AECOM

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Dear Wayne

Review of Approach to Assessing Relative Condition of Roads Assets in Asset Management Activities Hawkes Bay Region Local Authorities Report (MWH, 20 Jan 2015), and Table 3, Summary Report on Ring-Fencing, Hawkes Bay Councils, LGC

1.0 Introduction

1.1 MWH Report

AECOM New Zealand Ltd (AECOM) was engaged by Napier City Council to review the approach taken to assess and compare the condition of roads assets relative to other councils in the report “Asset Management Activities Hawkes Bay Region Local Authorities Report” (MWH, 20 Jan 2015).

We were unable to get in contact with the author of the MWH report at the time of writing, although consider that discussions with the author an essential part of the process prior to communicating the outcomes with third parties.

1.2 LGC Report

AECOM was also commissioned to reassess the numbers presented in Table 3: Equalising asset values and indicative asset condition in the Local Government Commission Summary Report on Ring-Fencing, Hawkes Bay Councils, 27 February 2015, on the basis of the valuation data received from Napier City Council, and excluding formation and berms.

We were unable to get in contact with the author of the LGC report at the time of writing, although consider that discussions with the author an essential part of the process prior to communicating the outcomes with third parties.

2.0 MWH Report

2.1 Approach Reviewed

The report states *A good indication of the present general condition, age and remaining life of the assets is to compare their current value (depreciated replacement value) with their estimated replacement value* (Section 3.3, page 22).

2.2 Key Review Assessment Findings

The following bullets summarise our key salient findings with respect to the roads assets data and analysis:

- The total asset replacement costs include the following non-depreciable items:
    - Land under roads. This item does not have a cyclic renewals lifecycle impacting Council’s renewals programmes and the “condition” of this item is therefore not applicable. We have no access to the data and analysis underpinning the summary table within the report. However, following review of the valuation information provided by Napier City Council, we believe that this has been excluded from the analysis.
    - Formation and berms. These items are not depreciated by Napier City Council, which they have advised reflects their renewal practices. That is to say, renewals work does not involve the replacement of these items, and little or nothing is done to them other than (generally) minor maintenance in the case of berms, which is expensed at the time the costs are incurred. They therefore do not have a cyclic renewals lifecycle impacting Council’s renewals programmes and the “condition” of these items is not applicable.

- Markings. These minor items have a short lifespan and appear to be expensed as a maintenance item by Central Hawkes Bay District Council. Although not depreciated, we believe markings should be included within the approach to articulate asset condition.

- Formation and berms, as a proportion of total Replacement Cost, range from 8.5% in the case of Napier City Council, to 45% in the case of Hastings District Council. That is to say that Napier City Council has a significantly greater proportion of built assets which need to be considered in the context of renewals planning. This reflects the different ratio of rural and urban network composition, and assumptions made within the valuation regarding the effort required to establish the formation.
- Data received indicates that there may be an issue with the Depreciated Replacement Cost used for Hastings District Council roads within the MWH report, although we have not been able to verify this without access to the data underpinning the MWH report. This may impact the calculated ratio for HDC.

2.3 Conclusions

We agree that the ratio of current value to replacement value can be used as a high level indicator of the general condition of the assets, as it provides information on how far the assets are through their lifecycle. However, care should be taken in the interpretation of the results, particularly in the case where comparisons are to be drawn between different networks and different organisations with varying network compositions and different assumptions underpinning their valuations.

Based on the information received, land under roads, formation, and berms should be excluded from this analysis. We believe that the inclusion of these components distorts the comparison of condition between the Councils because of the dominance of the formation component.

Our analysis indicates the following DRC/RC ratios for the roads assets excluding formation and berms:

Council	MWH Report[1]	AECOM Analysis[2]
NCC	57%	53%
HDC	90%	62%
CHBDC	76%	62%
WDC	66%	59%

Table 1 DRC/RC excluding formation and berms

These ratios by themselves do not necessarily imply under-investment. It is simply a high level indicator of the lifecycle position the assets in general are in, which would be expected to reflect the development history of the area.

We recommend a review of each of the Council's asset management plans be undertaken which should provide more detailed analysis of asset condition and lifecycle plans in place.

3.0 LGC Report

3.1 Review

AECOM recalculated the components of Table 3 of the LGC report based on:

- The methodology stated in Table 3 of the LGC report
- Roads valuation information for all Councils provided by Napier City Council
- Replacement Cost and Depreciated Replacement Cost information for the water supply, wastewater and stormwater networks, provided by Napier City Council
- Net Financial Assets information as stated in the Local Government Commission Summary Report on Ring-Fencing, Hawkes Bay Councils, 27 February 2015 (Table 1).

We have not been able to independently verify that this data is current and correct.

[1] Includes formation and berms
[2] Excludes formation and berms

In addition, we have recalculated the numbers using an alternative approach to assess the "calculated amount of spending required to reach equitable positions"[3]. This is based on a regional average of Depreciated Replacement Cost to Replacement Cost of just those assets which impact on the renewals process. We:

- Separated out depreciable items and calculated the ratio of Depreciated Replacement Cost to Replacement Cost for this depreciable amount, which provides a general assessment of how far the deteriorating assets are through their lifecycle
- Calculated the regional average of this ratio, excluding Hawkes Bay Regional Council as these assets are managed for the benefit of the region, as noted in Clause 13 of the LGC report.
- Calculated the Depreciated Replacement Cost required for each of the four councils to attain this regional average ("Equitable DRC")
- Calculated the difference between the current Depreciated Replacement Cost and this Equitable DRC.
- Added net financial assets to this sum.

3.2 Key Assessment Findings

We identified the following key differences in total Replacement Cost and Depreciated Replacement Cost values between the roads valuation information provided by Napier City Council, and the values provided to us by Napier City Council as assumed within the LGC report:

Council	Valuation	LGC
CHBDC	RC $786 million DRC $613 million	RC $779 million DRC $596 million
HDC	DRC $950 million	DRC $1,079 million

Table 2 Differences identified between roads valuation data provided from different sources

Further, we believe that the "Equitable Position" described in Table 3 of the LGC report includes the net financial assets given the methodology described and the results presented, although the text within the table implies that net financial assets are excluded.

Our recalculated components, following the methodology described in Table 3 of the LGC report, are presented in Table 3. With the input of the valuation data received from Napier City Council, there have been significant movements in the "calculated amount of spending required to reach equitable positions". With formation and berms excluded, there are now major movements in the relative positions of Councils, in particular Hastings District Council and Napier City Council.

Our alternative approach recognises the net financial assets within each council separately and adds this to an "equalised DRC/RC" ratio of those assets relevant to the renewals process. These results are presented in Table 4. This approach suggests that NCC's "older" asset implications are offset by the strength of the current financial position.

[3] These amounts are effectively the councils' current position (asset value plus net financial assets) after adjustment to bring the Depreciated Replacement Cost to Replacement Cost ratios to the regional average

	LGC Report					AECOM Analysis Including Formation and Berms					AECOM Analysis Excluding Formation and Berms				
	CHBDC	HDC	NCC	WDC	Total	CHBDC	HDC	NCC	WDC	Total	CHBDC	HDC	NCC	WDC	Total
Current position	685	1,476	577	222	2,959	702	1,347	577	221	2,847	365	806	549	168	1,889
Current position as %	73%	75%	67%	67%	72%	74%	68%	67%	67%	69%	60%	57%	66%	60%	60%
Equitable positions	677	1,421	621	240	2,959	656	1,363	598	230	2,847	366	855	501	167	1,889
Amount of required spending to reach equitable positions	**7**	**55**	**-45**	**-18**	**0**	**46**	**-16**	**-21**	**-9**	**0**	**-1**	**-49**	**48**	**1**	**0**

Table 3 Recalculated components of Table 3 of the LGC report

Component	CHBDC	HDC	NCC	WDC	Total
Depreciable Amount ($m)					
- RC	610.19	1,426.29	834.53	279.10	3,150.11
- DRC	365.78	851.60	470.54	155.90	1,843.82
Ratio	60%	60%	56%	56%	59%
DRC of Depr Amt at Regional Average ($m)	357.15	834.84	488.47	163.37	1,843.82
Difference	8.63	16.76	-17.93	-7.46	0
Net Financial Assets ($m)	-0.3	-45.2	78.6	12.5	45.6
Net financial position after adjusting for differences in asset condition	**8.33**	**-28.44**	**60.67**	**5.04**	**45.6**

Table 4 Recalculated relative financial positions with respect to the renewals process

3.3 Conclusions

We have not been able to independently verify the correctness of the data supplied to us for this analysis. However we believe:

- The calculated amount of required spending to reach equitable positions is extremely sensitive to the inputs as demonstrated in the comparative tables above. Therefore we believe great care is needed in the interpretation and use of this information. There are significant differences between our analysis and the results within the LGC report using the same approach which may be as a result of data discrepancies noted in the first table in 3.2. This indicates the need for reconciliation between the data sources.
- We note the accounting approach to this analysis, however, in *asset management terms* we believe the focus on capital position only can lead to misinterpretation of the results. We question whether adequate conclusions can be drawn from such a high-level analysis and the validity of using the ratio of "current position to asset replacement value". The results are highly reliant on whether non-depreciable assets are included or not, the assumptions underpinning the asset valuations and the accuracy of these valuations. Further, there is no consideration of the operating and maintenance expenditure needs which would be expected to have a significant impact on rate-payers, nor on the levels of service differences or future growth potential.
- We consider that a greater level of analysis would be required before drawing any firm conclusions regarding the relative current and future financial positions of the Councils. Such analysis would include long-term operations, maintenance, renewals and capital development expenditure needs against an overall funding plan.

Kind regards

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