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Report to the Utility Services Committee
from David Benham, Divisional Manager, Utility Services

Utility Services Division : Proposed Operating Plans 1999-2007

1. Purpose

To provide a summary of the Operating Plans for the Utility Services Division. The attached Operating Plans provide a more detailed overview of the 1999/00 budgets.

2. Background

During 1997 a major restructure of the water activities of the Division occurred. This involved significant management changes and overall downsizing in staff numbers. This year, 1998/99 is the first full year that will reflect those changes and the benefits that are expected to accrue.

While significant savings have been achieved operationally, reduced debt levels (as a result of surpluses) and an overall fall in interest rates have also reduced debt servicing costs considerably.

3. Focus For 1999/00

From a water perspective the Committee is well aware of the major issue facing us leading up to this new financial year - water integration. We certainly hope that this financial year we will see the implementation of our integrated water management proposal.

Notwithstanding the larger strategic issues, the focus for 1999/00 will also be on delivering further efficiency savings in our core function, wholesale water supply. In addition our Wellington City Water Contract expires at the end of June 2000 and the contract renewal will again require some careful management.

4. Water Supply Performance

A measure of the improved performance of our operations can be seen in the improved debt position of The Water Group. Lower debt levels, in combination with an interest rate reduction, has a rapid compounding effect on reducing future debt servicing costs and overall debt levels.

Our 1996/97 Annual Plan was predicting debt in 2006/07 at $67.3 M. If we retain the same levy through to 2006/07, then debt will **now** be $34.8 M in 2006/07. This is a revised forecast reduction of $32.5 M. The reduced debt level also impacts positively on interest costs and will reduce annual costs by $2.4 M in 2006/07, when compared to the 1999/00 figure.

Since 1990/91 we have spent $55 M on capital expenditure in improving the performance and operation of the system. We now are in the position of having:

- a modern water supply system with no deferred maintenance.
- improved security of supply which allows water from any of our four sources to be delivered anywhere in our supply area.
- water quality equal to, if not better than, anywhere in New Zealand.
- a water price today which is almost two percent below where it was in 1990/91 after adjustment for inflation.

5. Water Levy 1999/00

Clearly a major issue for us this year is setting the levy for the forthcoming year. Already we have seen pressure from some of the customers suggesting that the levy should be reduced. Given the performance of the operation I think this is an understandable request. My recommendation to you however, is that we retain the levy at the current level for 1999/00. My reasons are as follows:

- The operation we own and manage has assets that tend to be of a long life and indeed the business of providing water to the community is unlikely not to be required. Hence we need to plan well in advance. As you are aware, we will complete the implementation of our computerised asset management system by June 1999. We then plan to look at all those assets, review their useful life and obtain an independent valuation for those assets.
- That exercise will then confirm the adequacy or otherwise of our projected depreciation charge. You will be aware that depreciation is now required to be funded. Currently depreciation is well covered by existing and projected revenue.

- Based on these facts and our projections for future water demand, our capital expenditure requirements into the future will be determined. All this information will then impact on estimated debt levels. We would also propose to obtain independent advice on debt levels given the above information. This would incorporate inter-generational equity issues (ie fair payment by today's ratepayers as opposed to those in the future).

- Once these exercises are completed, which should be by the end of this calendar year, the required levy will be known. Clearly setting the future levy will require the above economic analysis to give the background and rationale for the political judgement that will then need to be made.

- I believe until these exercises are complete, we would be unwise to move the levy.

- Our current policy applies any surpluses to debt so the overall benefits of further savings will not be lost.

- If a change was to occur from July 2000, then that could well give us an opportunity to change the pricing of water to the cities.

I would also point out that if the levy is held at the current level, that will be the fourth year that the levy has been held. Our future projections in these plans anticipate no change in the level, upwards or downwards.

6. Plantation Forestry

Significant discussions concerning the Council's continuing role in Plantation Forestry are due to be held in March. From a planning perspective, our projections in forestry are not greatly changed from our expectations last year.

This in essence has us running deficits through to 2006/07. Debt in that period increases to approximately $13 M in 2005/06. Our projections then show that this debt will gradually be whittled away by 2015/16. During this entire period $300,000 is provided each year to reduce rates.

7. Summary of Operating Plans

7.1 Water Group

- No overall levy increase for 1999/00 is proposed. Future levy held at current level subject to impact of inflation and changes in interest rates.

- In addition, a minimum of a further $1.1 M per annum will be applied to debt reduction and hence result in significant improvement in overall debt position over time.

- This will be achieved primarily by expenditure savings.

- Capital expenditure for 1999/00 is $3.8 M and remains steady across the remaining period at between $4.0 M and $5.5 M per annum. This programme and elements of refurbishment expenditure carried in the operating budget means there is not, and will not be, any significant deferred maintenance in the infrastructure now or into the future.

7.2 Plantation Forestry

- Deficits across the operating plan period of up to $1.1 M per annum.

- Contribution to rates of $300,000 per annum maintained across the period.

- Debt incurred to cover operating deficits and fund capital expenditure in Plantation Forestry increases to approximately $13 M by 2005/06. Debt servicing at that stage reaches 49.9% of expenditure.

8. Recommendation

(1) *That this report be received and the contents noted.*

(2) *That the Water Group Operating Plan be approved in principle.*

(3) *That the Plantation Forestry Plan be approved in principle.*

(4) *That the draft operating plans for the above activities be recommended to the Policy and Finance Committee for inclusion in the Council's proposed long-term Financial Strategy 1999-2007.*

DAVID BENHAM
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Attachments