3. RESTRUCTURING OF CAPITAL BUDGETS FOR LIGHT VEHICLES

Officer responsible	**Author**
Corporate Services Manager	Merv Altments, DDI 941-8468

The purpose of this report is to request authority to restructure the forward capital budgets for light vehicles.

CONTEXT

Since 2001 a number of changes have been made in the way the Council's white fleet is managed. The major initial focus, which is ongoing, was to achieve a reduction in the fleet numbers (which is not part of this report), as well as to develop a better plant replacement policy that would incorporate sustainable principles. The current replacement/purchasing policy dated 1993 does not include any consideration of a vehicle fuel efficiency or its environmental impact and, in essence, is based on the vehicle's initial capital cost as the prime consideration. Costs are then managed on an annual basis. This has lead to depreciation over a greater number of years but significantly higher maintenance and fuel costs.

The major direction has now moved to reducing fleet operating costs while achieving sustainability improvements in two directions: providing more efficient operation of vehicles (initially at Civic Offices) and achieving better fuel efficiency and sustainability of the fleet. The latter issue lies under energy management responsibilities and was the subject of a recent report to this Committee.

Detailed analysis of the cost curves has indicated that for the average Council vehicle the lowest ownership cost occurs when the vehicle has been owned by the Council for 3–4 years during which time it will have run 35,000 to 45,000 km. This is consistent with advice contained in a report on the state of the Council fleet and options for improved fleet management commissioned in mid 2002 from Mr Jim Upston, an independent vehicle specialist. In the case of vans and utility vehicles there may be different cost curves in specific instances. In these cases some vehicles may be retained for a longer period where it is cost-effective and environmentally sustainable to do so. Unfortunately the current capital programme for vehicle replacement is based on a 6–8 year replacement cycle which would need to be restructured to achieve the operating savings and environmental improvements achievable through operating a more modern and fuel efficient fleet.

RELEVANT CURRENT POLICY

The Council at its meeting on 23 March 2001 considered a report from the Annual Plan Working Party containing a proposal that:

> *"for the next three years all draft budgets to be within the forecasts of financial model with new operating initiatives being funded from efficiency gains or substitutions*",

and resolved that:

> *"in the coming three years all capital and operating budgets be contained within the projections in the Financial Plan, adjusted for inflation"*

The Council's Financial Plan and Programme, 2003 Edition states that:

> *"in adopting this plan the Council has now resolved to set in place processes to identify opportunities to achieve cost reductions and revenue increases in its operational budget to ensure that by 2005/06 the projected budget is reduced by $10 million".*

The Council at its meeting on 12 December 2001 considered a report on a Climate Change Consultation Paper entitled "Kyoto Protocol: Ensuring Our Future" and resolved:

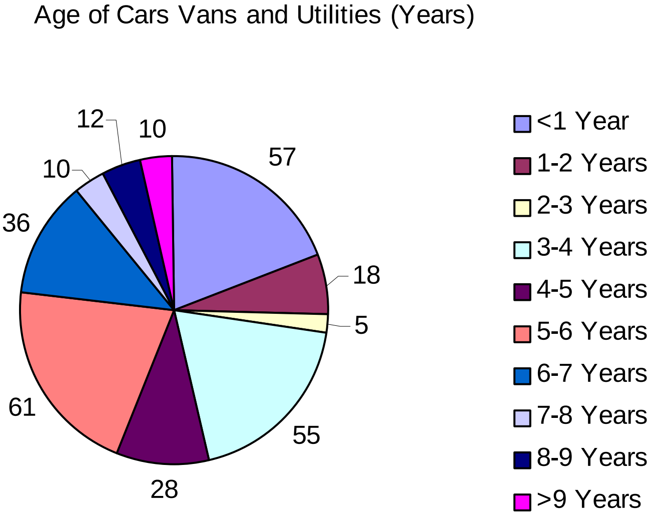
> *"that the Strategy and Finance Committee be asked to consider early in 2002 a proposal that the Council set targets, and decide on strategies and mechanisms, for the progressive reduction of carbon dioxide emissions from its own operations, subject to the inclusion of any required budget provision in the 2003 Financial Plan."*

Further reports on this matter were considered by the Council in April 2002 and September 2002 when it was resolved:

> *"that the Council continues to develop and implement programmes and policies leading to energy efficiency improvements and greater use of renewable energy sources."*
>
> *"that fuel efficiency, CO_2 emissions and local pollution effects be incorporated in consideration as significant criteria for plant purchasing/replacing."*

CURRENT AGE PROFILE OF THE LIGHT VEHICLE FLEET

The Council's light vehicle fleet consists of 292 vehicles with the following age profile:



As can be seen from the graph 57 (19.5%) vehicles are less than a year old but 212 (72.6%) vehicles are at least three years old. We are in the process of purchasing sufficient vehicles this financial year to achieve a three year replacement policy in respect of this year's purchases but over the next two years we would need to purchase 195 light vehicles.

IMPACT OF AGEING FLEET ON THE ENVIRONMENT

One of two major impacts of an ageing fleet is a significant delay in taking advantage of technologically more advanced vehicles that are often not only cost competitive but also more fuel efficient. This was discussed in more detail in the earlier report to the Strategy and Finance Committee (September 2002) mentioned above.

As a general rule, newer cars operate more efficiently than older ones. Based on actual fuel consumption of monitored vehicles from the Council fleet for example, a small car of the same engine size and from the same manufacturer but just five years newer provided a 17.8% improvement in fuel efficiency (which translates into a reduction of 127 tonnes of CO_2 emissions per annum). EECA use a more conservative and widely accepted figure of 1.5% per annum technology-related improvement in car fuel efficiency.

It is clear that a reduced replacement period would have the effect of improving overall fleet fuel economy as we take advantage of newer technology earlier. Any reduction in fuel consumption leads to environmental benefits because both global (CO_2) and local air polluting emissions depend, as a general rule, proportionally on the vehicle fuel efficiency.

IMPACT OF AGEING FLEET ON THE BUDGET

An ageing fleet is more costly to operate particularly once vehicles are out of their warranty period. In addition to the obvious items that wear such as tyres, brakes and shock absorbers any engine or body defects are more likely to create problems in some cases of a major nature. General wear impacts on the appearance of the vehicle and further reduces the value. While the rate of decline in the vehicle's value slows maintenance costs increase. This can result in operational disruption when vehicles are taken out at short notice for repairs. Thus reliability can become an operational issue for users.

It is clear that the capital budget as it stands currently is inadequate to upgrade all our vehicles. It is also clear that there are operating savings as well as environmental benefits from operating a newer fleet. The financial impacts are set out in the following tables.

	2003/2004	2004/2005	2005/2006	2006/2007	2007/2008
Current Capital Budget Plant	1,146,967	1,334,080	1,255,105	1,298,358	1,232,723
Sale of Assets	-226,430	-238,944	-258,704	-260,206	-246,071
Present Plant Capital Budget Net of Sales	**920,536**	**1,095,136**	**996,401**	**1,038,152**	**986,652**
Proposed Capital Budget Plant	2,207,490	2,479,700	2,194,070	2,315,400	2,283,000
Proposed Sale of Assets	-560,449	-582,670	-1,361,707	-1,373,840	-1,370,600
Proposed Plant Capital Budget Net of Sales	**1,647,041**	**1,897,030**	**832,363**	**941,560**	**912,400**
Plant Hire Services - Operational Costs	**2003/2004**	**2004/2005**	**2005/2006**	**2006/2007**	**2007/2008**
Current Budgeted Costs	**2,141,926**	**2,141,926**	**2,141,926**	**2,141,926**	**2,141,926**
Proposed Budgeted Costs	**2,141,926**	**1,873,928**	**1,682,392**	**1,677,392**	**1,672,392**
Net Effect of Capital and Operating Charges					
Additional Capital	726,505	801,894	(164,038)	(96,592)	(74,252)
Reduced Operating	-	(267,998)	(459,534)	(464,534)	(469,534)
Net Charge	**726,505**	**533,896**	**(623,572)**	**(561,126)**	**(543,786)**

These tables show that over a five year period there is a net saving in excess of $360,000 from a combination of the charges required in the capital budget and savings in operating costs. In addition to this there are the environmental savings from vehicle efficiency.

OTHER OPTIONS FOR FUNDING THE CHANGE OR REDUCING ITS IMPACT

1. **Leasing the vehicle**

This exercise has been carried out as part of the tender process for all vehicle purchases made during the past 18 months. To enable clear comparisons between the costs of ownership of vehicles and the costs of leasing we have converted the relevant costs (including costs of capital) to cents per kilometre. This has shown an operating cost benefit of owning the vehicles of approximately 15–18%.

There may however, at some future date, be benefits in leasing some or all of the fleet so it would be appropriate to extend the City Manager’s delegated authority to purchase vehicles to also include the ability to lease vehicles where there is a cost benefit to do so.

2. **Applying any operating surpluses to the capital budget**

It is anticipated that during the current year there will be operating surpluses in the order of $500,000 in the operation of the fleet and it would be appropriate to apply this to the capital budget for next year by way of carry forward. The surpluses have accrued as the result of efficiencies identified in the operation of the fleet and actioned, together with a reduction in the fleet of 24 vehicles. At the same time although charges to units were reduced in the current year to reflect actual fuel costs the effects of the abovementioned efficiencies were not reflected in reduced charges to units. The operating budget for 2003/04 has assumed that charges to users next year will more closely reflect actual costs and have been reduced accordingly so it is unlikely that there will be a significant surplus in that year. As the actual amount available would not be known until the end of the financial year it would be necessary to determine the actual amount at the year end and transfer any operating surpluses for the 2002/03 year from the Vehicle Management output to the capital programme for an accelerated replacement programme for light vehicles and then carry the amount forward to the 2003/04 year.

3. **Plant renewal fund**

Some surpluses accrue in this account and would be most appropriately used to increase the amount of capital available for new vehicle purchases. The balance accrued in this account as at the end of the current financial year will not be known until the end of year accounts are finalised in late July but an early estimate is that they would be in the order of $1,016,000. It should be noted that the Council resolved in September 2002 to close this account with effect from the current budget year.

SUMMARY

- Moving to a three year capital renewal programme for light vehicles would enable us to take advantage of newer, more environmentally-sustainable vehicles more quickly
- There would be an increased capital requirement for plant replacement in the next two financial years. In subsequent years the net capital requirement would be lower.
- This would be offset by an ongoing reduction in operating costs for future years through operating a newer fleet based on a three year replacement programme.
- There are a number of options available in the current year for funding this increase from anticipated operating surpluses in the plant account for 2002/03 and the use of any surpluses from the Plant Renewal Fund.

Staff Recommendation:

1. That the Committee support the restructuring of the capital programme for light vehicle replacement.
2. That this report be forwarded to the Annual Plan Subcommittee.
3. That the Director of Finance be authorised to transfer any operating surpluses for the 2002/03 year from the Vehicle Management output to the capital programme for an accelerated replacement programme for light vehicles and carry the amount forward to the 2003/04 year.
4. That the Director of Finance be authorised to allocate any uncommitted surplus in the Plant Renewal Fund to the capital programme for an accelerated replacement programme for light vehicles.
5. That the purchasing authority for implementation of the plant replacement policy currently delegated to the City Manager be extended to cover the entering into of lease agreements for plant where it is cost effective to do so.

Chair's Recommendation: That the above recommendation be adopted.