Advice to Wellington City Council Regarding Three Waters Services Operational Expenditure for the Financial Years 2022/23 and 2023/24

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DATE	20 April 2022

Purpose of this advice

1. This paper provides
   a estimates as at March 2022 of operational expenditure on Wellington City Council's three waters assets required to maintain existing levels of customer service for the coming two financial years, 2022-23 and 2023-24;
   b reasons the increased forecasts for those years are above the budgets in the 2021-31 Long Term Plan.
   c options for managing with budgets less than those forecast

Summary

2. Aging three waters assets continue to affect customer service and environmental outcomes in Wellington.
3. During the 2021-31 long term plan drafting process and in subsequent reviews, Wellington Water advised Council there would be a need for increased investment in three waters above historical levels and figures initially provided for the draft plan.
4. We have reforecast operational expenditure budgets based on latest actual figures and market changes, and they are above the long term plan budgets due to: increased monitoring and investigations work; increased planned maintenance work; increased reactive maintenance incidents and costs; a tight labour market; material supply constraints.

5. The forecast for this year is 24.3% above the previous year and this increase has been partially met by government stimulus funding. The increase for 2022-23 over the 2021-22 forecast is 4.7% and for 2023-24 over 2022-23 is 3.9%. These changes and the differences compared to LTP figures are set out in the table below.

Table 1. Budget and forecast costs for operational expenditure, 2022-2024

3 waters operational budgets	**2021-22** **$m**	**2022-23** **$m**	**2023-24** **$m**
2021-31 LTP	35.3	37.2	39.7
Forecast @April 2022	41.9	43.8	45.5
Change from LTP	6.6	6.6	5.8
% change from LTP	18.7%	17.7%	14.6%
Change from previous year	7.7	1.9	1.7
% change from previous year	**24.3%**	**4.5%**	**3.9%**

6. Holding operational expenditure at LTP budget levels would reduce levels of customer service including repairs and responses, curtail proactive maintenance and condition assessment work, and increase risks to human and environmental health.
7. Advice provided in November 2021 identified emerging additional risks to operational budgets, including: cyber security; regulatory changes including new Taumata Arowai standards (requiring additional testing, monitoring, calibration, and maintenance); continued work on asset information and data improvements; and labour market issues. This advice including forecasts has been updated where possible.
8. If Council is unable to fund at the forecast levels, any increase will still be valuable. Proactive maintenance activities will likely be the most affected.

Wellington City Council Operational Expenditure – three waters

Overview

9. Council-owned three waters assets are ageing. This means they're not being renewed or replaced as quickly as they're wearing out, and that means increasing failures. This situation is a result of under-investment in renewals, which has been the case in Wellington and in many other parts of NZ for decades. Because the network has been under-funded for such a long time, it will be very expensive to reverse the deterioration – and will take a long time.
10. As Council began developing its 2021-31 long term plan, it learned about these issues and more through the Mayoral Taskforce on the Three Waters, and from officers' advice. It set an intention to

address the deterioration of its assets and create a city with resilient water infrastructure that would support growth and environmental goals.

11. Wellington Water provided a range of investment scenarios to address these issues over time, and also advised that the limited information we had on the networks, along with other environmental factors, meant there was still a lot of uncertainty about what levels of improvement could be delivered by when. For example, an unexpected failure could reduce funding for repairs; or a sudden flood could mean there was less money to carry out proactive maintenance work – setting back the overall programme.

12. The three waters budgets set in the final draft of the 2021-31 long term plan were a significant increase on previous years, but they were at bottom of the range of scenarios presented. This meant that there was still considerable risk to customer service levels from increasing numbers of network faults and defects. The long term plan budgets also excluded a contingency for emergency work that had been made in previous budgets – meaning that if a major incident should occur, it would need to be covered from the reactive maintenance budget.

13. The long term plan includes annual budgets for three years. Setting these budgets low meant there was additional risk to years two and three not just from increased numbers of failures, but from increased costs. That is what has happened. Costs to repair faults, and the number of faults, have continued to rise.

14. The long term plan budget for operational expenditure – which includes reactive maintenance (repairs), proactive maintenance, asset condition assessments, network monitoring, investigations, and major incidents – for the 2021-22 year was $35.3m. The forecast at March 2022 is $41.9m. To help make up the difference, Council in March 2022 approved the use of government stimulus funding.

15. Based on the latest information about asset condition, numbers of leaks and overflows etc., inflation, regulatory and cyber-security requirements, labour market and material cost data, the forecast for 2022-23 is $43.7m and for 2023-24 is $45.5m.

16. These numbers are an increase of $6.5m and $5.8m over the budgets in the long term plan. Relative to the current year forecast of $41.9m, (including the stimulus funding) the increase is $1.9m (4.5%) for 2022-23 and $3.6m (3.9%) above 2022-23 for the 2023-24 year.

17. These numbers are slightly different from advice provided in November, due to better information on the impact of inflation (now over 6%), labour shortages, service requests and material supply issues.

18. The biggest area of operational expenditure activity is operating the wastewater treatment plants, and there has been a steady increase in those costs. The next largest activity is reactive maintenance (repairs, overflows). These two areas are the least unavoidable of operational expenditure – we have to treat wastewater, we have to fix bursts and clean up after wastewater blockages.

19. The current year also shows a big increase in planned maintenance, condition assessments and monitoring work. These areas were identified by the Mayoral Taskforce Report as being critical to turning the deteriorating asset story around – helping fix things before they break, avoiding major costs like the Mt Albert tunnel repair, and giving us a better understanding of the network to prioritise renewals.

20. If Council is unable to fund all the revised budgets, then treatment, reactive maintenance and incident responses would be prioritised, and Wellington Water would use proactive work as the budget-balancing activity. More detail would be provided based on the actual amounts funded.

21. In summary, our advice to Council is to continue with the proactive work of planned maintenance, condition assessments and monitoring and to allow for increased costs and the likely continued rise in the amount of reactive work. This will help maintain current levels of customer service with respect to keeping the water running, minimising the impact of wastewater overflows, and responding as quickly as we can, including at nights and weekends, to day-to-day as well emergency events.

Changes from previous advice

22. Advice was provided to Council in November 2021 and again in February 2022 on the forecast for the current and the next two years. Reasons given for the increased forecasts included higher costs for reactive maintenance, monitoring, investigations, condition assessment and planned maintenance.

23. In addition, the November 2021 advice identified that people and building and construction material shortages may cause cost escalations and delays.

24. We also signalled in November that we expected actual costs to be around $5m above the long term plan budgets for 2022-23 and 2023-24. Based on the latest data, we now expect those numbers to be closer to $6.6m and $5.8m respectively.

New forecast

25. The largest factor in the forecast increase is in the area of network maintenance. This is driven by:

    a record levels of customer service requests, a major burst, and significant storm events

    b increased breadth of response (such as providing drinking water, after hours work) to maintain service levels. External resources are being used to meet the service requests.

    c increased reactive maintenance

    d an estimated 20-30% increase in cost of materials for construction works.

    e There are vacancies across the organisation with some roles being filled by consultants or contractors at higher rates and this is expected to continue in the next two years. For example the Customer Operations Group (COG) have vacancy rates fluctuating between 20-30% for the deport that serves Wellington. This has resulted in an increase in sub-contractor teams being used for service requests.

    f Additional salary pressure is expected to be put on the organisation in future years in the constrained market. As an example, recently a minimum $5/hour increase over two years was given to all staff in COG (who predominantly respond to Service Requests and other network maintenance work), to help with staff retention

    g A significant increase in planned maintenance is required in future years to help manage the increase in reactive management for the ageing networks

    h The value of continued condition assessments.

26. The numbers presented for the years 2022-23 and 2023-24 do not include contingencies for significant events (e.g. asset failure or storm events with a large cumulative cost) outside of BAU reactive maintenance.