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## Transport Reserves

### 1. Purpose

To update the Council on the proposed use and funding of Transport Reserves in minimising the volatility in Transport expenditure.

### 2. Significance of Decision

The matters in this report do not trigger the significance policy of the Council or otherwise trigger section 76(3)(b) of the Local Government Act 2002.

### 3. Background

The Transport budget is prepared within a framework that can have a high level of complexity and volatility within it. This has been the situation for a number of years although this has been increasing over time. This complexity is mainly due to the contracts that Transport have with commercial operators to provide transport services, namely bus, trolley bus and rail.

A number of payments made under those contracts are dependent on complex calculations prepared by third parties. For example, the diesel price adjustment for the bus contracts is prepared by Land Transport New Zealand.

The volatility in these contracts has been evident for a number of years but the advent of new rail and trolley bus contracts will only add to this volatility.

This trend is expected to continue in future years. For example, total expenditure in 2004/05 is forecast at \$57 million. Within 5 years this is forecast at \$81 million and within 7 years, \$92 million.

While a portion of this expenditure will be under the control of the Transport Division, significant and increasing amounts will not. For example, expenditure on the rail contract, purchase/refurbishment of rolling stock, various bus/trolley contracts all have external factors which can, and have, significantly changed the amount of funds required.

Factors such as inflation, fuel, staff costs, patronage numbers, fares all impact on the actual amounts paid compared with the estimated budget amounts. This is evident in the level of variability shown in the current year.

The complexity of some of the calculations, coupled with the significant time delay between budget setting and the actual results being incurred means that there has been and will be material variability between the budget and actual results. To minimise the effect of this variability in the future it is proposed that there is a formal policy including the funding of Transport reserves to minimise the effect.

#### **4. Reserves**

Reserves have been used by GWRC over a number of years to ensure that ratepayers pay the appropriate amount for each project.

At its simplest, where a project has been rated for and is incomplete (or not commenced) at year end, then the unspent amounts may be transferred to a reserve account.

At year end a list of projects which have been rated for and are incomplete (or not yet commenced) is prepared by each division for review by senior management. If, after this review, it is considered appropriate for the unspent project expenditure to be carried forward to next year, then it is considered by Council for their approval.

At this point, the unspent monies are transferred to a rebudget reserve at year end which forms part of Ratepayers' Funds in the balance sheet.

On 1 July these rebudget reserves are reversed and credited against the specific project. As the monies are spent, the credit in the project account will be reduced.

Reserves are only used for specific projects (already rated for) and not for items of a general nature such as payroll.

Similarly, if projects have not been rated for (e.g. flood damage) then reserves are used to ensure that those ratepayers who benefited will eventually be allocated their share of the cost.

Reserves at any point in time can either be in surplus or deficit. Therefore, reserves have been used as a method of reducing the volatility on ratepayers of certain types of expenditure. The most notable example being in flood protection.

#### **5. Transport Reserves**

Apart from the Transport reserve, all reserves are either fully or partly funded by the general rates.

In respect of the Transport reserve, it is increased by any Transport funding surplus's during the year. Similarly, any deficits will reduce the reserve. No

general rates are allocated to the reserve as the Transport rates and general rates are calculated and allocated on different basis.

Thus, apart from rebudgets, increases and decreases in the Transport reserve occurs largely automatically.

As noted previously, the level of expenditure in Transport is forecast to increase significantly over the next few years. While around half of that expenditure is funded by LTNZ, the remaining amounts funded from rates are still large when compared with the Council's total rates, at around 50%.

There are a number of ways to deal with this potential variability.

1. Accept any funding surplus or deficits overs/unders as part of the new environment in Transport.
2. Allow for an additional amount within the Transport rate to cover for any higher than expected eventualities. Assuming this led to a funding surplus, then this would increase the Transport Reserve.
3. Devise a reserve strategy to smooth out this variability to minimise the effect on the ratepayers.

Currently there are only two Transport reserves:

- a) Reserve for rebudgets
- b) General reserve for all other items.

The forecast reserves at 30 June 2005 are:

	<b>\$000</b>		
	<b>Rebudget</b>	<b>Other</b>	<b>Total</b>
Opening Balance	495	2,296	2,791
Transfer from reserves	(495)	(1,105)	1,600
	<b>-</b>	<b>1,191</b>	<b>1,191</b>
Transfer to reserves			
Interest <sup>(1)</sup>	-	118	118
Funding Surplus	-	1,904	1,904
Rebudgets	705	-	705
<b>Forecast Balance 30 June 2005</b>	<b>705</b>	<b>3,213</b>	<b>3,918</b>

- (1) Interest is paid on the balance of the reserve by Treasury. If the reserve is in deficit then interest is charged by Treasury.

## **6. Proposed Reserve Strategy**

It is proposed to have three Transport Reserves.

### **6.1 Rebudget Reserve**

As noted above, projects which are incomplete at year end are reviewed by management prior to their consideration by Council. If approved, then the unspent monies will be transferred to the Rebudget Reserve.

The reserve will be cleared to zero at the start of the new year and transferred to the relevant project account.

### **6.2 Transport Commercial Reserve**

This would be used for surplus/deficits arising out of Transport's commercial contracts, namely:

- a) Rail contract
- b) Trolley bus contract
- c) Bus contracts

Each of these contracts commit GWRC to the funding of services to a certain level, dependent upon a number of factors such as inflation, diesel etc. Once entered into, GWRC has no option but to spend the amounts required by the contracts.

All of these contracts have large external influences on them, such as fuel, inflation, patronage, wages etc. and are likely to have most of the volatility which is outside of the direct influence of Transport.

This Reserve will be funded by:

- a) Any funding surplus arising from the above contracts.
- b) Any other funding surpluses arising within Transport
- c) Specific amounts rated for the purpose of increasing the Reserve.
- d) The opening balance as at 1 July 2005.

The forecast reserve balance as at 30 June 2005 of \$3.2 million (excluding rebudgets) would represent the opening balance of this reserve on 1 July.

### **6.3 Transport General Reserve**

This reserve will account for all other funding deficits ie. any deficit not arising from the bus/trolley/rail contracts. It will be funded by specific amounts rated

for it each year. Any deficits will attract an interest charge until the deficit is cleared.

As noted above, it is intended that any surpluses arising from the other parts of Transport operations will also be transferred to the Commercial Reserve.

There are two reasons for this:

- a) The spending/not spending of funds outside the rail/bus/trolley contracts is under the control of Transport. Therefore they can choose (albeit with the approval of Council) not to spend the money.

If the decision to spend monies above the budget is made, then this will not be shielded by any reserve surpluses arising from previous periods. To recover these amounts off ratepayers, then it will need to be rated for separately in future years. Therefore the use of this reserve will also act as a budget control mechanism as well.

- b) The large amounts involved in the bus/rail/trolley contracts will require a significant reserve balance to reduce the volatility.

## **7. How much is required?**

The rates requirement for Transport in 2005/06 is \$29.2. Of this, \$20 million relates to the bus/trolley/rail contracts.

The total Transport Reserve (excluding rebudgets) is forecast to have a balance of \$3.2 million at 30 June 2005 which represents 16% of the expenditure on the rail/bus/trolley contracts.

The reserve has to allow for the variability in revenues and expenditures in respect of the existing budgets arising from changed circumstances.

Transport is entering into a new environment with a new rail contract, changes to the Trolley bus arrangements and the purchase of new/refurbished rolling stock.

Thus the volatility is likely to be greater in the next few years as contracts are bedded in and assets purchased. However, the Council's ability to fund the reserve (if required) will be limited to the opening balance in the reserve, any funding surpluses plus any additional Transport rates.

A reserve of \$2.0 to \$3.0 million, which represents 10%-15% of the net expenditure, (i.e. that amount required to be funded by rates) would appear appropriate at this stage in respect of the Commercial Reserve.

This level of reserve should be sufficient to cover any additional amounts required by our contractual obligations. These, of course, would be noted to Council in a timely manner.

In respect of the General Transport Reserve, then this will have a zero opening balance. Any future deficits will be funded by increased rates in the following

year(s) if deemed appropriate by Council. The same in respect of increased rate requirements will also be true of the Transport Commercial Reserve.

The General Reserve should never be in surplus as any funding surpluses arising from the non contract operations will be transferred at year end to the Transport Commercial Reserve.

## **8. Additional Rates**

### **8.1 Commercial Reserve**

The balance of the Commercial Reserve as at 30 June 2005 is expected to be \$3.2 million. As discussed above, this is considered sufficient as a starting point and no additional rate monies are required in respect of 2005/06.

However, it is probable that additional rates monies may be required if the Commercial Reserve falls below what is considered an acceptable level.

The ability of the Council to rate additional monies to fund the reserve is not great. For example, \$250,000 will add approximately 1% to transport rates, 0.4% to total rates.

It is proposed that a minimum level of \$2 million is targeted for this reserve. No additional rate monies should be levied as long as the reserve is forecast to be in excess of \$2 million.

The \$2 million is a level which represents about 10% of the net expenditure on those contracts and this is considered an adequate level.

If, however, the reserve balance is forecast to be less than \$2 million, then it is proposed that additional rates monies will need to be levied.

The amount of monies that need to be raised when the reserve is below \$2 million could be as follows:

- a) The amount required to get the reserve up to \$2 million, up to a maximum of \$250,000.
- b) Where the amount required is greater than \$250,000, then \$250,000 should be rated for in the following year. Subsequent years will also need additional amounts, again up to a maximum of \$250,000.

In the event that the reserve has fallen significantly below \$2 million, then it is proposed that \$250,000 be rated for in each year until the balance of the reserve is \$2 million.

### **8.2 General Reserve**

If this reserve goes into significant deficit then any additional rating monies required shall be considered each year.

## 9. Reserve Deficits

Under current policy, reserves are permitted to go into deficit. However, the policy also states that deficits will be reduced to zero within three years by the charging of additional rates.

It is proposed that the Transport reserves will comply with that policy.

## 10. Communications

There is no communications required at this stage.

## 11. Recommendations

*That the Committee*

- (1) **Receive** the report.
- (2) **Note** the contents of the report.
- (3) **Approve** the policy and funding of the Transport Reserves as detailed in the report.

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