STAFF REPORT

TO: Chairman and Members, Engineering Services Committee

FROM: Roger Ashworth

REFERENCE: R864

DATE: 1 June 2006

SUBJECT: **COST FLUCTUATION ADJUSTMENT IMPLICATIONS**

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1 PURPOSE

To update the Committee on cost fluctuations with respect to roading maintenance contracts and forecasting implications for the 2006-2007 financial year.

2 BACKGROUND

2.1 Cost Fluctuation (CF) Adjustments Roading

Within the roading maintenance contracts, fuel and bitumen costs are a significant factor. In the 2005-2006 financial year CFs are likely to be in the order of 11-12% for the full year. For the 2006-2007 financial year the LTCCP is based on the Year-1 figure being correct and an inflation allowance of about 2.8% for each subsequent year has been included.

2.2 Operating Maintenance Contracts and Renewals

CFs are paid quarterly in arrears and the payments relating to the September 2005 and December 2005 quarters have been paid. The 2005-2006 budget had an allowance of 3% for CF/growth. Land Transport New Zealand instructions are very clear that the forward budget is not to include any allowance for inflation. They will apply that nationally and an allowance for growth is permissible provided it can be supported.

The actual figures for 2005-2006 are likely to be more than 10% CF for lump-sum items, area-wide pavement treatment, major drainage and reseals with a lower figure for separately tendered works such as minor safety. Most of the bridge works and some area-wide pavement treatment which are separately tendered due to the current competitive market have approximately a 7% CF allowance with an average across the total roading budget of around 10%.

The figures put through for the 2006-2007 financial year were based on the 2005-2006 financial year with an allowance for CF growth of 3%. Obviously, this figure is now much higher and without a crystal ball, it is impossible to determine what the final figure would be.

If we assume that the 3% allowed for is 1% growth and 2% CF, then, in summary we will be 7% behind on the 2005-2006 financial year.

In dollar terms, in the current financial year, 2005-2006, CF payments for the roading maintenance contracts are expected to total around $640,000. To date, we have paid for the first three-quarters within our maintenance budgets by deferring some work, however there is currently a shortfall of around $160,000 which is expected for the last quarter.

The deferment works could be termed "non-essential" in that the deferment will not create a noticeable impact on the network in the short-term. Work such as reseals, area-wide pavement treatment and major drainage have not been cut back at this stage.

For the 2006-2007 financial year CF payments to Fulton Hogan, who hold all three road maintenance contracts, are likely to be in the order of $800,000. Land Transport New Zealand obviously face this issue nationwide and will accept, where justified, claims from local authorities at the base rate which, for us, is 49%. The problem there being that for the 2006-2007 financial year, Council are likely to either have to defer $800,000 worth of work or alternatively, provide wholly or some of the CF increase by making application to Land Transport New Zealand for subsidy and thereby finding a local share of up to $400,000.

Whichever way we look at this issue, it does not paint a pretty picture. The intention at this stage is to attempt to fund the forecast $160,000 shortfall for the current financial year within the maintenance budget. As stated earlier, deferment as a short-term measure shouldn't have a major impact. Long-term deferment will create a "bow wave" effect and the improvement in level of service for roading will quickly deteriorate. The conundrum for Council is how we proceed for the coming financial year and potentially the ensuing years. While roading probably has the major budget impact, cost increases across the board will need to be addressed.

Attached is a copy of a letter from Oldfields Contractors. This is included for information and is typical of the types of increases that the whole industry is currently facing.

3 RECOMMENDATION

THAT this report be received.

Roger Ashworth
Transportation Manager