy for 2000/2001 is realistic and can be sustained in the future although the amount should be reviewed annually to see if it can be bettered and include gains from operational efficiencies. Examination of the drivers also suggests that:

- The Wellington Regional Council should be using the mid growth scenario for determining demand and debt management policy.
- Along with the use of a high growth scenario the allowance for future possible water sources and treatment that is only a possibility results in very conservative projections.
- A policy of repaying all debt some years before a major new debt loading is required could adversely impact upon inter-generational equity particularly when that policy is based on the conservative high population growth scenario.
- The funding of a refurbishment reserve from depreciation possibly indicates an incomplete asset management plan that is resulting in conservative decisions.

Overall consideration of the drivers suggests that the adoption of the high projection growth scenario is leading to a conservative strategy. Before adopting a long term financial strategy, the Wellington Regional Council should at least consider the mid growth scenario and examine whether or not current proposals are leading to an unnecessarily conservative strategy that may not be in the best interests of the users.

RECOMMENDATIONS:

1. **THAT** this report be received.

2. **THAT** a copy of this report be forwarded to the Wellington Regional Council in response to their request for comments on the Water Group's long term financial strategy.

3. **THAT** the Wellington Regional Council be advised that Council would expect the levy reduction to be annually reviewed to see if it can be bettered and not just sustained.

Lachlan Wallach
DIRECTOR, OPERATIONS

7/00 **BULK WATER LEVY FOR 2000/2001 & THE WELLINGTON REGIONAL COUNCIL LONG TERM FINANCIAL STRATEGY**
Report of the Group Manager Utilities Policy dated 2 February 2000
(ENCL.6, PAGE 42)

RESOLVED TO RECOMMEND TO COUNCIL,

That:

(a) *the Wellington Regional Council be advised that Porirua City Council believes that the assumptions in their financial model relating to population projections, and the non-inclusion of inflation, result in their analysis being conservative;*

(b) *based on this information Porirua City Council believes that the Wellington Regional Council should reduce the bulk water levy for the 2000/2001 year by 4% and in the subsequent 2 years that the levy not be increased.*

Chairperson/Walpole

8/00 **ESTABLISHMENT OF PERFORMANCE LEVELS FOR WATER AND DRAINAGE SERVICES**
Report of the Group Manager Utilities Policy dated 7 February 2000
(ENCL.7, PAGE 45)

RESOLVED

That the report be received.

Chairperson/Palmer

Officers were requested to provide a report identifying low water pressure areas in the city and solutions to rectify that problem.

9/00 **STREET LIGHT UPGRADING**
Report of the Group Manager Utilities Policy dated 10 January 2000
(ENCL.8, PAGE 52)

RESOLVED TO RECOMMEND TO COUNCIL

That:

(a) *the $80,000 that had been allocated for the undergrounding completion work be allocated to street light upgrading in the current year; and*

(b) *Council include $105,000 in the 2000/2001 Draft Annual Plan for a continuation of the street lighting upgrading programme.*

Chairperson/Green

ENCL 6
Files: EN/5/1
AD/9/2

PORIRUA CITY COUNCIL

Utilities Policy Group
2 February 2000

Chairperson and Members
SERVICES COMMITTEE

BULK WATER LEVY FOR 2000/2001 & THE WELLINGTON REGIONAL COUNCIL LONG TERM FINANCIAL STRATEGY

INTRODUCTION

The Chairperson of the Utility Services Committee of the Wellington Regional Council (Councillor Euan McQueen) has written to the Chairperson of the Services Committee seeking comment on the bulk water levy into the future. Last year this Council, in conjunction with Upper Hutt, Wellington City and Hutt City made a submission to the Wellington Regional Council requesting a reduction in the bulk water levy of 4%. This represented a saving to Council of $100,000 and this is shown as a surplus in the current Annual Plan. Wellington Regional Council officers have now suggested to the Regional Council that a further levy reduction of up to 4% is sustainable for the year 2000/2001. The Wellington Regional Council did not make a decision on this but preferred to consult with the four Councils in the region.

Comment from the four cities on this issue will enable the Wellington Regional Council to incorporate these views in their Draft Annual Plan for 2000/2001 and their Long Term Financial Strategy.

WELLINGTON REGIONAL COUNCIL'S PROPOSAL

In considering the setting of a levy the Wellington Regional Council has indicated that a number of issues need to be considered:

- Providing the required quantity of water to meet future demand
- Stability in the levy so that any changes between years is minor
- Ensuring there is no deferred maintenance
- Funding of future capital works
- Providing for inter-generational equity
- Prudent interest rate risk management
- The requirement to fund depreciation.

In their analysis the Wellington Regional Council have used a high growth projection. Based on these population projections they have provided a sum of $4 million to develop a new source of water in the year 2017 to 2020. The next significant capital investment is not required until 2026 when the cost of further source development is estimated to cost $15 million, Debt management is also an issue for the Wellington Regional Council with a debt of $80 million as at June 1999. This is compared to a recent asset revaluation of the Wellington Regional Council bulk water assets of $256 million. The higher the level of debt carried then the higher the exposure to interest cost increases if interest rates rise. The advice they have received from Bancorp indicates they should have a target debt level of $53 million based on the current level of water levy. The Wellington Regional Council openly admits that it is a matter of judgement as to the time taken to reach this target level of $53 million.

COMMENT

It is not clear why the Wellington Regional Council has shown a high growth projection for the population served by the bulk water supply. Population growth estimates are based on birth rates, death rates and migration, and this Council's economist advises that based on recent trends, the mid-growth projection is more likely than the high growth. Also, population increases will happen gradually over a number of years and there will be ample opportunity foi the Wellington Regional Council to review its Long Term Financial Strategy. With an indication that $4 million could be required in the year 20 17 under the high growth scenario, it is expected that the expenditure would be deferred beyond 2020. The Wellington Regional Council have not been able to provide us with details on the impact of a mid-population growth projection.

The Wellington Regional Council also indicates that the values in the model are expressed in today's dollars and are not adjusted for inflation. The real cost of debt servicing deflates over time as inflation erodes the real cost of the borrowed money. It appears that the model does not allow for this and therefore overstates the cost of debt servicing. Even at a modest level of inflation (say 2% per annum) the effect is quite significant where the sums of money involved are large, as in this case.

Considering the target debt level of $53 million and a maximum capital cost prior to 2027 of $19 million, a debt position prior to construction of a new water source of between $20 and $25 million would still be comfortably within the targets for debt proposed by the Regional Council.

Although the Wellington Regional Council indicate that a high level of debt exposes the Regional Council to risks from fluctuations in interest rates, it needs to be recognised that much of the Regional Council's debt is at fixed interest rates and for terms of some years. Hence average costs of rates of interest moves very little from year to year. Therefore there is a very low risk of significant fluctuations in interest rates.

The Wellington Regional Council also indicate that it will be preferable to have repaid all debt some years before a major new debt loading is required so as to reduce the impact of servicing the new debt. This is questionable from an inter-generational equity perspective. It is reasonable to spread the debt for water supply assets over their life so that the generation that benefits from them also pays for them. It is therefore quite reasonable for debt to be carried over and overlap with future capital requirements.

CONCLUSION

The financial modelling work for the Wellington Regional Council's calculation of the 2000/2001 bulk water levy and their Long Term Financial Strategy contains a number of conservative assumptions. These include assumptions on population projections, does not include adjustments for inflation and also they overstate the interest rate risk.

In combination these assumptions are very conservative. Therefore we believe that not only is a bulk water levy reduction of 4% achievable for the 2000/2001, year but that the bulk water supply price should remain constant in dollar terms for at least the next 2 years. This would result in further real reductions in the cost of water in each of the next 2 years as inflation reduces the real value of the bulk water levy. These levy adjustments will still achieve the Regional Council target debt levels in a reasonable time frame.

Accordingly, it is suggested that:

1. The Regional Council be advised that this Council believes that the assumptions in their financial model relating to population projections, and the non-inclusion of inflation, result in their analysis being conservative.

2. Based on this information this Council believes that the Wellington Regional Council should reduce the bulk water levy for the 2000/2001 year by 4% and in the subsequent 2 years that the levy ~~remain unchanged~~. not be increased
and no further increase for the subsequent

T M Davin
GROUP MANAGER UTILITIES POLICY

Stephen Garlick
Street Services
(04) 570-6857
(04) 570-6868
stephen.garlick@huttcity.govt.nz
FN35-62-10B

23 February 2000

Cr Euan McQueen
Chairperson
Utility Services Committee
Wellington Regional Council
PO Box 11-646
WELLINGTON

Dear Euan

The long term financial strategy of the Water Group was considered by the Works & Services Committee at its meeting on 22 February 2000.

The Committee agreed to forward the attached submission to the Regional Council, as Hutt City Council's response to your invitation to comment.

We appreciate your invitation to provide input to this issue and hope that our comments are helpful.

Yours sincerely

Councillor Joy Baird
CHAIRPERSON
WORKS & SERVICES COMMITTEE

copy to: David Benham
Divisional Manager, Utility Services
Wellington Regional Council
PO Box 11646
WELLINGTON

FN35-62-10B

Response from Hutt City Council to the Invitation to Comment on the Wellington Regional Council Water Group Long; Term Financial Strategy

As requested in recommendation 3 of Report No 99.717 "The Water Group Long Term Financial Strategy", the following comments on the Water Group Long Term Financial Strategy are within the context of the drivers set out in Section 8 of that report.

Provision of a quality water supply in accordance with changing standards.

1. The bulk water supply should comply with the New Zealand Drinking Water Standards for the current gradings.

2. Hutt City Council believes that the current standard of the bulk water supply is generally very good and significant upgrading of quality is not necessary now and will not be in the foreseeable future. It is accepted that some relatively minor upgrading may be necessary to resolve localised quality issues.

3. The Long Term Financial Strategy should ensure maintenance of the current quality of supply and only provide for upgrading which may be necessary to resolve specific localised problems.

Providing the required quantity of water to meet future demand.

1. In its financial modelling the Wellington Regional Council (WRC) has used the Statistics New Zealand high projection for population growth in the Wellington area instead of the mid projection. Population increases will probably happen gradually over a period of years, which should give ample warning of the need to proceed with an additional water source or any other major capital expenditure. The use of the high projection for population growth is unnecessarily conservative at this point in time. It would be more appropriate for the Long Term Financial Strategy to be based on the mid projection for population growth. . This would also reflect both our own opinion and our consultant's advice in respect of population growth modelling for the Hutt Valley & Wainuiomata Wastewater Project.

2. The high projection for population growth indicates that a new water source would be required about 2020. Provision of $4m in the Long Term Financial Strategy has been made for this water source. The Long Term Financial Strategy will be reviewed periodically and this will enable the

financial impact of a new water source to be incorporated if circumstances change. The $4m provision therefore appears unnecessary at this point.

3. Section 6 (2) of the WRC report on the Water Group Long Term Financial Strategy states the *"next significant amount of capital expenditure is not expected until approximately 2026. Our best estimates are that this would be of the order of $15m"*. This projection is also based on the high population growth projection. For similar reasons to those set out in 2 above the inclusion of the $15m in the Long Term Financial Strategy also appears premature.

4. Continuing investigations and preliminary planning for a new water source are supported as a prudent contingency against the high growth scenario actually occurring.

5. We request the Regional Council to consider and advise how a situation would be managed where the need for a new water source resulted from growth in only one part of the region. We believe that in this situation it would be unfair for the cost of the new water source to be spread over the entire region which is what would occur under the current pricing system for bulk water supply.

Stability in the levy so that any changes between years is minor.

1. It is hoped that ongoing efficiencies will enable operational costs for bulk water supply to be progressively reduced and that these will continue to be reflected in lower bulk water costs to the four cities.

2. Funding of depreciation funding should be used to help smooth the impact of fluctuations in the level of capital expenditure. Loan funding should be used as a further smoothing mechanism as required.

3. Apart from funding for depreciation, the establishment of funds or the retention of savings as a buffer against cost fluctuations is not supported.

Ensuring There is No Deferred Maintenance.

1. An objective to ensure there is no significant accumulation of deferred maintenance in the bulk water supply system is supported.

Funding Capital Works.

1. It is helpful for the bulk water capital works programme to be clearly split into the following two categories:

   a. Renewal capital expenditure (expenditure on replacement or refurbishment of existing infrastructure)

   b. Development capital expenditure (expenditure on entirely new infrastructure or major upgrading of existing infrastructure)

2. Funding renewal capital expenditure from the depreciation provision is supported with loan funding being used to bridge short term peaks in renewal expenditure if necessary.

3. Loan funding of development capital expenditure is supported.

4. Any depreciation funding not required for asset renewal should be applied to loan repayment.

Providing for intergenerational equity.

1. The Long Term Financial Strategy states a preference *"to have repaid all debt some years before a major new debt loading is required"*. We believe this is questionable from an intergenerational equity perspective. The Long Term Financial Strategy points out that *"the main driver for development of a new water source will be an increase in population"*. The cost of the new water source would be funded across the entire customer base, not just the increased population. Current generations who would have already paid off the debt for the current infrastructure would also contribute substantially towards the new water source, despite this being required to primarily service the additional population. It is suggested that a bulk water loan repayment programme should be driven primarily by intergenerational equity considerations rather than by objectives which could be considered somewhat arbitrary, such as to repay existing loans before a new water source is required. This is of further concern when the timing of the new water source is being driven by the high and not the mid population growth projection.

2. We would support accelerated debt repayment if this could be funded from asset sales. We would not support accelerated debt repayment if this would lead to higher bulk water costs to current ratepayers.

3. Where sustainable savings in operational costs can be achieved these should be reflected in lower costs to the cities rather than in accelerated debt repayment.

4. In addition to funding for depreciation the Water Group also puts *"into a reserve each year $885,000 to cover capital expenditure that is of a refurbishment nature"*. Asset refurbishment is renewal capital expenditure, which should be funded by depreciation charges. As the bulk water infrastructure is relatively new the level of depreciation funding should be more than adequate to cover asset renewal and refurbishment expenditure. Funding a reserve to cover asset refurbishment, as well as funding for depreciation, appears to be asking the current generation to pay twice and to be inconsistent with the principle of intergenerational equity.

Prudent interest rate risk management.

1. While lower debt levels reduce the exposure to interest rate increases, they also impose a greater burden on the current generation. Budgets should incorporate the effect of professional independent assessments of the most likely trend in interest rates. We do not believe that the possible exposure to interest rate increases justifies compromising intergenerational equity.

Compliance with the Local Government Amendment Act (No 3) 1996 with regarding to fully funding depreciation.

1. It is expected that all legislation will be complied with in the provision of the bulk water supply service.

HUTT CITY COUNCIL

ASSET MANAGEMENT

FN35-62-10B
4 February 2000

The Chairperson and Members
WORKS AND SERVICES COMMITTEE

WRC WATER GROUP LONG TERM FINANCIAL STRATEGY – INVITATION TO COMMENT

Report No. WS2000/2/4

RECOMMENDATIONS:

That the Committee:

(i) notes that the Wellington Regional Council Water Group has produced a Long Term Financial Strategy and has invited comment from the four cities in the Wellington metropolitan area;

(ii) notes that the Long Term Financial Strategy will affect the Bulk Water supply levies payable in the future by the four cities; and

(iii) agrees to the draft response in Appendix 1 of this report being forwarded to the Wellington Regional Council as Hutt City Council's response to the invitation to comment.

1. REPORT SUMMARY

1.1 The Wellington Regional Council (WRC) has invited comment from the four cities in the Wellington metropolitan area on the Long Term Financial Strategy for the Water Group.

1.2 As requested by the WRC, the Long Term Financial Strategy has been considered in relation to a number of drivers including quality, security, cost, funding, equity, financial management and legislative compliance.

1.3 A draft response to the invitation to comment is appended to this report.

2. ISSUES

Background

2.1 The WRC Water Group has produced a Long Term Financial Strategy and has invited comment from the four Cities in the Wellington metropolitan area.

2.2 The Long Term Financial Strategy will affect the Bulk Water supply levies payable in the future by the four cities.

2.3 The opportunity to comment is appreciated and will enable the WRC to incorporate the views of the four cities on the Long Term Financial Strategy in its draft Annual Plan for 2000/2001. There will be an opportunity for further comment as part of the consultation over the draft Annual Plan.

2.4 The WRC has requested that comment from the four cities have particular regard to the following issues:

a. Provision of a quality water supply in accordance with changing standards.

b. Providing the required quantity of water to meet future demand.

c. Stability in the levy so that any changes between years is minor.

d. Ensuring there is no deferred maintenance.

e. Funding future capital works.

f. Providing for intergenerational equity.

g. Prudent interest rate risk management.

h. Compliance with the Local Government Amendment Act (No 3) 1996 with regarding to fully funding depreciation.

2.5 A copy of the WRC report on the Water Group Long Term Financial Strategy and the letter inviting comment are appended to this report.

Provision of a quality water supply in accordance with changing standards

2.6 The bulk water supply should comply with the New Zealand Drinking Water Standards for the current gradings.

2.7 The current standard of the bulk water supply is generally very good and significant upgrading of quality is not necessary now and is not expected to be in the foreseeable future. Some relatively minor upgrading may be necessary to resolve localised quality issues.

2.8 The Long Term Financial Strategy should ensure maintenance of the current quality of supply and only provide for upgrading necessary to resolve specific localised problems.

Providing the required quantity of water to meet future demand

2.9 In its financial modelling the WRC has used the Statistics New Zealand high projection for population growth in the Wellington area instead of the mid projection. Population increases will probably happen gradually over a period of years, which should give ample warning of the need to proceed with an additional water source or any other major capital expenditure. The use of the high projection for population growth is unnecessarily conservative at this point in time. It would be more appropriate for the Long Term Financial Strategy to be based on the mid projection for population growth. This would also reflect both our own opinion and our consultant's advise in respect of population growth modelling for the Hutt Valley & Wainuiomata Wastewater Project.

2.10 The high projection for population growth indicates that a new water source would be required about 2020. Provision of $4m in the Long Term Financial Strategy has been made for this water source. The Long Term Financial Strategy will be reviewed periodically and this will enable the financial impact of a new water source to be incorporated if circumstances change. The $4m provision therefore appears unnecessary at this point.

2.11 Section 6 (2) of the WRC report on the Water Group Long Term Financial Strategy states *the "next significant amount of capital expenditure is not expected until approximately 2026. Our best estimates are that this would be of the order of $15m"*. This projection is also based on the high population growth projection. For similar reasons to those set out in 2.10 the inclusion of the $15m in the Long Term Financial Strategy also appears premature.

2.12 Continuing investigations and preliminary planning for a new water source are supported as a prudent contingency against the high growth scenario actually occurring.

Stability in the levy so that any changes between years is minor

2.13 It is hoped that ongoing efficiencies will enable operational costs for bulk water supply to be progressively reduced and that these will continue to be reflected in lower bulk water costs to the four cities.

2.14 Unlike reticulation networks, the bulk water supply system comprises a relatively small number of highly valued assets. This leads to the likelihood of significant fluctuations in the level of capital expenditure required. The impact of this can be reduced through depreciation funding which provides a relatively uniform level of funding for capital works. Loan funding should be used as a further smoothing mechanism as required.

2.15 Apart from funding for depreciation, the establishment of funds or the retention of savings as a buffer against cost fluctuations is not supported.

Ensuring There is No Deferred Maintenance

2.16 Deferred maintenance does not represent a saving in real terms, but a liability which must be faced in the future. It is an acceptable financial management technique for non urgent maintenance to be deferred where this is necessary to smooth expenditure, as long as this deferred maintenance is kept to low levels, is non urgent in nature and is not allowed to accumulate into a significant maintenance backlog. An objective to ensure there is no significant accumulation of deferred maintenance in the bulk water supply system is supported.

Funding Capital Works

2.17 It is helpful for capital works to be clearly split into the following two categories:

a. Renewal capital expenditure (expenditure on replacement or refurbishment of existing infrastructure)

b. Development capital expenditure (expenditure on entirely new infrastructure or major upgrading of existing infrastructure)

2.18 Renewal capital expenditure should be funded from the depreciation provision with loan funding used to bridge short term peaks in renewal expenditure if necessary.

2.19 Development capital expenditure should be loan funded.

2.20 Any depreciation funding not required for asset renewal should be applied to loan repayment.

Providing for intergenerational equity

2.21 Providing for intergenerational equity is intended to ensure that the costs of providing services, including capital costs, are spread reasonably uniformly over the generations receiving those services. This is a particular issue with services provided by infrastructures with very long lives (such as water systems), where expenditure over the life of the infrastructure may be subject to significant peaks and troughs, while the service provided by the infrastructure remains reasonably constant. Achieving intergenerational equity is one of the objectives of the Local Government Amendment Act (No 3) 1996, in requiring funding for depreciation.

2.22 Achieving intergenerational equity is more difficult with "ringfenced" bulk services where the peaks and troughs in expenditure are likely to be much greater than with more diverse infrastructures.

2.23 In the report on its Long Term Financial Strategy, the WRC has stated a preference *"to have repaid all debt some years before a major new debt loading is required"*. This is questionable from an intergenerational equity perspective. The WRC report points out that *"the main driver-for development of a new water source will be an increase in population". The* cost of the new water source would be funded across the entire customer base, not just the increased population. Current generations who would have already paid off the debt for the current infrastructure would also contribute substantially towards the new water source, despite this being required to primarily service the additional population. It is suggested that a bulk water loan repayment programme should be driven primarily by intergenerational equity considerations rather than by objectives which could be considered somewhat arbitrary, such as to repay existing loans before a new water source is required. This is of further concern when the timing of the new water source is being driven by the high and not the mid population growth projection.

2.24 Where sustainable savings in operational costs can be achieved these should be reflected in lower costs to the cities rather than in accelerated debt repayment.

2.25 In addition to funding for depreciation the Water Group also puts *"into a reserve each year $885,000 to cover capital expenditure that is of a refurbishment nature"*. Asset refurbishment is renewal capital expenditure, which should be funded by depreciation charges. As the bulk water infrastructure is relatively new, the level of depreciation funding should be more than adequate to cover asset renewal and refurbishment expenditure. Funding a reserve to cover asset refurbishment, as well as funding for depreciation, appears to be asking the current generation to pay twice and to be inconsistent with the principle of intergenerational equity.

Prudent interest rate risk management

2.26 While lower debt levels reduce the exposure to interest rate increases, they also impose a greater burden on the current generation. Budgets should incorporate the effect of professional independent assessments of the most likely trend in interest rates. We do not believe that the possible exposure to interest rate increases justifies compromising intergenerational equity.

Compliance with the Local Government Amendment Act (No 3) 1996 with regarding to fully funding depreciation

2.27 It is expected that all legislation will be complied with in the provision of the bulk water supply service.

3. CONSULTATION

3.1 Copies of this report have been forwarded to officers of the other 3 cities in the Wellington metropolitan area.

4. FINANCIAL CONSIDERATIONS

4.1 The Bulk Water Levy payable by Hutt City Council to the Wellington Regional Council is $6.63m in the 1999/2000 financial year. This levy forms part of the Hutt City Council water supply budget. The Long Term Financial Strategy adopted will affect the future level of the Bulk Water Levy.

5. LEGAL CONSIDERATIONS

5.1 No legal considerations have been identified beyond the Local Government Amendment Act (No 3) 1996 requirements referred to in this report.

6. INFORMATION TECHNOLOGY CONSIDERATIONS

6.1 There are none.

7. PUBLICITY CONSIDERATIONS

7.1 No publicity considerations have been identified.

8. OTHER CONSIDERATIONS

8.1 No other considerations have been identified.

9. APPENDICES

Appendix 1: Proposed Response to the Wellington Regional Council on the Water Group Long Term Financial Strategy

Appendix 2: Letter from Cr Euan McQueen, Chairperson, Utility Services Committee

Appendix 3: WRC Report No.99.717 "The Water Group Long Term Financial Strategy"

Report prepared by:

Stephen Garlick
Water Services Manager

Approved by:

Stuart Duncan
Deputy Chief Executive
Asset Management

Proposed Response to Invitation to Comment on Wellington Regional Council Water Group Long Term Financial Strategy

As requested in recommendation 3 of Report No 99.717 "The Water Group Long Term Financial Strategy", the following comments are within the context of the drivers set out in Section 8 of that report.

Provision of a quality water supply in accordance with changing standards.

1. The bulk water supply should comply with the New Zealand Drinking Water Standards for the current gradings.

2. Hutt City Council believes that the current standard of the bulk water supply is generally very good and significant upgrading of quality is not necessary now and will not be in the foreseeable future. It is accepted that some relatively minor upgrading may be necessary to resolve localised quality issues.

3. The Long Term Financial Strategy should ensure maintenance of the current quality of supply and only provide for upgrading which may be necessary to resolve specific localised problems.

Providing the required quantity of water to meet future demand.

1. In its financial modelling the Wellington Regional Council (WRC) has used the Statistics New Zealand high projection for population growth in the Wellington area instead of the mid projection. Population increases will probably happen gradually over a period of years, which should give ample warning of the need to proceed with an additional water source or any other major capital expenditure. The use of the high projection for population growth is unnecessarily conservative at this point in time. It would be more appropriate for the Long Term Financial Strategy to be based on the mid projection for population growth.

2. The high projection for population growth indicates that a new water source would be required about 2020. Provision of $4m in the Long Term Financial Strategy has been made for this water source. The Long Term Financial Strategy will be reviewed periodically and this will enable the financial impact of a new water source to be incorporated if circumstances change. The $4m provision therefore appears unnecessary at this point.

3. Section 6 (2) of the WRC report on the Water Group Long Term Financial Strategy states the *"next significant amount of capital expenditure is not expected until approximately 2026. Our best estimates are that this would be of the order of $15m"*. This projection is also based on the high population growth projection.

Appendix 1

For similar reasons to those set out in 2 above the inclusion of the $15m in the Long Term Financial Strategy also appears premature.

4. Continuing investigations and preliminary planning for a new water source are supported as a prudent contingency against the high growth scenario actually occurring.

Stability in the levy so that any changes between years is minor.

1. It is hoped that ongoing efficiencies will enable operational costs for bulk water supply to be progressively reduced and that these will continue to be reflected in lower bulk water costs to the four cities.

2. Funding of depreciation funding should be used to help smooth the impact of fluctuations in the level of capital expenditure. Loan funding should be used as a further smoothing mechanism as required.

3. Apart from funding for depreciation, the establishment of funds or the retention of savings as a buffer against cost fluctuations is not supported.

Ensuring There is No Deferred Maintenance.

1. An objective to ensure there is no significant accumulation of deferred maintenance in the bulk water supply system is supported. However, it is submitted that it is an acceptable financial management technique for non urgent maintenance to be deferred where this is necessary to smooth expenditure, as long as this deferred maintenance is kept to low levels, is non urgent in nature and is not allowed to accumulate into a significant maintenance backlog.

Funding Capital Works.

1. It is helpful for the bulk water capital works programme to be clearly split into the following two categories:

    a. Renewal capital expenditure (expenditure on replacement or refurbishment of existing infrastructure)

    b. Development capital expenditure (expenditure on entirely new infrastructure or major upgrading of existing infrastructure)

2. Funding renewal capital expenditure from the depreciation provision is supported with loan funding being used to bridge short term peaks in renewal expenditure if necessary.

3. Loan funding of development capital expenditure is supported.

4. Any depreciation funding not required for asset renewal should be applied to loan repayment.

Providing for intergenerational equity.

1. The Long Term Financial Strategy states a preference *"to have repaid all debt some years before a major new debt loading is required"*. We believe this is questionable from an intergenerational equity perspective. The Long Term Financial Strategy points out that *"the main driver for development of a new water source will be an increase in population"*. The cost of the new water source would be funded across the entire customer base, not just the increased population. Current generations who would have already paid off the debt for the current infrastructure would also contribute substantially towards the new water source, despite this being required to primarily service the additional population. It is suggested that a bulk water loan repayment programme should be driven primarily by intergenerational equity considerations rather than by objectives which could be considered somewhat arbitrary, such as to repay existing loans before a new water source is required. This is of further concern when the timing of the new water source is being driven by the high and not the mid population growth projection.

2. Where sustainable savings in operational costs can be achieved these should be reflected in lower costs to the cities rather than in accelerated debt repayment.

3. In addition to funding for depreciation the Water Group also puts *"into a reserve each year $885,000 to cover capital expenditure that is of a refurbishment nature"*. Asset refurbishment is renewal capital expenditure, which should be funded by depreciation charges. As the bulk water infrastructure is relatively new the level of depreciation funding should be more than adequate to cover asset renewal and refurbishment expenditure. Funding a reserve to cover asset refurbishment, as well as funding for depreciation, appears to be asking the current generation to pay twice and to be inconsistent with the principle of intergenerational equity.

Prudent interest rate risk management.

1. While lower debt levels reduce the exposure to interest rate increases, they also impose a greater burden on the current generation. Budgets should incorporate the effect of professional independent assessments of the most likely trend in interest rates. We do not believe that the possible exposure to interest rate increases justifies compromising intergenerational equity.

Appendix 1

Compliance with the Local Government Amendment Act (No 3) 1996 with regarding to fully funding depreciation.

1. It is expected that all legislation will be complied with in the provision of the bulk water supply service.