Long Term Plan For Auckland Transport

Background

The Mayor has released his proposal for the Auckland Council Long Term Plan, this has been through a process with Auckland Council (AC) and will, following consideration and amendment by AC form the Draft Long Term Plan for public consultation.

The Long Term Plan is an important document for the Group. The document is a statutory requirement for the AC and establishes a framework for the funding and service decisions for the next three years. While it has financial and service projections in place for at least 10 years, little reliance is placed on information for years 4 to 10, which are only required to be shown in general terms. However the importance strategically of the years 4 to 10 should not be underestimated, as it provides the context of the implications and affordability of the service level and capital programme decisions.

While the plan is only legally required to be on the AC core activities the AC officers have indicated that the Long Term Plan will be presented on a Group basis. We have yet to see the plan and analyse the implications of this for the Transport Activity and for Auckland Transport, however we have supported the AC officer position to proceed on this basis as it is a parent decision, and it should enhance the understanding of the consolidated work programme and the role undertaken by each entity, which is not easy to understand in the current accountability documents.

The draft financial information for the Auckland Transport plan is attached. This includes the financial statements based on two assumptions. The draft financial information for the Auckland Transport plan is attached. It is included with two alternative scenarios. The first scenario is the status quo. That is AT is funded by an operating grant for operating costs, a capital grant for part of the capital work programme and an equity injection also for the capital programme. The equity injection is borrowed by Council and the debt sits in the AC transport activity but not as a debt within the AT balance sheet. The second scenario is that the equity injection is treated as a loan to Auckland Transport and the grants are increased to cover the debt servicing which currently sits in the Auckland Council. Within Auckland Council these transactions are shown within the Transport Activity but it has AT as a subset of that Activity. The second scenario makes the AT Plans closer to the information which AC report as being the transport activity delivered by AT.

Background

The attachments are based on exactly the same work programme and operating profile. The different scenarios have only been prepared at the high level Accounting statements With the exception of the capital work programme the attachments have been prepared on an inflation adjusted basis. That is inflationary effects have been added to the baseline information. Capital has been presented in constant dollar values based on 2012 dollars.

When the Annual Report was considered the Board may recall that there was concern about the fact that without the introduction of the vested assets AT would have had a loss, due to the reduction in revenue because of the implications of capital funding. The financial statements have a similar potential. Essentially the only reason the Profit and Loss account shows a profit is due to the capital subsidies which are contingent on the capital work programme being completed and subsidised at the assumed rates. This occurs in the early years of the plan only, while the capital grant from AC reaches more sustainable levels. Vested assets have not yet been included in the financial information. These will have the effect of increasing the capital and increasing the revenue. They will be added clearly as “Vested Asset” lines in both areas. They are a non cash cost but will have an impact on Profit and Loss and increase the depreciation charge, though not material to the depreciation line.

Depreciation has been calculated at a high level based on a very rough calculation on the whole programme. It will be recalculated in more detail based on the "Addsto" column of the capital work programme.

The detail of the proposed capital work programme is also attached. This has been included at 2013 constant dollar values, as it is easier to understand on this basis and is the basis for all AC activities. For the financial statement scenarios these totals have been inflated based on inflation assumptions provided by AC. There is some work to do to reconcile inflated figures with inflators used by AC, as AT and AC use the same assumptions but the level of detail of the calculations may vary. The information will be reconciled to ensure that the two sets of figures are the same in public information.

Also attached is a more detailed activity view of the services AT provides. This has been broken down in a manner consistent with the activities put to the Board in previous papers. Staff are working on the textual content of an AT Long Term Plan and this will be presented to a future Board meeting. Staff are working to ensure that the information in the text and performance measures are being taken from a single agreed source to ensure the robustness of the information.

The CRL is included in the capital work programme and in the Activity information. We are still working with AC to determine what the correct organisational representation of this information is. This has not yet been fully determined as staff have been working on getting the estimates for the CRL into the plan. Financial modelling for the CRL has been undertaken by a team from AC, and the capital spend has been included in AT budgets along with an assumption on alternative revenue, this is why the User Fees for rail services show an increase. The assumption on funding for the CRL and how that is reflected in AT or AC financial statements is still being worked on and needs to be considered "tentative". Staff will update the Board on that issue at the next Board meeting.

Transport Activity and Auckland Transport funding

The Board has had some preliminary discussions on the AC funding mechanisms and have asked for a paper to outline the issues and implications of alternative approaches.

The original position for Auckland Transport is that the organisation did not have any debt. There was a common misconception that Auckland Transport could not borrow, based on a borrowing restriction in the establishing legislation, which stated that Auckland Transport needed approval of AC to borrow. The issue over which organisation would have debt was first raised in regards to the EMU/Depot decisions. AC staff were keen for the debt to be raised by AC, however this was the first decision where the consequences of the organisational context of funding became apparent. The debt for that project now sits with Auckland Transport due to the funding implications of the debt servicing and subsidy of the service (This will not often be the case as the EMU is the first time that debt servicing has been subsidised). However, the issue highlighted the fact that where the assets and debt resides in an organisational context is an important matter in relation to public perception, accountability and is important to clarify responsibility of Directors.

Local Government funding strategy revolves around three inter-related financial elements. The first is rates, the second is capital programme and the third is debt. These are the things that AC and the public focus on. Obviously there are a number of items below these which impact as follows:

- Rates is the result of costs less other funding. Increasing other funding can reduce rates and efficiencies can reduce rates, however equally those items could be used to fund more capital work or reduce debt.

- Capital is simply the programme of work. It is impacted by alternative funding sources available, and whether the capital will provide greater amenity, improved service or more cash flow. Where they provide more cashflow the historic convention tends to argue that it is a commercial service which is best left to the private sector.

- Debt is the result of the capital work programme, minus available funding which may be from operating revenue if that is set at a level to contribute to capital, from capital subsidy, or the sale of assets.

To give examples of the relationships, rates level have an impact on, and are impacted by the debt level through the capital programme. More capital under any given rates level will require more debt, more debt will incur higher interest costs and this will raise costs and flow through to the rates. Conversely if rates are set higher then either more capital can be undertaken or less debt can be raised.

Balancing those factors is a governance choice, in the AC Group given that in the end they are driven by what is an acceptable on-going rates funding position, it is a political matter. Having made those choices on the appropriate balance between the three principal elements through the Long Term Plan, then it is a question of how within the group each element should be managed by the individual entities, to the best result for the ratepayer.

There are essentially three points along the continuum of service delivery that should be considered :

1) The first model is where the service deliverer manages a specific programme of work. It would be funded for that programme and any changes in programme would be determined by the parent. Any savings in efficiency would go into the corporate pool, rather than to the service deliverer. This model puts the parent in the position of making all strategic decisions, deciding on funding methodologies and distributing those savings between its activities as it sees fit.

2) The second model is where the delivering entity is ring-fenced in regards to funding, and is accountable for the delivery of a service in accordance with higher level outputs and outcomes. In such a model the organisation has more certainty over funding streams and has the goal to make efficiency to enhance the services it provides. In these circumstances the focus of the governing body and the parent is on the longer term outcomes, in addition to the medium term programme.

3) The third model is that the entity is more separate from the parent and is responsible for the long term delivery of the service, is accountable for the service strategy and the funding/balance sheet implications of the service strategy. The parent holds the reins but relies on higher level controls on the deliverer to influence the outcomes.

No single model is right and the choices made depend more on the nature of the service and the extent to which the parent believes a specific model will result in the right balance of incentives and control.

Currently AT is being positioned in the second model. That is longer term funding certainty will be in place through the Long Term Plan, but debt will sit with AC and be injected into as equity, this equity will be borrowed by AC and will sit in the AC transport activity in the Long Term Plan. This will raise a question of the increasing differences between the Transport Activity and the funding and financial statements of Auckland Transport. The differences between Scenario 1 and Scenario 2 will get very large. In the current Annual Plan the Transport Activity has revenue of about $400m while the funding provided to AT through Grant is about $280m. Therefore about $120m of Transport costs are not AT costs, under current scenarios this will rise.

At present overarching philosophy to funding AT is that funding decisions will be made by the parent. Operational funding and capital funding are determined by the parent and modified in a manner which is in the best interests of the parent. This is a valid process and is recognised in the Companies Act for a subsidiary which is wholly owned by a parent. If efficiencies are made by the current mechanisms see those gains going to the parent for distribution within the other services provided by AC.

It is not a question that benefits should go to the benefit of the ratepayer, but rather a question of what the best incentives are for the operating units to ensure that the ratepayer and taxpayer get the best value for money in the long term.

Part of the deliberation must be transparency and inclusiveness. The work of AT has an impact on the funds required from the ratepayer, however the AT Board have little visibility of that impact. The Directors are aware of the funding requirements of AT's services but the implications of how they are funded have a long term implication on the service levels and on ratepayer affordability. It is not for AT to make determinations on that affordability. That is a political determination. However the impacts of the funding and the mechanisms used do impact on the public perception of AT as an entity. An example of this was the S and P release that AC credit rating may be impacted by the debt taken on for the transport programme.

When the Long Term Plan is released it will be apparent that rates rises are due to the capital programme for Transport, this was so in the current Long Term Plan and will be more so with the introduction of the new major capital works. In the current year about 70% of AC's debt raising is for Transport projects. This will remain so for the next decade, in fact it is likely that the proportion will rise.

The funding implications for AC are most in focus at the time of the Long Term Plan. This process identifies a 10 year programme and sets in place the funding mechanisms to deliver on that programme. Rates and debt levels over the full period must be considered and the plan is audited and goes for public consultation with an audit opinion included. The aim is to ensure that the plan has acceptable rates rises and debt capacity to undertake the programme.

The primary issue is which organisation is best to manage funding mechanisms for transport services once AC has determined the debt level.

Under the current scenario the Board does not have the information to determine what is the best mix of revenue funding and debt funding. With this being the case the Board may not be aware of a growing gap between what the public perceive as being the funding going into transport from an AC perspective, compared to the funding coming to the organisation.

The impact of funding mechanism is fundamental over the long term. If the funding mechanisms are set correctly they can create greater organisational capacity. If they are not set correctly then there will be organisational leakage which could mean that the organisational efficiencies get lost and the rates funding issues always remain.

The effect is most dramatic on services which have high capital requirements being driven by debt raising. Under the current funding methodologies, funding for AT is assessed for operations on one basis and for capital on another. If AT was to increase the efficiency of the organisation then the operational grant would reduce by a corresponding amount. If the capital work programme is not achieved then the implications of that on the funding profiles is negated and the savings go into the AC pool.

The principle question to consider when determining what model works best is to ask the question, would the same decisions be made based on the two different scenarios presented in the financial information attached (compare Attachment 3 & 4).

If the questions and decisions would be the same there is no requirement to address the funding model. If they are different the Board may wish to consider how the funding model discussions should be progressed with AC.

Recommendation

It is recommended that the Auckland Transport Board receives this report.

Attachments

Attachment 1: Activity Details

Attachment 2: Capital Works Programme

Attachment 3: Financial Scenario 1

Attachment 4: Financial Scenario 2

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