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SPECIAL: Focus on New Zealand

The two major issues for debate in New Zealand at the present moment are both asset management issues!

- A draft bill to commercialise the management of roading corridors
- The impact on council rates of a decision to require all councils to fully fund their depreciation.

Both of these debating topics have raised a wide range of asset management issues involving

- Governance and pricing, and the links between
- holistic management,
- the link between efficiency and effectiveness,
- valuation, depreciation and use of funds and
- interpretation of such well known (but little understood!) catchwords as “the level playing field”.

While these two issues have ‘hogged the headlines’, of at least equal importance for asset managers and the general community is the proposed use of asset management plans for public monitoring of Mercury Energy – an outcome from the disastrous outage experienced in Auckland last year. This issue of SAM looks at these topics and more in our “Focus on New Zealand”

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Local Government Reform and Asset Management

The Reforms.

Local government has been in a continuous process of reform since the amalgamations of 1989. There has been increasing separation of policy development from organisational management, particularly by the introduction of LATEs (Local Authority Trading Enterprises), the introduction of accrual accounting, the pressure to become more customer focussed and the tension between containing rates and increasing services.

Annual plans are now compulsory (10 years ago they were voluntary). One of the highly visible effects of these changes on local government in the 1990s has been the widespread practice of contracting out delivery of services – a trend which had become apparent even by the early 1990s. In core infrastructural services, such as water, sewerage, stormwater, and land drainage, this is particularly pronounced. In 1989 ¾ of territorial authorities delivered these services exclusively in-house. By 1993 less than a quarter of councils did so.

Enter Asset Management!

The most significant change to the way local authorities manage their business has been the enactment of Part V11A of the Local Government Act – the new financial management regime. Local authorities must now prepare, in addition to an annual plan,

A long term financial strategy

To cover a period of 10 or more years. A strategy must be prepared at least once every 3 years with public consultation. Strategies must include estimated expenses, the reasons why activities are to be engaged in, proposed sources of funds, and estimated cashflows.

A funding policy

This sets out:

Who benefits from each council function

Who should pay for each function, and
By what means they shall pay

An investment policy

This is required to set out the general policy of the local authority on how its financial assets and financial reserves are to be managed. It includes an outline of the procedures by which investments are to be managed and reported to councils and how risks associated with investments are to be assessed and managed.

A borrowing management policy

This includes a council's interest rate exposure, policies on liquidity, credit exposure policy, debt repayment, giving of securities, and specific borrowing limits.

Meeting the requirements of Part V11A has led directly to the discipline of asset management planning although, rather than being seen as a way to meet the needs of legislation, asset management planning should be seen simply as good management practice.

Asset Management Plans

Asset management plans provide key information for the long term financial strategy covering the timing and value of

- Maintenance expenditure;
- Renewal expenditure; and
- Capital expenditure.

AMP Changing Way Councils Think!

Roger Blakely, Secretary for Local Government (to whom I owe much of this information) says:

“While it's still early days, the comments we have been receiving from local authorities indicate the new regime is having a considerable impact on how councils are thinking about the way they manage and plan, particularly in respect of funding asset replacement. For example, a much clearer picture is already emerging in many areas of the state of local infrastructure assets and the possible future costs”.

Commercialising Roads

Direct Charging for Road Users

A few years ago, the New Zealand Government announced its intention to make far reaching changes in the way that New Zealanders paid for road use. The pricing changes were complex and difficult to implement for a service that many see as the quintessential 'public good'. Whilst there was a lot of support for 'direct charging' for roads, the actual mechanics were not determined.

Road Management Companies

Last year the Government announced a major potential change in governance. Management of the roading corridor (roads, footpaths, drainage, stormwater and street trees) is to pass to roading companies. Groups of councils within a given regional area are to transfer their assets to be managed by these companies, in return for equity in the companies.

An important aspect of the draft Roads Bill is that road companies would be empowered to set prices for road use, including congestion charges for particular roads, subject to the pricing principles contained in the regulations. Transfund, the national road funding body, determines the recommended levels for road use levies and road user charges.

Discussion Document

A consultation document "Better Transport, Better Roads" was issued and produced a large number of responses, some of which can be accessed on the web at www.roading.govt.nz (Submissions close on 30 April 1999.) Most of the comments are interesting, some display deep philosophical commitment (not necessarily to party politics), some see commercialisation as being or leading to privatisation, some are just fatigued by all the changes and a few contributions use economic arguments to sup-

port the concepts proposed. One comment neatly summed up for me the importance of asset management and life cycle costing:-

"I am 22. The decisions that are made now will affect my lifestyle for the next 40 years. Therefore, I give a damn!"

Visit the site, read the comments. You will enjoy it and learn much about direct charging, user pays, capital expansion, maintenance and road issues generally.

Pricing and Governance

In the arguments for and against the new roading regime, it is difficult to disentangle those that relate to a change in pricing and those that relate to a change in governance.

At the IIR Seminar most agreed in principle with better, ie more direct pricing but they were not so comfortable with change in governance and few arguments put by either the government spokesmen or others really supported such a change.

The rationale for a change in governance regime seemed to be that a commercial body would have incentive to find and apply the appropriate pricing techniques. Exactly how this would happen was not made clear. One of the speakers argued strongly that it would be "more sensible to first apply pricing reform and *then* consider what extra value would be added by changing the governance regime". Application of the 80:20 rule?

What kind of pricing?

Shadow tolls, petrol taxes and smart card technology were addressed:

Tolls may be introduced for new roads in special cases, particularly tourist roads.

Commercialising Roads

Pricing and Governance Issues

“Shadow tolls”. Contracts between road companies and road service purchasers (local councils) could be in the form of “shadow tolls” expressed in terms of cents per vehicle kilometre travelled on a particular stretch of road or the roads in a particular area.

Petrol taxes. All petrol cars pay through a tax on petrol purchased. This is seen as regressive since the rich can afford new cars and new cars burn less fuel than older cars, so that the rich pay less for the same road use. New technology cars are expected to make inequity more obvious and unfair.

Environmental Issues. *In the ‘light-handed’ regulatory environment in NZ, emission control requirements are not closely monitored and one of the website contributors suggested that they were regularly disabled by NZ motorists. If so, managing road use by means of petrol taxes could contribute to environmental damage - not an holistic AM mechanism!*

Smart card technology, according to the Ministry of Transport, might soon be simpler and cheaper than “Singapore type” technology because roading companies would have the incentive to find and introduce such schemes.

**Robin Dunlop, General Manager, Transit New Zealand, presented a paper on “The Options and Implications of Directly Charging Road Users”. Robin has kindly made this paper available for the www.amqi.com website’s resource centre.*

A level playing field – or is it?

It is argued that the new roading regime is necessary to put roading on the same basis as air and sea transport. But this is a patent nonsense: (1) Air and Sea transport are com-

petitive industries, not monopolies, and their efficiencies are driven by competition which will not be the case with the roading companies. (2), The correct comparison should not be with *transport* but rather with air and sea *corridors* and nowhere have the *corridors* been commercialised.

It is too easy for meaningless rhetoric and catch phrases to overcome reason and logic.

Efficiency AND Effectiveness?

Will road companies go on a road expansion binge? Some think so, others argue that since road companies would want to make a good return on their investment they would be more interested in increasing utilisation than in creating more roads. They also argue that road bodies would have an incentive to ‘build right’ in the first place since they are responsible for their own maintenance.

There is an implied assumption in much of the pro argument that commercialisation = efficiency = effectiveness. At the very heart of the debate is doubt whether this is really so - it just seems politically incorrect to say so!

Service delivery is complex. Every road, *every asset*, provides a bundle of services, not just one, so that focussing on one alone de-optimises total delivery.

For example, an urban arterial road must provide for road users, but also for roadside businesses and access for their customers and the surrounding residents have a different interest again. For local roads, transport may be the lesser of the functions. Roads are basically access corridors. People want to see them dust free and with surfaces that are relatively noiseless. Children use the roads to play ball. Neighbours gather for chats on the footpath.

How will roading companies cope with these road uses?

It has been proposed that councils, in effect, buy such amenity rights from the roading companies on behalf of their citizens, but where so little is known about desired service levels, the community could miss out in favour of the car (some would say, yet again!)

Service levels

This issue of ascertaining service levels is one which is bedevilling all councils and government agencies at the moment. Knowing the desired service levels is fundamental to the design of asset management plans and we will be dealing with measurement techniques in a later issue.

Funding Depreciation Now Mandatory

“Wellington City Council Rates to Increase by 30%!!”

Similar headlines are being seen in other towns and cities. Many councils are claiming a need to increase rates by from 11% to 30%! While some of these claims may be a ‘softening’ process – with the community expected to be happy to wear a 17% rise when they had been led to expect 30% - nevertheless the figures being quoted by many councils are substantial.

New rules require funding of depreciation based on a percentage of the CR value - rather than on the basis of need as previously. Those councils that, because of the age and condition of their assets, are currently in a renewal phase may not need to increase their rate much, if at all. The major increases will be with those councils who are not currently spending much on renewal - either because they are neglecting renewal OR because their assets are still new or do not yet need renewal. This distinction has been overlooked in the media frenzy to blame the increases on past poor council performance.

Use of depreciation funds

Depreciation must be recovered but can be spent on new capital and does not have to be reserved for renewal. This is appropriate since the community may not wish to renew all of its existing assets as demand and technology changes. However, there is a fear, particularly in the newer councils where renewal is still a long way off, that the monies will be frittered away on inessentials and that, when the time comes to renew essential items, the funds will not be there. (In the meantime more assets = more maintenance required.)

Asset valuation

The new accounting rulings put a lot of strain on both the accuracy and appropriateness of the valuations used. Councils are being told to value ‘for renewal purposes’, but it would not be stretching a point to say that there is a great deal of confusion as to how to do this.

Renewal annuity/ infrastructural accounting

However, it is understood that commonsense may yet prevail and that a review is underway

to retain and use information from the asset management plans for funding purposes. Under current rules, the asset management plans account for renewal coming up within the next 10 or more years and lay out an investment and borrowing policy that could cope both with growth and the re-investment capital required. Renewal funding requirements are therefore based on established need, and not as a percentage of a valuation. Plans are revised at a minimum every 3 years. Many have been updating more regularly.

Exhibition of Asset Management Plans

Asset Management Plans from New Zealand and other countries will be available for examination at the International Asset Management Competition Finals in November this year. For further information see www.amqi.com

(See our forthcoming AMP series starting in Issue 7).

Asset Management Plans Proposed As Means For Monitoring the Electricity Industry

Few will need reminding of the time that the Auckland CBD was without power for many days and the outer Auckland area for longer. Outside New Zealand, it was a case of "There, but for the grace of God, go we!"

Disclosure of Asset Management Plans

The Ministerial inquiry into the Auckland power failure was critical of Mercury Energy's asset management planning and practices. The inquiry team recommended that the Government consider publication of asset management plans as part of the disclosure regulations. The Minister of Energy announced on 21 July 1998 when the inquiry report was released, that he had directed officials to develop detailed proposals for disclosure of asset management plans.

Ensuring security of lines is a matter of legitimate public interest. The Ministry considers that disclosure of asset management plans will help promote strong incentives to put in place and maintain good practices within New Zealand and will assist companies in demonstrating that they follow high standards.

Disclosure is also expected to enhance the qual-

ity of discussion between line businesses and those parties who have the ability and incentive to review the plans. A strong measure of peer review within the industry will also be possible following disclosure.

Price Waterhouse Coopers was requested to conduct preliminary work on the suggested requirements for the disclosure of asset management plans for discussion with the industry and other interested parties.

In summary it is proposed that the asset management plans contain

- The background and objectives of the plan (including relationships with other corporate goals, and accountabilities and responsibilities for asset management);
- the assets covered;
- proposed service levels;
- network development and life cycle asset management action plans (including planning assumptions, demand forecasts and policies on non-asset solutions);
- risk policies and mitigation; and
- performance measurement, evaluation and improvement.

Hospitals and Commercialisation in NZ

In the early days of the Reform, in the early 90s, the National Government in New Zealand had attempted to put the hospitals on a commercial footing. Their assets were valued and hospital directors were required to make a 'profit'.

Failure to do so was recorded as a deficit in their accounts*. In this sense it may be said to be 'neutral' with respect to service delivery since no funding was actually cut. However this did not sit well with many of the senior hospital personnel at the time who saw it as placing 'profit' before 'service'. Economic arguments that all assets should 'pay their way' were not well received.

Senior hospital management quit in large numbers. New managers, who could be expected to take a commercial focus, were then brought in, some from the manufacturing sector. More hospital personnel quit! Headlines in the daily papers!

Today, health services are 'off limits' for further attempts at commercialisation, the community doesn't want it. Contracting out public health service provision and co-location which are now being practiced in most states of Australia, for example, have not been adopted in the current reforms. There is a reluctance on the part of the general population to accept private sector involvement in the provision of public health services.

Morale: Good asset management is 'holistic'. Fine tuning use of physical assets whilst losing human assets is a losing game.

*** *Implications for Capital Charging?***

Recording a deficit is the proposed procedure for Victorian agencies that fail to clear all of their costs after paying capital charges (a return on assets) after the first year when the initial 'capital charge allowance' is progressively withdrawn.

Asset Management and the World Bank

Without attention to asset management, World Bank project funding may inadvertently make countries poorer, not richer.

In November last year I made an informal presentation to an all-sectors meeting of the World Bank. The basis of the talk was that if insufficient attention, or 'lip-service' was paid to asset management, developing countries could find themselves becoming poorer rather than richer as a result of World Bank funded

projects. The ongoing costs, or unexpectedly short life of the assets acquired could result in the end project costing more than the value achieved.

Understanding required, not merely paperwork

When so little exists by way of utilities or infrastructure, it is easy to put the emphasis on acquiring new, and neglect the maintenance and management of what already exists. Particularly if new capital attracts funding and management does not. But simply imposing

formal compliance with a list of 'asset management requirements' will only add to costs, where there is no understanding.

In some instances the application of standard 'developed country' type requirements to capital projects has been more than the recipients could reasonably be expected to understand or achieve, so consultants have been called in to provide 'the paperwork' and little or no understanding of asset management has been transmitted. This does nothing to improve ongoing asset management.

World Bank Review

After the meeting Angela Griffin, Urban Infrastructure Sector (and ex CEO Wellington City Council) and John Shepherd, Water Sector (ex water authority, South Australia and my host) discussed initiating a project to determine how the World Bank could improve its procedures with respect to asset management. That project has now been let.

The initial task is to provide advise on strategic local government (municipal) asset management policies, plans and methodologies for local municipal governments; and the relationship of strategic asset management to long-term municipal financial planning.

The project has been won by Worley in New Zealand. Worley-GHD pioneered the introduction of asset management in local government in New Zealand. Working with ALGENZ (Association of local government engineers, New Zealand) they guided the choice and introduction of standard asset information software across New Zealand councils and have developed country-wide training in asset management planning for councils.

(Worley-GHD are also the Sponsors of a Special Award for the **Best New Zealand entry in the International Asset Management Competitions.**)

Opportunity for Consultants working on World Bank or similar aid-funded projects

I am advised that the current project is only the start and the Bank intends to take the issue of asset management much further. This is an opportunity for experienced asset managers who have ideas for the improvement of asset management in developing countries.

I am collating ideas. All ideas will be written up (with full citation to their authors) in an advisory note to the World Bank. So if you have an idea, don't miss out! Make sure your interest to be involved is known. Email me to have your idea and your company included. Everybody contributing will receive a copy of the full advisory note and a shortened version (again with full citation of your company) will appear in the *Strategic Asset Management* newsletter.

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For comment, or inquiries
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SELF DEVELOPMENT

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Current topic: Forecasting Renewal