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TOWNSHIP OF ESQUIMALT

FINANCIAL SUSTAINABILITY ANALYSIS

OCTOBER 2024

ACKNOWLEDGMENTS

This Financial Sustainability Analysis was prepared by Christopher Paine, CPA, CGA, FIT Local Government Consulting. FIT Consulting would like to express appreciation to the Township's staff who contributed data and input into the analysis:

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EXECUTIVE SUMMARY

Introduction

The Township of Esquimalt is a municipality with a vibrant character located adjacent to the core of the Capital Regional District. The area known as Esquimalt has been inhabited by Coast Salish First Nations for over 4,000 years.

Esquimalt has a diverse business landscape including light industrial enterprises, office spaces and a variety of local businesses. The Township was incorporated in 1912 and has accumulated a significant inventory of infrastructure assets to serve the public since then.

Purpose of this Analysis

The Township developed a 2023-2026 Council Priorities Plan which was updated most recently in September of 2024. The Council Priorities Plan sought to produce a Long-term Financial Planning analysis which was led by the Director of Financial Services and delivered in 2023. This analysis supplements that work. Broadly speaking, this analysis confirms the findings of the 2023 Long-term Financial Planning analysis:

- (1) The Township's assets are nearing the end of their useful lives on average,
- (2) The replacement cost of the Township's assets are significant, and
- (3) The Township is not currently devoting enough annual funding to sustainably fund the replacement of their infrastructure.

For a comparison of key findings please see Appendix B.

Key Findings

This Analysis has the following key findings:

- **Inventory Valuation:** The replacement costs of the Township's depreciable assets (not including vehicles, equipment, land improvements and select facilities) are estimated to be approximately \$583.6M
- **Infrastructure Consumption:** The Township's assets are estimated to be 64% through their useful life on average. The value of this consumption is estimated to be \$371.8M. In comparison, the Township has \$10.0M in accumulated reserves that can be used for infrastructure replacement. It is estimated that approximately \$35.8M of the Township's assets are overdue for replacement.
- **Annual funding levels:** Annual funding levels are currently not sustainable. Annual funding is estimated to be 40% sustainable. Modelling indicates that current funding levels could result in a \$550M 100-year funding gap.
- **Existing Financial Sustainability Practices:** The Township is currently exercising several financial sustainability practices with respect to infrastructure. Recommendations address formalizing these practices into current policy.

Key Recommendations

The Plan contains the following key recommendations:

1. **Increase funding to sustainable levels:** Implement 9-years of 2% tax increases for infrastructure replacement. This annual funding increase would replace the 1% annual increase currently in place.
2. **Re-evaluate annual infrastructure funding levels** in 5 years.
3. **Capital cost escalation:** Establish a policy within the Financial Plan bylaw to increase infrastructure replacement funding by an appropriate infrastructure cost escalation factor annually.
4. **Debt servicing retirement:** Integrate language into the Township's policy section of the Financial Plan bylaw such that when debt expires, the associated debt servicing budgets be considered for reprioritizing to fund annual infrastructure funding.
5. **Non-market change:** Integrate language into the Township's policy section of the Financial Plan bylaw such that non-market change property tax revenue is prioritized for infrastructure renewal.
6. **Lifecycle costing in purchasing decisions:** amend the Township's purchasing bylaw to encourage staff to consider lifecycle costs when scoring procurement processes.

DRAFT REVIEW

SCOPE OF WORK AND LIMITATIONS

Scope of Work

FIT Local Government Consulting was engaged to provide the following services:

Prepare a professional report that includes

- Estimated replacement costs by asset class,
- Analysis of current funding vs. sustainable funding,
- Quantification of annual funding gap or surplus,
- Recommended funding levels, and
- Policy recommendations.

Sources of Information

The Analysis was prepared using the following sources of information:

- 2024-2028 Financial Plan
- Annual Report – Year Ended December 31, 2023, Township of Esquimalt
- Appraisal Report of Specified Property, Suncorp Valuations, June 20, 2024
- Internal databases, Sanitary Sewer, Storm Drain, and Roads
- Purchasing and Disposal Bylaw, 2023, No. 3123
- Township of Esquimalt Asset Management Policy FIN-17
- Township of Esquimalt Investment Policy FIN-18
- Long Term Financial Planning – Asset Management Strategy, December 18, 2023
- Council Priorities Plan 2023-2026

FINANCIAL FINDINGS

Replacement Costs

The estimated replacement costs of the Township's depreciable assets (not included assets explicitly excluded) are approximately \$583.7M. The value of the Township's Inventory demonstrates the significant service-providing value they have to the Community.

Table 1: Asset Inventory Valuation

Asset	Quantity	Replacement Value	Useful Life
Buildings	16,300 m ²	75.8M ¹	75 years
Road Infrastructure	488,600 m ²	164.4M ²	20-100 years
Drainage	67.2 KM	183.3M	60-100 years
Sanitary Sewer	58.2 KM	160.2M	60-100 years
Total		\$583.7M	

1: This does not include the cost of a new Public Safety Building, the Township's proportionate share of the Greater Victoria Public Library Central branch, nor the Esquimalt Library branch.

2: Replacement cost of roads include replacement of both base and top layers. However, the Township may engage in capital maintenance activities throughout the lifecycle of the asset, including top layer only replacement.

Inventory Consumption

Overall, the Township is estimated to be 64% (\$371.8M) through the useful life of its depreciable assets.

Table 2: Asset Inventory Consumption

Asset	% Consumed	\$ Consumed	% Overdue	\$ Value Overdue
Buildings	54.4 %	41.2M	0.0% ¹	0.0M
Road Infrastructure	57.1 %	93.8M ²	17.2% ²	28.3M ²
Drainage	67.6 %	124.0M	2.5%	4.6M
Sanitary Sewer	70.4 %	112.8M	1.7%	2.7M
Total	63.7 %	\$371.8M	6.1%	35.6M

1: Note this represents buildings that are overdue for replacement but does not include potential facility capital maintenance that is overdue.

2: In-service date was not available for Roads data. Therefore, the consultant utilized 2019 Pavement Condition assessment information to estimate consumption. Please see Appendix A for detailed assumptions. Furthermore, no consumption was estimated for sidewalk, street lights, traffic signals, nor curb and gutter as in-service date and PCI data was not available.

The estimated infrastructure backlog of \$35.6M indicates that this amount is overdue for replacement. An asset can be overdue for replacement without having failed (or reached its maximum physical life). This means that approximately \$35.6M of infrastructure is not achieving a desired level of service.

Annual Funding Levels

Current annual funding levels are estimated to be \$3.8M as detailed below in table 3:

Table 3: Current Infrastructure Funding

Funding Source	\$ Value
Transfer to Infrastructure Reserve Fund	990,000
Transfer to Capital Projects Reserve Fund ¹	1,398,900
Debt Principal and Interest ²	560,000
Annual Community Works Fund grant ³	861,800
Total annual funding sources for capital maintenance and replacement	3,810,700

1: Note this does not include debt servicing costs for the Public Safety Building as this building has been excluded from this analysis.

Summary of Reserves (Accumulated Funding)

The total reserve balances available for infrastructure replacement is estimated to be approximately \$10.0M. This contrasts with estimated infrastructure backlog of \$35.6M and consumption of \$371.8M.

Table 4: Current Reserve Balances available for infrastructure replacement

Reserve	\$ 2023 Ending
Capital Projects	\$4.8M
Infrastructure and Revitalization	2.9M
Community Works Fund	2.3M
Total Infrastructure Replacement Reserves	\$10.0M

Sustainable Annual Funding vs Actual

Annual sustainable funding is estimated to be \$9.3M as outlined below. Annual sustainable funding is equal to the replacement cost of assets divided by its useful life.

Table 5: Annual Sustainable Funding

	Annual Sustainable Funding
Buildings	\$2.4M
Road Infrastructure	2.8M
Drainage	2.2M
Sanitary Sewer	1.9M
Total Annual Sustainable Funding	9.3M

Annual sustainable funding is the average annual cost to replace assets over their lifecycle. Therefore, the Township, on average, will have to invest an estimated \$9.3M (table 5) annually. However, current funding is approximately \$3.8M (table 3). Therefore, the annual sustainable funding gap is estimated to be \$5.5M (\$9.3M – \$3.8M).

Table 6: Annual Funding Gap

Annual sustainable funding	\$9.3M
Current annual funding	\$3.8M
Annual Funding Gap	\$5.5M

Left unchanged, this annual funding gap would lead to a 100-year funding gap exceeding \$550M. The Township will be forced to close the funding gap via property tax increases or level of service reductions. There are limited options to reduce levels of services to meaningfully reduce this funding gap. However, early investment in infrastructure funding reserves can help the Township earn investment returns that can offset what would otherwise be property tax increases.

Note that optimistic useful lives were used for road base to determine annual sustainable funding requirements. Other municipalities in the Region have similar expected useful lives but have supplemented with preventative road maintenance treatment which extend the useful lives of the road components. The Township can develop such a program with increased core road maintenance funding. Feasibly, the Township could increase road replacement funding and then convert part of that funding into core road preventative maintenance funding in the future.

POLICY REVIEW

The function of this report is primarily to identify potential historical funding shortfalls and provide options for addressing such shortfalls moving forward. How the Township manages new infrastructure will determine whether shortfalls continue to crop up in the future. Therefore, a comprehensive asset management policy review was conducted to identify opportunities to enhance forward looking financial sustainability processes

As asset management is an integrated process, spanning all Township departments, it was necessary to review policies that were not specifically related to asset management. However, these policies can have an impact of asset management maturity and financial sustainability. In particular, the following policies were reviewed:

1. Asset Management Policy No. FIN-17
2. Financial Plan Bylaw, 2024, No. 3137
3. Purchasing and Disposal Bylaw, 2023 No. 3123
4. Investment Policy No FIN-18

Asset Management Policy

The Township's Asset Management Policy No FIN-17 meets best practice recommendations for financial sustainability. In particular:

- ✓ Level of service consideration and integration with Financial Plan
- ✓ Lifecycle cost consideration for new services and assets
- ✓ Natural asset financial planning
- ✓ Training for financial management

Financial Plan Policy

The Township's Financial Plan is the primary policy tool used to support sustainable service delivery and asset management principles. The Township's financial commitments necessary to support sustainable service delivery appear in the Financial Plan.

The Township's policy section in the Financial Plan currently exceeds statutory minimum requirements and likely leads amongst its municipal peers:

- ✓ **Financial sustainability** is explicitly referenced and promoted:

"Long term financial sustainability is important if the Township is to continue delivering the services and programs expected by the community. It is also important that community assets are maintained as a potential means to attract and retain businesses and to ensure that they costs do not become a greater burden for future taxpayers."

- ✓ **Levels of services** for existing assets, and the funding required to support existing assets must be considered prior to the consideration of new services/assets:

"...Council will consider the property tax increase required by the projected cost increases for existing service levels before considering other service level enhancements."

- ✓ **Capital asset accountability** has a specific section outlining the need for adequate capital maintenance funding to support the lowest life cycle costs. This section also requires that all lifecycle costs must be integrated into the financial plan.

While the Township may be currently engaging in financial sustainability practices, documenting policies will strengthen the probability these practices will continue far into the future.

1. **Capital cost escalation:** Establish a policy within the Financial Plan bylaw to increase infrastructure replacement funding by an appropriate infrastructure cost escalation factor annually.

As cost rise, the Township must increase revenue (typically property taxes) to ensure the same level of service is delivered. Failure to increase required funding, results in a reduced level of service. In recent history, infrastructure cost escalation has exceeded the general Consumer Price Index increases. The Township should strive to ensure the appropriate cost escalation factor is applied annually to all capital funding sources.

The Township currently increases property taxes by 1% annually to generate an increased cumulative capital infrastructure investment. This is needed due to the impact that historical inflation has had on infrastructure renewal costs.

2. **Debt servicing retirement:** Integrate language into the Township's policy section of the Financial Plan bylaw such that when debt expires, the associated debt servicing budgets be considered for reprioritized to fund annual infrastructure funding.
3. **Non-market change:** Integrate language into the Township's policy section of the Financial Plan bylaw such that non-market change property tax revenue is prioritized for infrastructure renewal.

Often the municipality will benefit from increased tax revenues when a property is initially subdivided. Even more revenue is earned when a property is developed, and new buildings are constructed. However, the capital maintenance, operating maintenance, and replacement costs all lag. Therefore, when a municipality uses new development taxation revenue to reduce the tax burden for current taxpayers, the long term cost of development is not integrated into the tax rate.

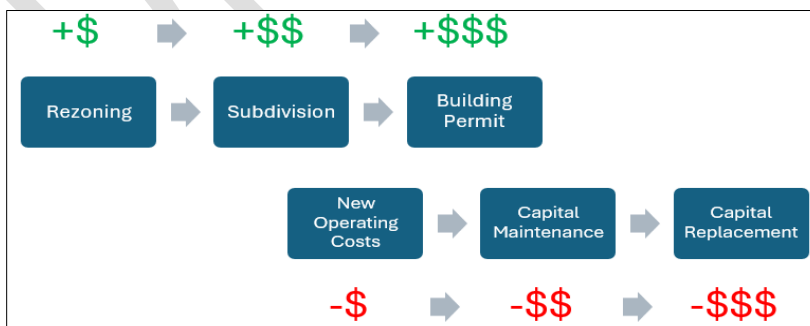


Figure 1: Misalignment of non-market change revenue and infrastructure costs

Since there is a lag between when a municipality receives new taxation revenue from development and when it incurs related costs, it is recommended that at least a portion of Non-Market Change revenue be set aside for infrastructure funding.

Purchasing Policy

As the Township has a detailed and comprehensive purchasing bylaw, it does not maintain a separate and subordinate purchasing policy. The bylaw was reviewed for integration of lifecycle costing concepts. The bylaw currently does not require or encourage staff to use annual lifecycle costs as the basis for determining the lowest price when evaluating bids.

Procurement decisions utilize evaluation scoring based on numerous factors. Often financial considerations contribute between 30% and 60% to scoring. However, if a procurement decision only considers implementation or capital costs and fails to consider lifecycle costs, a more expensive solution may be selected. For instance, the hypothetical software purchase example is shown below:

Table 7: Procurement scoring: non-life cycle costing

	Software #1	Software #2
Software Purchase	\$50,000	\$100,000
Implementation Costs	\$20,000	\$50,000
Total Acquisition Costs	\$70,000	\$150,000

At first glance, Software #2 appears to be more expensive and, therefore, would receive half the score of Software #1. However, when evaluated from a lifecycle costing perspective, Software #2 is much less expensive:

Table 8: Procurement scoring: life cycle costing

	Software #1	Software #2
Software Purchase	\$50,000	\$100,000
Implementation Costs	\$20,000	\$50,000
A Total Acquisition Costs	\$70,000	\$150,000
B Annual Licensing Costs	\$20,000	\$10,000
C Expected Useful Life	10 years	15 years
D Total Licensing Cost per Useful Life (BxC)	\$200,000	\$150,000
E Total Lifecycle Costs (A+D)	\$270,000	\$300,000
F Annualized Lifecycle Costs (E/C)	\$27,000 per year	\$20,000 per year

Notice that under the Acquisition Costing Procurement Method in table 7, Software #2 appears to be more than twice as expensive. However, Software #2 is found to be 25% less expensive when annual lifecycle costs are calculated.

It is therefore recommended that the Township's purchasing bylaw be amended to encourage staff to consider lifecycle costs when scoring procurement processes.

Investment Policy

A review of the Township’s investment policy was conducted to ensure the Township can align long term cash flow with long term investment returns. The policy does support this objective, and writes, “Long term investments may be acquired if the maturity is related to a specific program, and is made to coincide as nearly as practicable with the expected use of the funds.”

As the Township dedicates greater funding levels for infrastructure replacement, larger reserve balances may accumulate in anticipation of infrastructure replacement. The Township should leverage investment returns to reduce what would otherwise be property tax funded contributions. For instance, the Municipal Finance Authority has recently introduced a new Diversified Multi-Asset Class Fund, which is exposed to market equities and is expected to produce high yields over the long term. The performance objective of this fund is to exceed inflation by 3.5%.

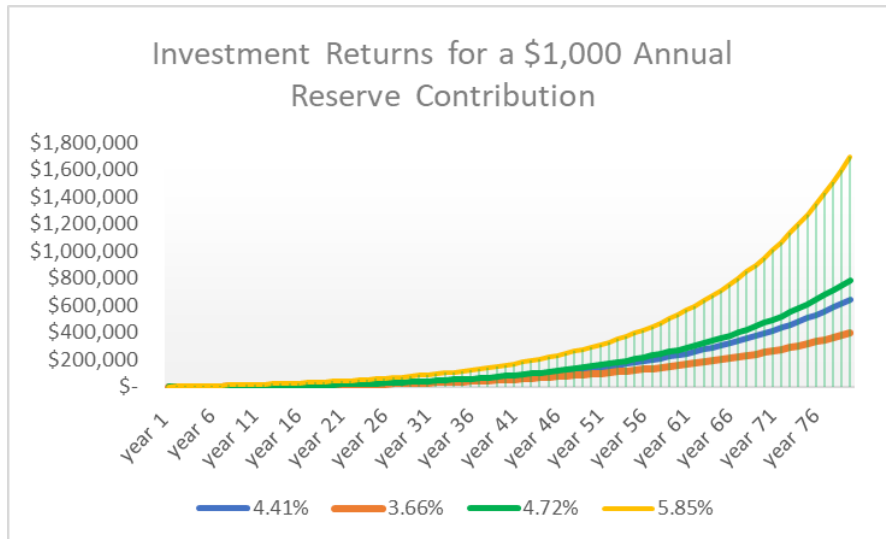


Figure 2: Investment Return Modelling

RECOMMENDATIONS

Funding Recommendations

The estimated annual funding gap for infrastructure replacement is \$5.5M (table 6). Currently property taxes are approximately \$23M. This means property taxes will have to rise by approximately 23.9% (5.5M/23M) over the long run to address forecasted funding gaps. Rate increases can be partially offset by interest revenue earnings if rate increases are implemented early.

Given that the Esquimalt’s major assets are estimated to be 63.7% consumed on average, the Township may wish to close the annual funding gap at a quick pace. Two options are outlined below:

Table 9: Funding increase options

Option	\$ Annual Increase to average residential	Cumulative Increase to average residential
1: 2.00 % per year for 9 years	\$75 per year for 9 years	≈ \$600.00
2: 1.50 % per year for 12 years	\$50 per year for 12 years	≈ \$600.00
3: 1.00% per year for 17 years	\$35 per year for 17 years	≈ \$600.00

A strategy that the Township may consider is to significantly increase its proactive preventative maintenance program on its road assets. Such a program can significantly defer the need to replace major road components. The Township could increase taxes for a shorter duration (e.g. 5 years) and allocate part of the new funding to a stronger road preventative maintenance program to reduce road lifecycle costs. At this point, road lifecycle costs can be evaluated and the Township can determine new annual funding targets.

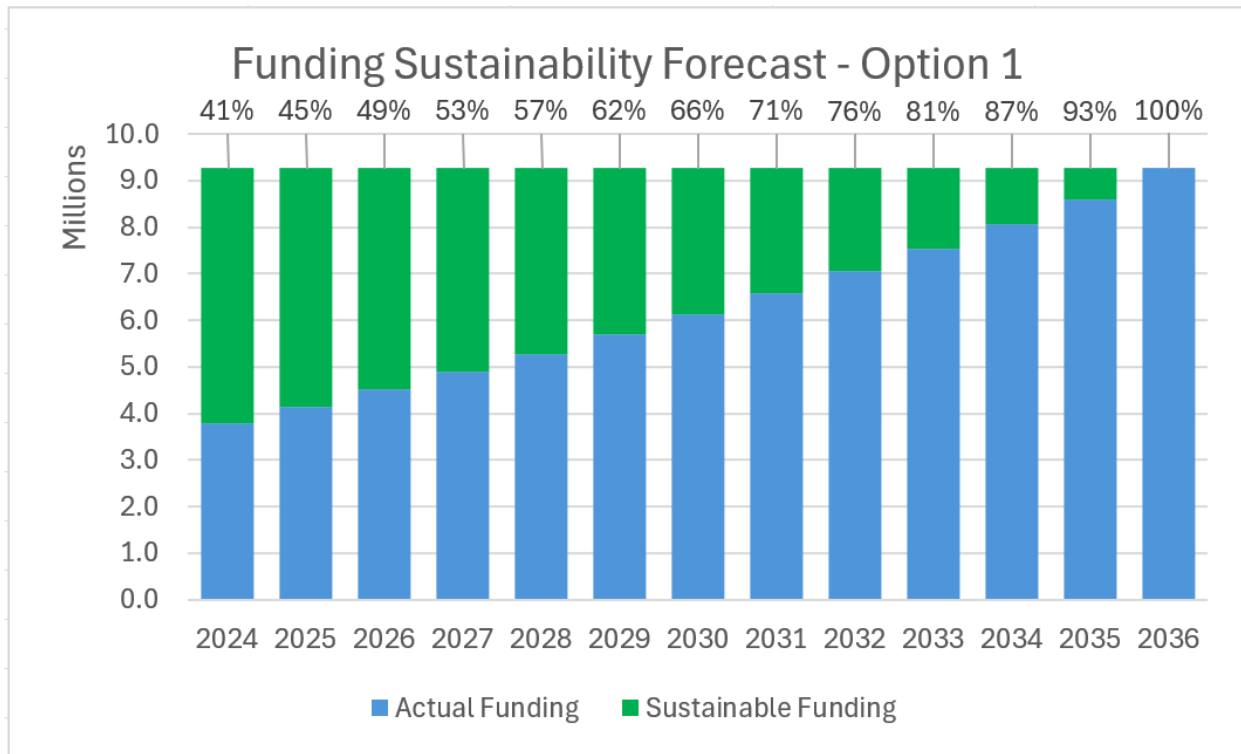


Figure 3: Funding Sustainability Roadmap

The Township may utilize non-market change revenue to reduce the financial burden of increasing taxes by 1.50% per year.

Policy Recommendations

Rationale for policy recommendations can be found in the Policy Review section of this report. Policy recommendations are summarized below:

1. **Capital cost escalation:** Establish a policy within the Financial Plan bylaw to increase infrastructure replacement funding by an appropriate infrastructure cost escalation factor annually.
2. **Debt servicing retirement:** Integrate language into the Township's policy section of the Financial Plan bylaw such that when debt expires, the associated debt servicing budgets be considered for reprioritizing to fund annual infrastructure funding.
3. **Non-market change:** Integrate language into the Township's policy section of the Financial Plan bylaw such that non-market change property tax revenue is prioritized for infrastructure renewal.
4. **Lifecycle costing in purchasing decisions:** amend the Township's purchasing bylaw to encourage staff to consider lifecycle costs when scoring procurement processes.

GLOSSARY OF TERMS

Annual Lifecycle Costs: Annual lifecycle costs include the cost to acquire or construct a Tangible Capital Asset, plus all operating and maintenance costs incurred over the life of the asset.

Backlog: An infrastructure backlog is the amount of infrastructure that has exceeded its useful life.

Canada Community Building Fund: The Administrative Agreement on the Canada Community-Building Fund in British Columbia (Agreement) took effect on April 1, 2024. The tripartite Agreement between Canada, British Columbia, and UBCM replaces the 2014-2024 Agreement and provides the administrative framework for the delivery of the Canada Community-Building Fund (formerly the federal Gas Tax fund) to local governments and other recipients in British Columbia from 2024 to 2034.

Pavement Condition Index (PCI): This is an index that assigns a score between 0 and 100, indicating the general condition of pavement.

Municipal Finance Authority: The Municipal Finance Authority of British Columbia (MFA) is a co-operative financial institution, owned and governed by its Members for the benefit of public institutions throughout BC. The MFA offers three main services: reliable and low-cost borrowing solutions, purpose-built, investment funds, and financial support for professional development for local government leaders.

Non-market change revenue: This is the amount of property tax revenue earned on assessed values of properties that didn't exist in the prior assessment year. For instance, when a property is subdivided and two lots are created, the Township can now earn more tax from the properties, as they have a high value created through non-market means.

Tangible Capital Asset (TCA): Tangible capital assets are non-financial assets having physical substance that:

- I. are held for use in the production or supply of goods and services, for rental to others, for administrative purposes or for the development, construction, maintenance, or repair of other tangible capital assets,
- II. have useful economic lives extending beyond an accounting period,
- III. are to be used on a continuing basis, and
- IV. are not for sale in the ordinary course of operations.

Useful Life: Useful life is the length of time an asset is expected to be in service before it is replaced. Useful life may differ from physical life. Physical life is the maximum length an asset can be in service before failure. To manage risk, and maintain service continuity, a municipality may select a useful life that is lower than the physical life of the asset.

APPENDIX A: LIMITATION AND ASSUMPTIONS

Capital grants: Forecasts do not include any potential conditional grants awarded by senior levels of government. However, forecasts do include ongoing Canada Community Building Fund payments.

Capital Service Continuity: For modelling, it was assumed that the Township would want to continue with the current capital services and capital service levels. The Township may choose not to replace some of its capital or reduce / increase capital services. Such decisions could materially impact modelling.

Culvert Data: No culvert data was provided during the engagements. As such forecasts and inventory quantification excludes culverts.

Curb and Gutter: No curb and gutter data was provided during the engagements. As such forecasts and inventory quantification excludes curb and gutter.

Climate change: The Plan did not examine the risk or impact of climate change to the Township's infrastructure or private property. Further review, funding, and staff capacity would be required should Council wish to understand the broader implications of climate change risk to the community.

Existing Capital Only: The Plan does not model anticipated growth in infrastructure requirements. Forecasts are based on the replacement of existing municipal infrastructure only. For instance, these forecasts have not contemplated the increased capacity required to support future densification or development. This analysis has not anticipated potential future decisions to increase capital service levels. Adoption of the sustainable asset management recommendations in this analysis, will support the sustainable funding of future growth.

Inflation: Modelling has been prepared using 2024 values. No inflationary factor has been applied to forecasted replacement costs. As unit costs are likely to escalate, the Township should consider applying an appropriate annual construction cost index increase to recommended investment levels.

Infrastructure Replacement Standards: Forecasts are prepared with the assumption that infrastructure will be replaced at the same standard that currently exists. However, some of the Township's infrastructure does not meet existing standards, for example, some of the Township's sidewalks are 1.5m in width and would need to be widened to 2.0m to meet improved standards.

Park Improvements: Park and Land improvements have not been included in the scope of this project. Replacement costs of park and land improvements are expected to be a small proportion of the Township's asset inventory and relatively immaterial to findings.

Replacement Cost Accuracy: Unit rates were developed to estimate overall replacement costs and to develop a long-term sustainable funding model. No Class-D or above construction estimates have been prepared. Therefore, none of the spending forecasts should be utilized to prepare a capital plan. Spending forecasts demonstrate an overall funding level likely needed to support the ongoing replacement of existing infrastructure. Replacement cost accuracy will differ between asset class and subclass:

- **Roads, storm sewer, and sanitary sewer:** assumed zero bedrock removal, depth of mains 1 to 2.5 meters, nothing deep, no bypass pumping, or removal of existing mains is assumed.
- **Buildings:** based on most recent replacement cost appraisals available. Capital maintenance of subcomponent was estimated using industry accepted best practice of percentage of replacement cost componentization. The estimates do not include the Greater Victoria Public Library Esquimalt branch and the new Public Safety building.

Road consumption: In-service data was not available for road segments. As a result, most recent Pavement Condition Index scores were used as a basis to estimate consumption. A PCI score target of 70 for major and collector and 60 for residential roads was established to calculate consumption. Although road deterioration normally follows a non-linear pattern, deterioration was assumed to be linear for simplicity.

Unit Pricing Inclusion: Unit prices were current as of April 2024. All unit costs used to derive replacement costs include 15% Engineering and Construction Administration plus a 40% contingency.

Useful lives: The Plan utilizes a modified National Asset Management Standards (NAMS) approach to useful lives. Useful lives were generally estimated to be near the midway point of the NAMS recommended useful life range, except for road base for residential roads. The base useful life used to model annual sustainable funding was 160 years. Reducing useful lives for road top layer and base would result in an annual sustainable funding figure of \$3.6M as opposed to the \$2.8M determined using the longer useful lives.

APPENDIX B: COMPARISON OF FINDINGS: 2023 LONG-TERM FINANCIAL PLANNING BRIEFING NOTE

Table 10: Comparison of Replacement Cost Estimates

Asset	Replacement Value (2024 Analysis)	Replacement Value (2023 Briefing Note)	Comment
Buildings	75.8M ¹	Not quantified	
Road Infrastructure	164.4M ²	Not quantified	
Drainage	183.3M	\$121.2M	Note 1
Sanitary Sewer	160.2M	\$73.7M	Note 1
Total	\$583.7M		

1: difference in valuation largely attributable to greater contingency and inclusive of project costs.

Table 11: Comparison of Estimated Consumption

Asset	% Consumed (2024 Analysis)	\$ Consumed (2024 Analysis)	% Consumed (2023 Briefing Note)	\$ Consumed (2023 Briefing Note)	Comment
Buildings	54.4 %	41.2M	Not quantified	Not quantified	
Road Infrastructure	57.1 %	93.8M ²	Not quantified	Not quantified	
Drainage	67.6 %	124.0M	77%	\$93.4M	Note 1
Sanitary Sewer	70.4 %	112.8M	74%	54.7M	Note 1
Total	63.7 %	\$371.8M			

1: The assumed useful lives in this analysis was increased to 80 year for most pipe types. The useful lives assumptions in the 2023 Briefing note assumed 60 years. Both useful life estimates are within the National Asset Management Standards Practice Note 12 survey responses averages. However, the useful life estimates used in this analysis were closer to the midway point of the ranges reported in the survey.

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