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## NZCID Submission on the Auckland City Council 10 year Plan

### Key Points

The New Zealand Council for Infrastructure Development appreciates the opportunity to submit on the Council's ten year plan. The purpose of this submission is not to comment specifically on the details of the plan or the projects listed within it, but rather to make comment on the approach to prioritising and funding critical infrastructure for the City and the region.

NZCID agrees with the Council's desire to manage down its expenses at a time when rate payers are significantly impacted by the current economic climate and we support the Council's overarching goal to keep rates increases to a minimum.

We endorse the Council's commitment to the future through investing the largest ever amount on capital projects in a single year next year – \$516 million – and building and acquiring \$1.8 billion of new assets for the city over the next 10 years. We think this is necessary given the significant backlog of infrastructure needs that the city faces and the future challenges that continued population growth will bring.

We note that Auckland City has decided to reduce its borrowing programme compared with the levels projected in the 2006-2016 plan. The council's borrowings will peak at \$1.2 billion (2016/2017) compared with a peak of \$1.7 billion projected in the previous amended plan. This is a result of marked reduction in capital expenditure which has reduced from \$5.2 billion to \$3.5 billion in the revised plan.

It is clear that Auckland City is finding it difficult to balance rising operational, capital and infrastructure expenditure in tandem with ongoing growth demands. There are increasing pressures to peg council rates increases to a small premium above inflation. There is also a reluctance to move from a conservative debt funding position to higher debt levels in order that infrastructure projects can proceed.

However, to ensure that Auckland City is able to maximise opportunities for economic development and manage growth demands from the increasing population, it is essential that the Council continues to invest

in infrastructure. The risk is that deferral of investment will have a further adverse affect on the current economic situation and hold back Auckland's future potential. Conversely, timely investment will help lift the region's performance so that the city is in a stronger position to grow as the current recession abates and be well placed to realise its true potential as a world class city.

For these reasons, NZCID recommends the following actions should be adopted by council:

1. Review and provide more transparency around infrastructure requirements from both a "needs" and "affordability" perspective in order to explicitly define the extent of the funding gap. This ensures that funding follows strategy, rather than being a constraint on growth.
2. Explore innovative ways of funding infrastructure "needs" including:
  - Borrowing to fund projects in the short term;
  - Further use of bond issues.
  - Public private partnerships.

## Background Information about the New Zealand Council for Infrastructure Development

The Council was formed in 2004 to promote world class infrastructure development for the benefit of all New Zealanders, a goal we are committed to achieving by:

- Raising awareness of the fact that infrastructure underpins our community's quality of life and that inadequate infrastructure holds back New Zealand's economic, social and environmental development
- Generating valuable debate on the quality and level of infrastructure provision to meet New Zealanders' needs
- Encouraging the implementation of best practice infrastructure provision and management

NZCID is a non profit organisation. Members comprise over sixty of New Zealand's leading private and public organisations including Auckland City Council along with other public authorities, infrastructure equity owners, financiers, constructors, service providers and major infrastructure users. Information on the Council, its members, policy and work can be found at [www.nzcid.org.nz](http://www.nzcid.org.nz).

In developing its policy position on infrastructure issues, NZCID consults extensively with its member organisations and with key stakeholders with central and local government and business and community interests and undertakes workshops and seminars on policy and undertakes independent research. This submission represents the views of NZCID as a collective whole, and may not necessarily represent the views of individual member organisations, some of whom will be making their own individual submissions.

## Summary of the changes between the 2006 and 2009 ten year plans

To assist with its preparation for submissions to councils ten year planning processes NZCID engaged PricewaterhouseCoopers (PwC) to carry out an assessment of Long Term Council Community Plans (LTCCPs) across a range of Councils to establish the funding changes for major infrastructure projects between the 2006 and 2009 plans. PwC were also asked to evaluate the implications of deferring infrastructure spend and examine the options that councils have to fund major infrastructure projects. Much of the content of this submission is based on the work undertaken by PricewaterhouseCoopers.

A sample of 25 councils was selected for this assessment and agreed with NZCID. The sample included:

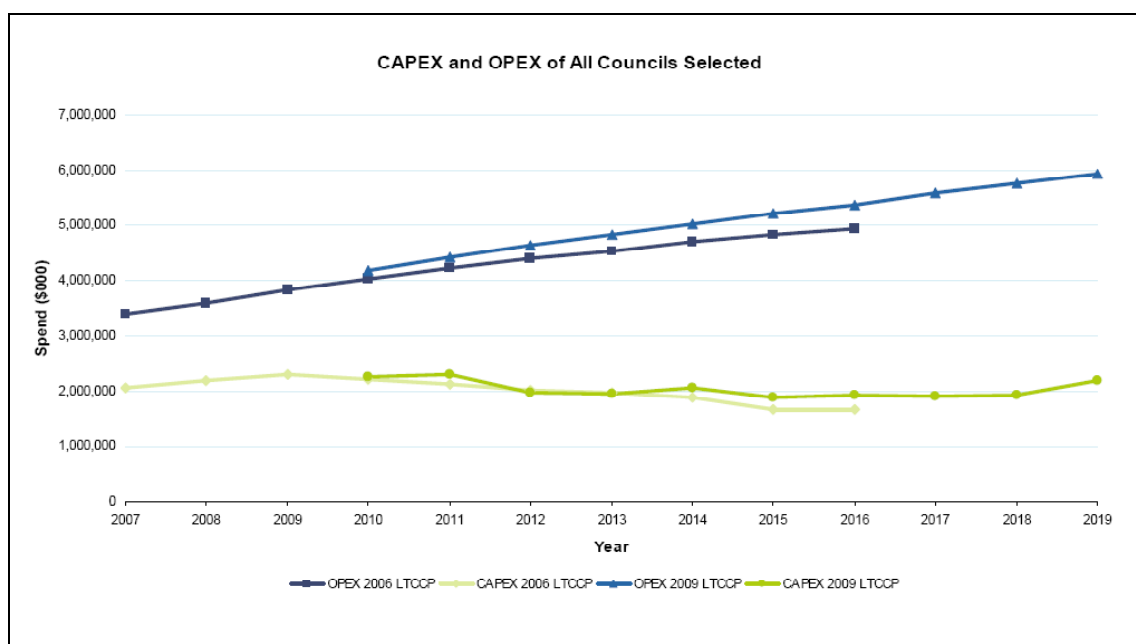
- Councils in the north and south islands;
- Large and small urban councils; and
- Large and small rural councils.

The assessment was carried out using publicly available draft LTCCPs and accessing other documentation such as annual reports for project status or background information. Information was also collected from both the 2006 and 2009 LTCCPs to build up a full picture of each council's financial status.

In commissioning this work we had expected to see a trend of project deferral across the country as Councils sought to mitigate the impact of rates increases. Interestingly, contrary to expectation, PwC found there is an overall increase of 1.3% in total Capex spend between the 2006 and 2009 LTCCPs across the councils sampled. This reflects what seems to be a reasonably consistent view held by councils, that significantly reducing infrastructure spending will be negative for the economy in terms of both growth and long-term infrastructure maintenance.

A summary of capex and opex spend for all 25 Councils surveyed is depicted in the chart below.

**Figure 1: Capex and Opex of all Councils Sampled**



## Use of Debt Finance

In aggregate, the sampled councils are forecasting a more rapidly increasing level of debt than asset value. Table 1 indicates a 63% increase in debt. This overall position however, needs to be put in context with the fact that debt is increasing off a very low base of \$4.5 billion compared to \$60.5 billion for assets.

**Table 1 – Summary financial information for all sample councils<sup>3</sup>**

	2010 \$m	2019 \$m	\$ variance	% variance
Debt	4,508	7,340	2,832	63%
Assets	60,473	83,605	23,132	38%
Rates	2,386	3,847	1,460	61%
Debt/Assets ratio	7.45%	8.78%	N/A	1.3%
Debt/Rates Income Ratio	0.53	0.52	Ratio change = 0.01	N/A

The change in debt/assets ratio is accordingly low at 1.3%. The projected rates movement of 61% is predicted to move in line with the increase in debt. Accordingly, there is little change in the Debt/Rates Income Ratio between 2010 and 2019, indicating minimal change in the use of debt overall. The projected increased rates revenue does however change markedly at an individual council level with increased rates revenue varying between 30% and 140%.

## Auckland City's reduction in capital spending and borrowing is inconsistent with other councils

In contrast to the average of the 25 councils surveyed, Auckland City has planned a marked reduction in its capital spending programme and has adopted a very conservative borrowing programme.

Figure 2 below provides a summary of the changes in expenditure between to 2006 and 2009 plans for Auckland City. Whereas capex spending increased on average 1.3% for the 25 Councils surveyed, Auckland City's total capex spending including renewals is projected to decrease by 47%.

Figure 2: Summary of findings for Auckland City Council

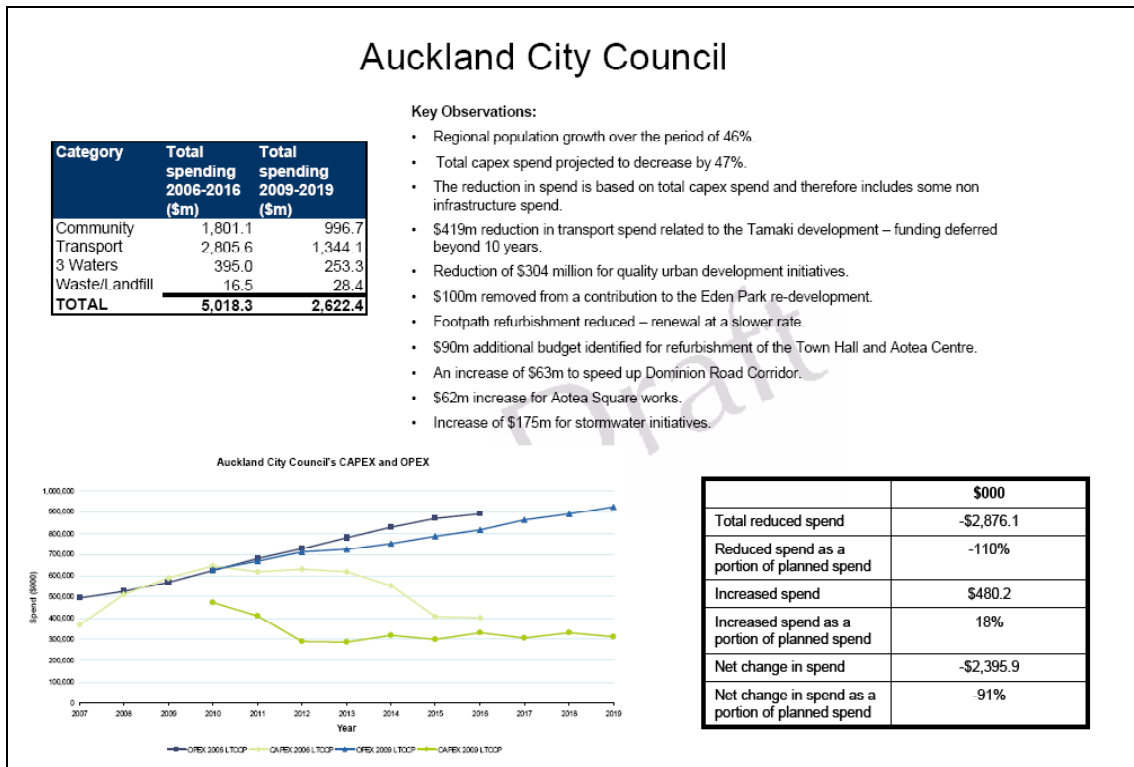


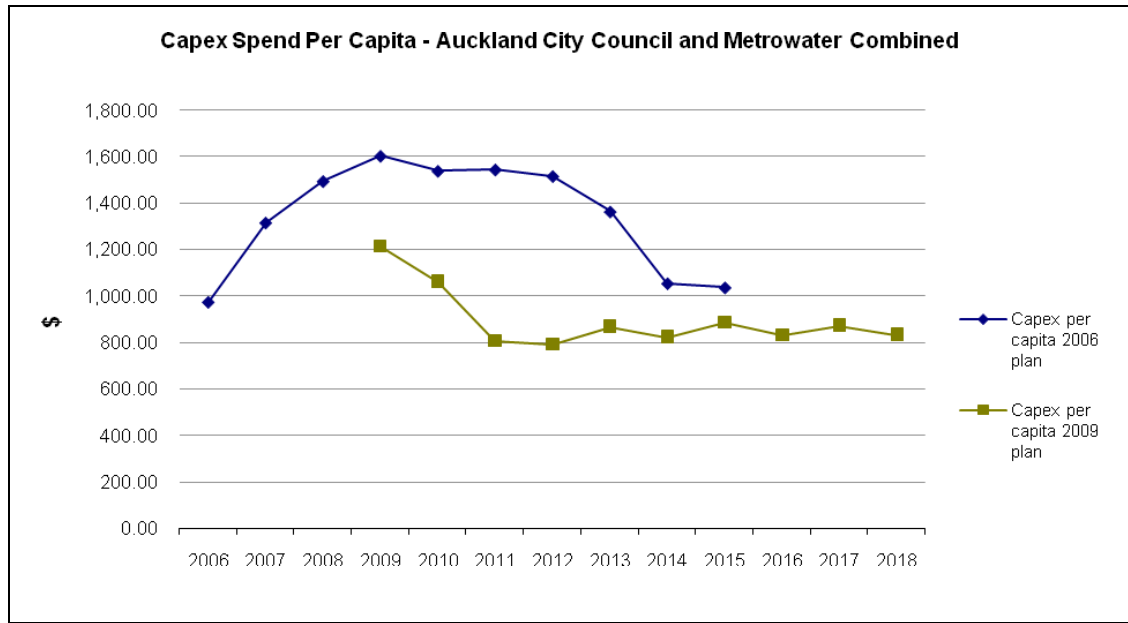
Figure 3 shows a comparison of key financial statistics of the 25 Councils surveyed. This shows that although the debt to assets ratio increases modestly from 6.71% in 2010 to 8.53% in 2019, Auckland's debt ratio sits below the average for all Council's surveyed. Given that New Zealand councils are noted for their conservative policies in respect of debt financing, and noting the significant growth pressure that the city faces both now and into the future, the Council has adopted a very conservative position. This is likely to have an unnecessarily adverse impact on service to ratepayers.

Figure 3: Comparative Statistics of Councils Surveyed

	\$000	Debt 2010	Total Assets 2010	Total rates income 2010	Debt/Assets Ratio 2010	Debt/income ratio 2010	Debt 2019	Total Assets 2019	Total rates income 2019	Debt/Assets Ratio 2019	Debt/income ratio 2019	Rate increase 2010-2019	Rate increase %
Auckland City Council		723,851	10,785,903	433,059	6.71%	0.60	1,183,187	13,869,556	830,777	8.53%	0.53	187,718	45.66%
Auckland Regional Council		52,107	1,116,792	154,538	4.67%	2.98	85,983	1,192,183	244,477	7.94%	2.98	89,040	58.21%
Christchurch City Council		304,254	7,092,158	256,052	4.25%	0.85	863,117	9,681,248	398,397	6.81%	0.46	140,345	54.81%
Dunedin City Council		306,869	2,953,191	98,463	10.32%	0.32	237,872	3,509,584	154,837	6.81%	0.65	56,144	57.00%
Gisborne District Council		36,550	1,776,744	44,250	2.05%	1.21	30,784	2,108,114	63,890	1.46%	2.07	19,450	43.98%
Hamilton City Council		355,053	3,422,434	109,461	10.37%	0.37	621,192	5,022,529	180,234	12.37%	0.29	70,773	64.86%
Hawke's Bay District Council		74,735	1,383,144	54,839	5.41%	0.73	59,418	1,598,417	73,758	6.04%	0.76	19,380	33.49%
Hutt City Council		69,737	1,183,209	80,439	6.00%	1.15	40,241	1,521,558	105,279	2.94%	2.62	24,788	30.79%
Invercargill City Council		43,500	866,784	39,915	6.52%	0.92	60,025	884,190	52,418	7.03%	0.97	12,503	31.32%
Manukau City Council		260,000	6,429,043	195,026	4.04%	0.75	425,006	6,075,200	345,852	5.20%	0.81	148,237	75.77%
Marlborough District Council		20,919	1,195,143	47,200	1.75%	2.28	109,955	1,785,989	79,142	6.11%	0.73	31,942	67.87%
Napier City Council		11,520	1,319,347	42,390	0.87%	3.65	4,058	1,743,279	58,110	0.23%	14.32	15,744	37.18%
Nelson City Council		85,783	1,203,849	48,734	7.12%	0.57	116,555	1,641,292	81,890	7.10%	0.70	33,162	65.05%
New Plymouth District Council		130,360	2,243,460	57,830	5.81%	0.44	174,850	2,931,350	96,790	5.98%	0.55	39,160	67.95%
North Shore City Council		436,761	4,811,327	139,508	8.95%	0.32	668,992	8,096,348	248,859	8.14%	0.38	109,151	78.24%
Porirua City Council		36,458	1,140,085	38,679	3.20%	1.08	55,458	1,573,146	59,822	3.53%	1.08	20,243	51.02%
Queenstown Lakes District Council		105,041	893,226	46,031	11.76%	0.44	412,930	1,705,712	78,000	24.21%	0.19	32,059	69.65%
Rotorua District Council		118,473	978,209	33,828	12.21%	0.28	99,957	1,441,438	48,318	6.93%	0.48	14,460	42.83%
Taupo District Council		141,814	1,345,779	43,373	10.54%	0.31	194,210	1,911,727	66,115	10.16%	0.34	22,742	62.43%
Tauranga City Council		333,720	2,874,380	78,895	11.61%	0.24	545,388	4,870,537	151,863	11.20%	0.28	72,968	92.49%
Upper Hutt City Council		19,821	524,258	26,152	3.74%	1.33	36,620	628,426	35,268	5.86%	0.98	8,068	34.70%
Waikare City Council		69,175	2,972,882	137,810	19.85%	0.23	972,499	5,042,647	331,438	19.39%	0.34	183,828	143.80%
Wellington City Council		123,591	790,625	78,814	15.83%	0.64	197,547	1,059,423	132,338	18.65%	0.67	53,724	68.17%
Whangarei District Council		120,184	1,296,709	89,783	9.69%	0.70	128,583	1,715,808	134,180	7.55%	1.04	34,405	34.46%
<b>ALL COUNCILS</b>		<b>4,608,218</b>	<b>60,473,285</b>	<b>2,386,589</b>	<b>7.45%</b>	<b>0.53</b>	<b>7,340,886</b>	<b>83,605,525</b>	<b>3,847,363</b>	<b>8.78%</b>	<b>0.52</b>	<b>1,460,779</b>	<b>61.21%</b>

The graph on the following illustration puts this reduction in capex spend into context against the projected population increases in the city, showing the reducing per capita spend over the next ten years. The planned per capita spend for 2009 is \$1,213 per person. By 2019 this is projected to reduce to \$833 per person.

**Figure 4: Auckland Capex Spend per Capita**



Of concern is that infrastructure planning is being constrained through unnecessarily conservative borrowing programme and that the level of investment will not keep pace with population growth. While a declining spend per capita would be more acceptable in a situation where there is not an infrastructure backlog, it is less than satisfactory when substantial investments in transport and water infrastructure (among others) are required. Best practice in infrastructure planning would entail conducting a detailed infrastructure needs assessment and the development of a plan where funding follows strategy, rather than the other way around as it currently seems.

### The impact of contraction in infrastructure spending

It is acknowledged that local government should be prudent in its spending at this time and that delaying spending on infrastructure will provide some short term savings. However short term reductions in spending may have three key impacts:

Firstly, deferral of spending may lead to the requirement to spend more in future years as infrastructure deteriorates and is unable to meet capacity required. The costs of "catching up" are almost inevitably greater than the costs of undertaking the expenditure today.

Secondly, low spending on infrastructure now may constrain the economic growth of the City. This is of particular concern in Auckland where it has been widely acknowledged that the New Zealand economy is dependent on the ability to leverage the Auckland economy. Auckland

currently accounts for 34% of the country's GDP but has the lowest per capita GDP of comparable cities such as Sydney, Melbourne and Vancouver.

A third issue is the impact on firms engaged by councils on infrastructure projects and who have geared up for existing project levels. A reduction in work volumes now will mean that they need to reduce capacity which in turn means that they will not be ready for an upswing in infrastructure projects when the economic situation improves. There are also impacts on the wider economy if these firms have to make staff redundant.

For these reasons NZCID recommends that rather than defer critical infrastructure that will help sustain growth and improve community services, so that Auckland is a more attractive city to live and invest in, a more prudent approach long term is to fund investment in infrastructure through an appropriate mix of public and private debt among the Council's various alternative funding tools.

## Funding Options

### Local Government Act 2002

Unlike most corporate entities, local government does not have complete freedom in respect of how it decides to fund its activities. It must also consider its funding decisions in relation to the requirements of the Local Government Act 2002.

### General Funding Provisions

Section 103 of the Local Government Act 2002 enables Local Authorities to adopt a variety of funding sources to cover operational and capital expenditure. These sources include:

- General rates;
- Targeted rates;
- Fees and charges;
- Interest and dividends from investments;
- Borrowing;
- Proceeds from asset sales;
- Development contributions;
- Financial contributions; and
- Grants and subsidies.

The section of the Act also includes an "any other source" clause ensuring that local government is not tied to using only the above funding mechanisms, should there be other sources available. When determining their funding policy, local authorities must also consider:

- Community outcomes sought;
- Whether the benefits affect the whole community or an identifiable section;
- Over what period the benefits will occur;
- To what extent the actions or inactions of a particular group contribute to the need to undertake an activity;
- The costs and benefits of funding the activity from other activities;

- The impact of allocating liability for revenue on the current and future social, economic, environmental and cultural wellbeing of the community.

## Options to Fund Major Infrastructure Projects

### Increase Debt

Councils are required by the Local Government Act 2002 to consider the lifetime benefits of their investments i.e. while infrastructure may be developed today, the benefits of the asset will be experienced by future generations over the lifetime of the asset. It is therefore appropriate that the cost of such assets is also spread over future generations and not borne entirely by current ratepayers.

### Sale of assets

Prudent sale of surplus assets can provide funds for priority areas, making the assets work more optimally for the residents and ratepayers. There are large differentials in the level of assets councils own and therefore varying levels of ability to leverage their value.

Traditionally, asset sales have proved difficult due to a perceived public fear of “asset stripping” and lack of the protection of the public realm. Councils have accordingly tended to overcompensate by maintaining very conservative asset portfolios.

### Public/Private partnerships (PPPs)

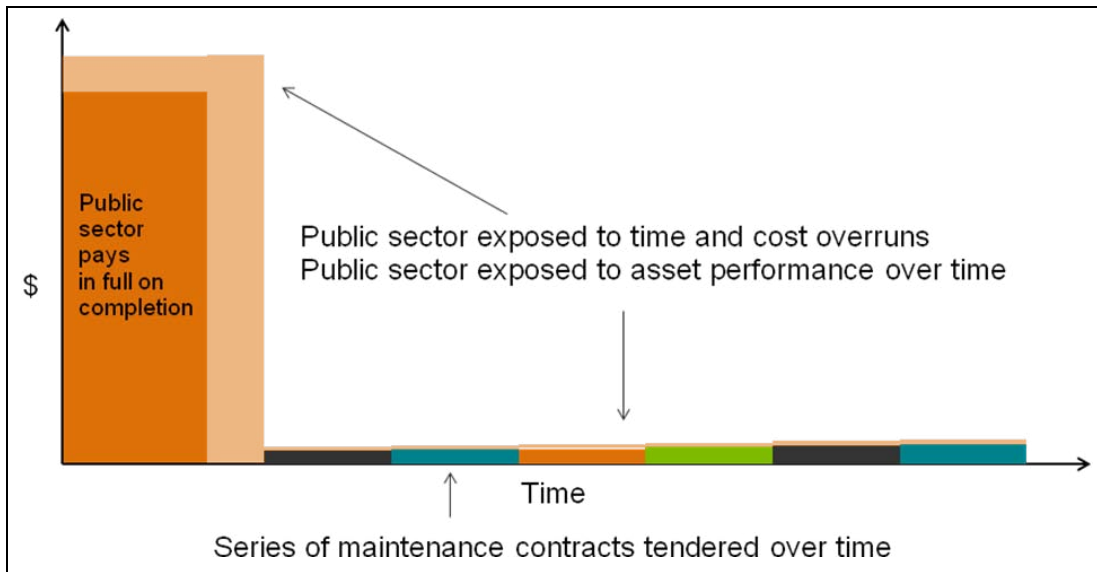
In the New Zealand context, Public Private Partnerships (PPPs) are not generally well understood as both a procurement and an alternative funding mechanism. The common features of a PPP are a large capital cost infrastructure project (typically greater than \$100 million construction cost); the private-sector funding of the construction phase; and the eventual payment by users and the government sponsor for the delivery of services over a long period. Examples include roads, schools, water waste and treatment, hospitals and other social infrastructure.

Crucially, entering into a PPP arrangement does not mean that councils do not have to pay for a project. The current financial crisis (temporarily) and New Zealand’s low population density (permanent) imply that the candidates for “economic infrastructure”, that are able to financially sustain themselves from user payments, are few. Instead infrastructure projects would likely be funded by a mixture of user payments, central government subsidies and local government payments.

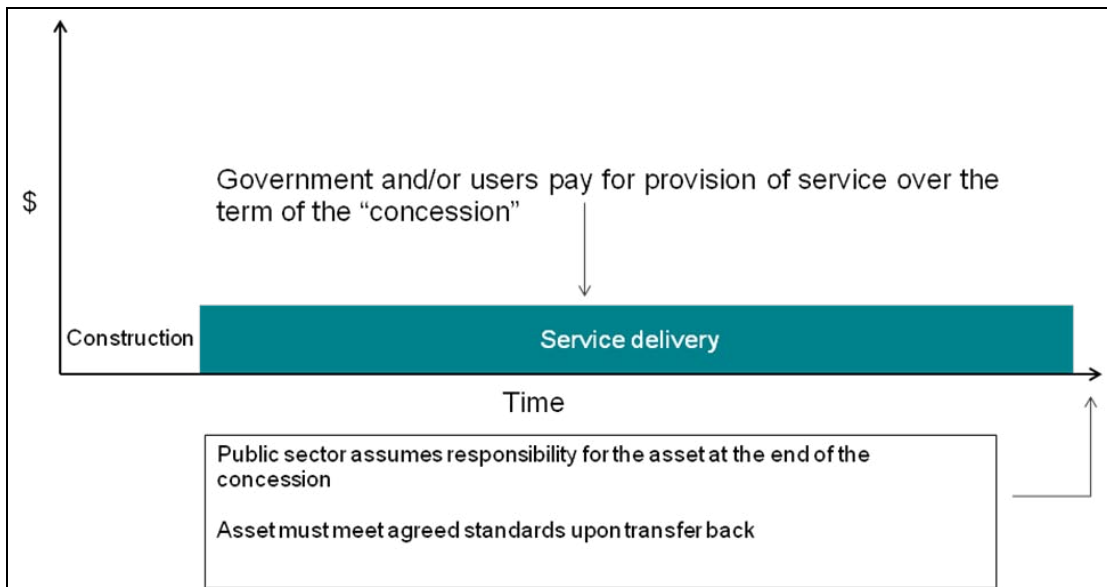
The key difference from traditional infrastructure procurement is that councils are able to transfer some of the risk of cost blowouts and time delays to the private sector partner, and the local government payments are not made as a lump-sum for construction milestone progress, but instead for service deliveries after the infrastructure is in place. Increasingly, “availability payments” made by the government sponsor are the financial underpinning for PPPs such as roads and schools.

Figures 5 and 6 show the differences between traditional procurement and procurement by means of PPP.

**Figure 5: Conventional Procurement**



**Figure 6: PPP Procurement**



An alternative to PPPs is “Alliancing”. This is typically used where there are more unknown risks. An example of this is the Northern Gateway, where the unknown risks associated with the tunnelling meant that the private sector was not willing to take on the risk within a PPP model. However, unlike PPPs alliance contracts do not normally consider whole of life costs, and therefore there the Council must accept operational and maintenance risks.

Research carried out in the UK and Australia into the success of PPP financing consistently demonstrates a substantially reduced risk of PPP projects being over budget and over time.<sup>1</sup> For these reasons, the ability to transfer risk and essentially defer payment for large projects and spread the cost of payment over

<sup>1</sup> A range of reports undertaken by HM Treasury and the National Audit Office along with Australian research on PPP value for money is available at <http://www.nzcid.org.nz/publicprivatepartnerships1.html>

the life of the asset is a very attractive proposition to councils who do not want to increase rates or increase traditional debt levels. It also provides for intergenerational equity to pay for the assets as they are used, rather than imposing the bulk of the cost onto the current generation.

### **Rates – general and targeted**

The 2006 LTCCP led to increases in rates in many areas and significant ratepayer backlash because of this. While increasing rates generally, or in a targeted way for specific projects, is always an option for councils, most are very conscious of not over burdening ratepayers following the reaction in 2006. This issue has been exacerbated by the current economic climate. Part of the problem is the over reliance on using rates to fund capital expenditure on a pay as you go basis, rather than matching payment with the use of the service over the life of the assets.

### **Development and financial contributions**

Development contributions are levied by councils on commercial and residential developments in their area. The levy is collected to enable councils to provide for growth in infrastructure demand due to increase in population in an area. The funds are levied on identified projects over the following ten years. Councils are not permitted to levy more than is needed to fund these projects.

The downturn in the building industry has meant that the development contributions councils are receiving have been significantly impacted, while the demand for infrastructure has not declined in line with this reduction in funds received. Most councils have had to re-forecast their projections of funds collected and where they will be spent. Accordingly there is no growth in development contributions between the 2006 and 2009 LTCCP comparatives.

### **Government funding**

Councils receive significant funding from the Government for infrastructure projects, particularly in the area of transport.

In the current economic climate where infrastructure investment is viewed as a tool to keep unemployment down and help keep the economy afloat, councils appear to be leveraging some of their funding for infrastructure projects from the receipt of more central Government funding.

Given the timing of the drafting of LTCCPs which was prior to the Government infrastructure response, this increase was probably already in the pipeline from the 2008 Government's budget.

### **Bond Bank**

The job summit held in Auckland in February 2009, proposed the establishment of a "Bond Bank" to enable councils to raise money for major infrastructure projects. It is not clear at this stage whether this idea will be adopted by the Government.

In Australia the Australian Council of Trade Unions (ACTU) recently proposed a National Infrastructure Bank backed by the Commonwealth Government Bank guarantee scheme. The intention is to make it easier for the public sector to borrow money to fund infrastructure projects, and may also have the effect of making PPPs more attractive to the private sector.

### **Council Bond Issues**

A number of Councils including Auckland and Tauranga City Councils, and Environment Bay of Plenty have issued bonds to reduce the need to increase rates. These bonds sold very well as councils are perceived as a safe and reliable place to invest.

### **Fees and Charges**

Councils receive significant funding from fees and charges paid by users of services and as penalties such as parking fines. While most of these fees and charges are used to directly fund the provision of services, in some areas, parking being an example, there are excess revenues which can be applied other projects.

As with increases to general rates, councils are very sensitive about any increases to fees and charges. Most legislation, under which fees and charges are collected, specifies that they must be "fair and reasonable" or "actual and reasonable". Identifying what the actual or fair cost for a service should be is often challenging. Fees and charges do however appear to have increased significantly over the period. This is likely to be in response to large increases in operating expenses.

### **Third Party Community Funding**

Funding from community trusts such as the ASB Trust will continue to be a funding stream for community infrastructure projects. In the short term these organisations may have less money to distribute as the economic situation impacts on their investments and other funding sources.

Overall, councils have still assumed a growth in this form of funding by 20% between the two plans.

### **Council Debt levels**

Councils operate under financial policies which fix what they regard as being the appropriate levels of:

- Debt to asset ratios;
- Debt to income ratios; and
- Operating cash flow.

Detailed debt levels for all of the councils considered in this review can be found in the Figure 2 above. This indicates debt is expected to rise from \$4.5 billion to \$7.3 billion in 2019.

Despite this increase, comparison of the New Zealand Local Government sector against international comparisons shows that the sector is relatively lowly geared. In this regard a relevant study of New South Wales Councils<sup>2</sup> benchmarked gross debt as a percentage of total operating revenue. It highlighted that a council's ratio would be undesirable if it exceeded 100%. This contrasts with a ratio of 53% for a debt to rates income ratio for Auckland City.

Based on the information available Auckland City has considerable potential for increased debt levels.

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<sup>2</sup> The Financial Sustainability of New South Wales Councils, October 2007, Fiscal Star Service Pty Ltd.

## Recommendations

It is clear that Auckland City is finding it difficult to balance rising operational, capital and infrastructure expenditure in tandem with ongoing growth demands. There are increasing pressures to peg council rates increases to a small premium above inflation. There is also a reluctance to move from a conservative debt funding position to higher debt levels in order that infrastructure projects can proceed.

However, to ensure that Auckland City is able to maximise opportunities for economic development and manage growth demands from the increasing population, it is essential that the Council continues to invest in infrastructure. The risk is that deferral of investment will have a further adverse affect on the current economic situation and hold back Auckland's future potential. Conversely, timely investment will help lift the region's performance so that the city is in a stronger position to grow as the current recession abates and be well placed to realise its true potential as a world class city.

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Yours faithfully,



Stephen Selwood  
Chief Executive