USING LAND FOR HOUSING

SUBMISSION TO THE NEW ZEALAND PRODUCTIVITY COMMISSION

4 AUGUST 2015

BACKGROUND TO IPENZ

The Institution of Professional Engineers New Zealand (IPENZ) is the lead national professional body representing the engineering profession in New Zealand. It has approximately 16,000 Members, including a cross-section from engineering students, to practising engineers, to senior Members in positions of responsibility in business. IPENZ is non-aligned and seeks to contribute to the community in matters of national interest giving a learned view on important issues, independent of any commercial interest.

SUMMARY

IPENZ commends the Productivity Commission on a well-researched report. In brief our comments are:

- Some comments are not necessarily relevant to smaller rural councils and they face a very different set of challenges
- The Finding on the renewals/depreciation "gap" may not reflect a real problem and the should be reviewed
- In the water sector there are very real efficiency opportunities through economies of scale, improved procurement arrangements, and through greater use of commercial disciplines and institutions.
- Without comprehensive sector reform, economic regulation of prices for water services creates problematic accountability issues.

GENERAL COMMENTS

The draft report is of high quality and reflects the comprehensive research that has been undertaken by the Productivity Commission. We also note that there has been considerable input by local authorities adding to the quality of the Findings and Recommendations.

IPENZ supports many of the findings and recommendations relating to infrastructure – for planning, delivering, paying for, and governance of infrastructure.

The focus of the report has appropriately been on the larger urban councils, and some of the issues are relevant to many other councils – and some are not. For example we believe there is scope for institutional reform of water infrastructure management across the entire sector.

On the other hand some territorial councils with modest of no growth welcome new development and provide rates holidays for commercial developments. Such growth and growth in urban areas increases the rating base so these territorial authorities are generally incentivised to facilitate growth.

Also there are real affordability concerns for smaller rural councils, some with declining populations, and probably face infrastructure funding challenges in the future. The extent of this problem is largely unknown at this stage.

We were surprised that in the context of affordable housing the document scope has extended to water management reform. The reason for this is unconvincing, and is found on page 213: "capitalising on these opportunities could improve the performance of the sector in general and in the way it contributes to the supply of land for future urban growth."

Due to our general support for the draft report we make only a few comments and have confined them to a few Findings and Questions where there is an engineering aspect, and where we thought we could add value to the draft report.

SPECIFIC COMMENTS: RESPONSES TO QUESTIONS IN THE CONSULTATION DOCUMENT

SECTION 6.6 EFFECTIVE USE OF EXISTING INFRASTRUCTURE ASSETS

Finding 6.9. Forecasts in the Long-Term Plans of high-growth councils point toward a growing and potentially under-funded requirement for infrastructure renewals. Effectively managing ageing assets and funding the renewal of infrastructure are likely to be major challenges for councils in the coming years.

Figure 6.2 shows a so called "renewals/depreciation gap" for the high growth councils. Finding 6.9 provides a similar finding to the Castalia Strategic Advisors Report for Local Government NZ (*Exploring the issues facing New Zealand's water, wastewater and stormwater sector*, October 2014, p14), and the Report of the Office of the Auditor General (*Water and Roads: Funding and Management Challenges*, November 2014, Figures 8 & 9). Both draw the conclusion there is an asset sustainability gap and that this is a problem.

This is a contentious issue as predicting remaining useful lives for long life assets is difficult. Also for water assets in particular capital expenditure is often very lumpy (unlike roads) as, for example, the case of a new or significantly upgraded wastewater treatment plant.

It often does not make economic sense to cash fund depreciation now for an ill-defined future renewal programme that may not be required for 30-40 years and whose timing is almost always uncertain. Similarly for new capital works loan funding may be used, and it is inappropriate in equity terms or economic terms that the current generation are requested to both service the debt and cash fund depreciation for the same new asset at the same time.

Section 100 (2) (Balanced budget requirement), of the Local Government Act 2002 enables councils to fund infrastructure capital works and renewals by debt rather than cash funding depreciation (well in advance of expenditure) as follows:

"a local authority may set projected operating revenues at a different level from that required by that subsection (subsection 1) if the local authority resolves that it is financially prudent to do so".

Therefore care needs to be taken in interpreting this "gap" as a problem. We think the approach by Treasury to this issue is more measured. The National Infrastructure Unit (*Evidence Base – Urban Water - How well are we managing it?*), conclude, from the same data, that with forecast renewals expenditure on physical

assets being below depreciation, in and of itself, is not conclusive. They explain that there are concerns with this formula and all parties recognise that there will be valid reasons why, for some local authorities, a ratio of less than 100% is appropriate.

Therefore Finding 6.9 should be reviewed.

SECTION 8.2 WATER INFRASTRUCTURE

Question 8.2. Are there significant scale economies in the provision of water infrastructure that could improve the efficiency of provision that are not being realised in New Zealand's high growth cities?

We note the report refers to a joint report *Who, What, Wai – Improving Urban Water Services* by IPENZ, Water NZ and Ingenium (now IPWEA NZ Division) in 2013.

Our conclusions in that report were:

It is apparent that economies of scale and to some extent of scope, sufficiency of funding and use of commercial disciplines in decision making are the key factors that determine the efficiency of a water entity. Nevertheless, it is important to recognise the trade-off between accountability and economies of scale.

Overall, our assessment suggests there are opportunities for greater water industry efficiency and effectiveness by creating greater economies of scale and to a lesser extent utilising scope. Detailed analysis of the options suggests rationalising smaller entities into larger, single-focus groupings combined with a commercial approach, should be encouraged in many circumstances.

The obvious step to improve efficiency and effectiveness is introduce CCOs and combined CCOs – particularly in provincial and rural New Zealand. This leaves the existing accountability mechanisms in place and yet harnesses both economies of scale and commercial disciplines.

One of the interesting issues is the state of procurement practices for water and wastewater maintenance activities and we believe that the procurement practices for the three water services need to be reviewed. We note from the report by NZIER for Local Government NZ - *Three Waters Services - Results of a survey of council provision* (objective 6 – service providers, page 24), that 96% and 88% of provincial and rural councils respectively have in house service provision of potable water services. There are similar high figures for wastewater and stormwater services.

There is substantial international evidence that tendering of infrastructure services in competitive markets delivers savings. It is our view that better procurement (outsourcing) will in turn lead to joint contracting out by councils to achieve economies of scale – as has happened for roading over the last decade or more. Outsourcing of water service delivery (particularly potable and wastewater services) has the potential to provide considerable savings to ratepayers.

Question 8.4. Does a case exist for introducing access, quality and price regulation for water services in New Zealand?

There is already regulation of some elements of water services. Drinking water quality requirements are covered in the New Zealand's drinking water standards and are nationally regulated by the Ministry of Health. The means of compliance is prescribed in the Health Act 1956. There is a clear national benefit that justifies a national approach to drinking water quality.

Other quality measures are now standardised and are set out in the Non-Financial Performance Measures Rules 2013 for all three water services. This will allow comparisons or benchmarking but it is difficult to see any national benefit in for example requiring the same response times. In other words it makes sense to have standard measures, in parallel with different levels of service, to suit the needs of different communities.

Economic regulation or regulating prices nationally is problematic and raises some central government/local government accountability issues. Who would the regulator be accountable to? Currently there is direct accountability between the users (the payers) and the council. Is it really feasible for central government to be accountable for water prices in a small local authority?

The co-regulatory model for the gas market is essentially industry supported government regulation. It is difficult to imagine that territorial authorities would support government deciding local rates for water services. Hence in our view economic regulation would only be feasible with widespread institutional reform of the water sector.

Water is charged on a volumetric basis by most territorial authorities for commercial and industrial users but only a few territorial authorities (including the Auckland Council with 1.5 million users) use volumetric charges for residential users. Most other councils charge for residential water on a uniform annual charge i.e. a flat rate per property. Prices are based on the costs of provision.

Question 8.5. How could the governance and funding arrangements for water infrastructure be improved to encourage providers to be more responsive to demands for new connections to the water network?

The governance and funding arrangements for new connections are covered by the current arrangements for development contributions and financial contributions.

Adequate funding of water infrastructure is difficult for some councils, but there is no firm evidence on the extent of this problem. Our perception is that there are issues with some smaller councils who have very limited financial resources. This can be resolved to some extent by using area wide pricing (some urban areas supporting others urban/rural areas in the same territorial authority).

Note that water networks for many councils consist of a number of different discrete networks each with their own distinct cost drivers so the term “network” pricing is not appropriate.

CONCLUSION

We appreciate the opportunity to make this submission.

For more information please contact:

Tim Davin Director External Relations, IPENZ

Email tim.davin@ipenz.org.nz

Phone 04 473 2027

PO Box 12241, Wellington 6144