

CAPACITY INFRASTRUCTURE SERVICES LIMITED

REVIEW OF 2008/09 ANNUAL REPORT

The Company presents its Annual Report including unqualified audited financial statements and performance measures.

Highlights for the year

- The Company integrated the Upper Hutt City Council water management business during the year.
- During the year Capacity was responsible for managing \$29m of capex and \$65m of opex (excluding interest and depreciation) for the three councils.
- While not all performance measures were achieved (notably the savings target as discussed below), the Company achieved the majority of performance targets included in the Service Level Agreement and Statement of Intent.

Performance

1. Financial

A review of the Council's internal reports detailing the performance of Council's water infrastructure assets shows that there was overspend against the Council's opex budget and underspend against the Council's capex budget for 2008/09.

- At first glance, Capacity underspent by \$2.7m against the opex budget for the year, largely due to \$6.2m of unbudgeted vested asset income which is unrelated to the Company's activities.
- Excluding the 'stewardship' accounts which the Company does not control (including vested asset income), Capacity overspent the opex budget for the year by \$662k. The largest contributor to this was unbudgeted maintenance on the stormwater network due to CBD culvert cleaning and Miramar flood mitigation work – this work was undertaken following consultation with the Council.
- Of the total capex underspend of \$3.7m, the majority (\$3.1m) was due to the deferred construction of the Messines Road Reservoir until 2009/10. Another \$1.1m was underspent due to resource consent delays for the Moa Point UV pilot plant and inlet pump station; this work is now scheduled for 2009/10. Sewage network renewals, water reticulation renewals and stormwater network renewals cost slightly more than budget.
- The entire \$4.2m of capex underspend relating to the Messines Road Reservoir and Moa Point UV pilot plant and inlet pump station delays has been approved to be carried forward to 2009/10. The delays in these projects were outside the Company's control and Capacity followed all appropriate procedures in requesting the carry forward.

A summary of the Capacity financial statements is given below. The key points to note are as follows:

- Revenue was \$191k ahead of budget because of the \$218k funding received for the Company's relocation, which was unbudgeted.
- Actual expenditure was \$233k more than budget due to higher 'operational expenditure' (\$376k) more than offsetting the lower 'rental and operating lease costs' (\$54k) and 'personnel expenditure' (\$85k).
- The majority of the increase in operational expenditure was due to unbudgeted relocation costs (\$218k) and additional consultancy and IT development costs on projects like the workflow management system, website review, and ISO accreditation.

Statement of Financial Performance

\$ '000	FY Actual	FY Budget	2007/08 Actual
Income	6,520	6,329	5,423
Expenditure	6,498	6,265	5,508
Operating Surplus	23	64	(85)
Net Surplus	(8)	64	(89)

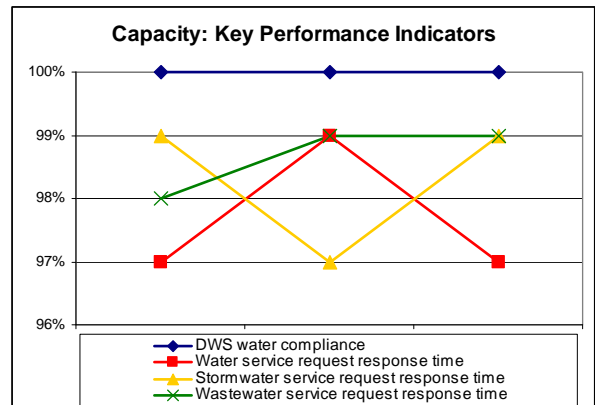
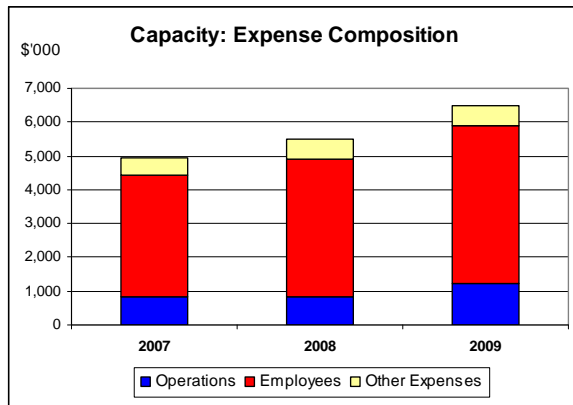
Statement of Financial Position

\$ '000	FY Actual	FY Budget	2007/08 Actual
Current assets	1,305	1,045	1,036
Non current assets	53	39	59
Current liabilities	1,083	707	808
Non current liabilities	-	-	-
Equity	275	376	287
Current ratio	1.2 : 1	1.5 : 1	1.3 : 1
Equity ratio	20%	35%	26%

Statement of Cash Flows

\$ '000	FY Actual	FY Budget	2007/08 Actual
Operating	112	110	(85)
Investing	(15)	-	(5)
Financing	-	-	-
Net	98	110	(90)
Closing balance	384	274	286

Note: the Company's financial statements have been prepared using NZ IFRS.



2. KPIs

The KPIs reported by the Company for the 2008/09 year are given below. The Company has achieved its target for the majority of its performance measures. Of those not achieved, it is worth noting:

- The five year savings targets were not achieved; there was a variance of \$3.377m versus the WCC savings target of \$2.505m for the first five years of operation (i.e. there was overspend of \$0.872m).
- It should be noted that with the conclusion of the savings model inputs for the initial five year period, there are a number of operational expenditure elements that occurred throughout the term of the SLA that may be considered by Council as potential mitigation factors to the savings target variance. These factors were potable water leak detection, critical drains inspections and repairs, Miramar alternative flood protection response, and restoration of stormwater culverts capacity.
- In its annual report, the Company notes that it achieved 80% of the HCC savings target.
- Delivery of capex and opex against budget for HCC were not achieved for the 2008/09 year due to some emergency repairs required at Naenae Reservoir and the carry forward of five projects.
- Capacity labour recovery was at 69% for the year, below the 80% target. The Company notes that the labour productivity rate (which it considers a more accurate measure) was 82%.
- The percentage of sampling days where a range of contaminants are not seen was below target, at 98%.
- One resource consent compliance infringement notice was received by a contractor at the Moa Point treatment plant operating under Capacity management.

Performance targets for Capacity as set out in the Statement of Intent 2008/09	
KEY PERFORMANCE TARGET	ACTUAL
Achieve total overall savings of \$4.175 million to shareholding councils after five years (30 June 2009), and \$1.6 million annually thereafter	Not achieved. HCC - \$1.342m savings realised of the \$1.67m target. WCC - \$872k overspent on the savings target of \$2.505m As noted above, there are some expenses that may be considered by Council as potential mitigation factors to the savings target variance. The Company notes that, in particular, \$1.53m of additional work was undertaken with Council's agreement that was not factored into the model.
Achieve targets within allocated Capacity budget	Achieved. Targets achieved within budget.
Comply with financial, technical, and regulatory standards	Achieved. All standards have been complied with.
Delivery of capex against budget for respective Councils	Achieved – WCC Not achieved – HCC (5 projects carried forward) Achieved – UHCC
Delivery of operating expenditure against budget for respective Councils	Achieved – WCC (excluding depreciation) Not achieved – HCC Achieved – UHCC
Establish a strategic business plan by 30 June	Achieved. The 2009/10 strategic business plan was completed by 20 May 2009.
Develop asset management plans as required	Achieved. Asset management plans for 2008/09 completed.
Capacity labour recovery to be 80% or more at year end	Not achieved. 69%
Meet performance measures as set in the service level agreements	29 out of 34 performance measures were achieved.

Performance targets for Wellington City Council 2008/09			
WATER - KEY PERFORMANCE INDICATOR	TARGET	ACTUAL	RESULT
Compliance with New Zealand drinking water standards	100%		2009: Achieved 2008: Achieved
Service requests relating to the water network are responded to within one hour of the request being received (response includes initial investigation and prioritisation of work)	97%	97% 99%	2009: Achieved 2008: Achieved
Residents surveyed about water network service are satisfied with work carried out	75%	99% 91%	2009: Achieved 2008: Achieved
Minimising unaccounted for water loss from the network	No more than 19%	17% 21%*	2009: Achieved 2008: Not achieved

STORMWATER - KEY PERFORMANCE INDICATOR	ANNUAL TARGET	ACTUAL	RESULT
Service requests relating to the stormwater network are responded to within one hour of the request being received (response includes initial investigation and prioritisation work)	97%	99% 97%	2009: Achieved 2008: Achieved
Residents surveyed about stormwater network service are satisfied with work carried out	75%	93% 100%	2009: Achieved 2008: Achieved
Percentage of sampling days where the following contaminants are not seen: scums or foams, floating or suspended material, abnormal colour or clarity, fats or gross solids	100%	98% 97%	2009: Not achieved 2008: Not achieved
The percentage of sampling days at monitored bathing beaches when water quality complies with Ministry for the Environment guidelines (green status)	90%	98% 93%	2009: Achieved 2008: Achieved
Percentage of monitored freshwater sites where the median annual faecal coliform bacteria counts are less than 1000 per 100ml	90%	90% 89% (target 80%)	2009: Achieved 2008: Achieved

WASTEWATER - KEY PERFORMANCE INDICATOR	ANNUAL TARGET	ACTUAL	RESULT
Service requests relating to the wastewater network are responded to within one hour of the request being received (response includes initial investigation and prioritisation work)	97%	99% 99%	2009: Achieved 2008: Achieved
Residents surveyed about stormwater network service are satisfied with work carried out	75%	93% 100%	2009: Achieved 2008: Achieved
The percentage of monitored consented harbour/coastal sites where the median annual level of faecal coliform bacteria counts are less than 2000 per 100ml (lower levels of these bacteria mean the water is cleaner)	80%	92% 92%	2009: Achieved 2008: Achieved
Resource consent compliance – the number of infringement notices received	No infringement notices are received	One infringement notice received for Moa Point treatment plant	2009: Not achieved 2008: Achieved

* Company has now adopted Statistics New Zealand's methodology for calculating population in the production of the water use, per capita and the water loss figures. As a consequence the 2007/08 figure would likely be 20%. It should also be noted that this metric involves some assumptions and therefore a degree of subjective risk in assessing its accuracy.

3. Operational

The Company notes that the UHCC water services operation was successfully integrated during the year. In June Capacity moved premises within Petone to provide room for expansion in the future.

Capacity completed asset management plans for each of its three customer councils. The wastewater plan for WCC was highly rated by Audit New Zealand as part of the Council's LTCCP audits. The Company also received ISO 9001:2000 accreditation (a widely used quality management system) during the year. Using primarily internal resources and HCC's asset management system, Capacity was

able to complete the HCC valuation for water services during the year – the Company notes that this saved HCC \$43k.

During 2008/09, Capacity implemented a business improvement process, with a particular focus on management of contracts, which assisted the Company in more effectively managing its capex program for WCC. From the Council's perspective, Capacity appears to be following the asset management plan principles in effectively planning and prioritising renewal work.

During the year Capacity worked with WCC on lodging a resource consent application for stormwater operations around the city and work continued on the Western Wastewater Treatment Plant resource consent application. The Company has also obtained a 25 year duration resource consent to operate the Moa Point Wastewater Treatment Plant. In Hutt City the Company is continuing to work towards renewing the resource consent for wastewater overflows into Waiwhetu Stream.

Redesign work was undertaken for the Messines Road Reservoir, which reduced the budgeted capex by \$1m. A resource consent application has been lodged and construction on the reservoir will begin in 2009/10.

Following a tender process, City Care Ltd was awarded a five year maintenance contract for the three customer councils from July 2009.

Governance

The directors during the year were:

Bryan Jackson (Chair)
Peter Allport
Andy Foster (WCC Councillor)
Peter Leslie
Ray Wallace (HCC Councillor)
Richard Westlake (retired 30 June 2009)
Ian Hutchings (appointed 1 July 2009)

Bryan Jackson's term expires on 30 November 2009.

Key issues going forward

Capacity has changed its trading name to Capacity Infrastructure Services Limited from 1 July 2009.

The Company continues to see potential further regionalisation of water services as an area of opportunity, particularly following the integration of the UHCC operation. Capacity is monitoring both developments in Auckland and the investigation of a potential regional water strategy by the regional council and Porirua.

It is worth noting that the fact that Capacity had to request additional funding from its shareholder councils in order to fund its office relocation illustrates the constraints placed on its operation by the current financial structure. This may be an issue the Council needs to consider going forward.

The Company is currently finalising new Service Level Agreements. As a result, performance monitoring will be more closely tied between the SLA and SOI going forward. In addition, Capacity has agreed a \$432k savings target for 2009/10 with the Council; however, there is some risk that the Company may fall short of this target given historic savings targets have not been achieved. In particular, it is important that the level of service is not compromised to achieve a savings target.

Capacity will continue to work on the capex programs of its customer councils, including work such as the Messines Road Reservoir. Over the 2009/10 year Capacity will be undertaking an estimated \$34m in capital works and \$67m (excluding interest and depreciation) in operational work for clients. For example, the Company will be trialling the first pressure management zone in Wellington as it monitors flows and installs pressure-reducing valves, flow meters and telemetry in the Roseneath district metered area. If this program is successful, it may be rolled out to additional areas and could be part of a wider demand management strategy.

The Company is continuing to work on strategic plans for the Council and is in the process of finalising these. Capacity is also starting to build in-house design capability to enable routine design work to be performed internally in the future (initially the team will work with an external consultant to build expertise).

As part of the Capacity health check process, the Finance team recommended the following: monthly monitoring of the management fee and consultancy charges (along with forecast expenses); monthly SLA meetings; a review of the 2010/11 Asset Management Plan; Audit and Risk Management Subcommittee monitoring of the implementation of the risk assurance audit recommendations; and CCOPS monitoring of the key SLA performance measures once the Service Level Agreement and Statement of Intent are linked.

Conclusion

During the year Capacity appeared to manage the business within the appropriate asset management plan principles, integrated the Upper Hutt water management business and moved premises. Going forward, the Company continues to see potential further regionalisation of water services as an area of opportunity and will monitor developments in Auckland closely.