



New Zealand Fire Service Fire Service Review Funding Options and Affordability 30 March 2016



Draft Report v0.91

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This report is provided pursuant to the Statement of Work issued by The New Zealand Fire Service and dated 6 October 2015.

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IN CONFIDENCE - SENSITIVE

1. Executive Summary

1.1 The Way Forward

Given the current fiscal pressures faced by the Fire Service and the increasingly operating and capital costs the current funding model is not sustainable and is likely to deteriorate further in the 2016 – 2018 period.

There is a need for long term levy growth to provide financial sustainability to the organisation. Unfortunately, the current levy provisions do not provide sufficient revenue for both the regular ongoing capital expenditure as well as extraordinary non business-as-usual costs like the Christchurch rebuild and the national seismic strengthening programmes.

Indeed the amalgamation of the NZFS and Rural Fire into a single organisation from 2017 at an estimated cost of \$112 million is expected to place additional pressure on cashflows during the 2016-2018 financial years. NZFS needs some degree of certainty during this transition period to ensure ongoing continuity of service during a period of significant change and disruption for both career and volunteer firefighters, and the communities they serve.

As a capital intensive public service agency with one major source of income and a significant proportion of its costs (95%) being fixed in the short term, the Fire Service has a limited number of fiscal management tools at its disposal. As a consequence, the Fire Service has to date adopted a relatively conservative approach to financial management designed to minimise risk to ensure that it is sustainable into the future. In adopting this conservative approach the Fire Service has acted prudently in the management of its funding and will continue to exercise the financial management and decision making necessary to manage its projected cash shortfalls. The Fire Service will continue its policies of capital expenditure prioritisation, reduced spending where possible and capped spending limits together with the continued support of cash reserves to help reduce the looming fiscal challenge.

However, despite the continued efforts of the Fire Service these will not be enough to avoid the looming fiscal crisis and further steps are required to support the business and ensure its longer term sustainability.

These support mechanisms are both short and longer term in nature and when combined with other prudential decision making by the Fire Service will help to meet the level of operating expenditure and cashflow funding that is required to support the new combined business.

In the short term it is suggested that Ministers allow NZFS to increase its level of borrowing both to cover working capital as well as continue to invest in its capital programme, including the reconstruction of the Christchurch Fire Stations and the National Seismic Strengthening programme.

Looking at the longer term, the solution is to ensure that the Fire Levy is set at a rate with appropriate thresholds that ensures the service has security of income and is able to generate sufficient cashflow to invest in capability into the foreseeable future. In reviewing the Levy It is important to consider any adjustments only after full engagement with key stakeholders and not over react to current circumstances or projections until the transition to a new 'One Service' is in place and there is greater understanding of the cost impacts on the new organisation.

1.2 Findings

This report considers a broad range of funding and affordability issues facing the Fire Service, from capital and operating expenditure through to capital rationing and revenue generation as well as extraordinary non business-as-usual costs like the Christchurch rebuild and the national seismic strengthening programme.

A summary of the key findings of this report include:

- The current status quo is not financially sustainable with a funding gap projected over the 2016 – 2018 financial year. Planned capital expenditure in the areas of new buildings, seismic resilience and replacement appliances is expected to place significant pressure on cashflows from 2016/17 while operating expenditure is expected to rise with higher interest costs and depreciation
- In line with international trends the number of fires in New Zealand is decreasing, however the number of non-fire incidents is increasing, (for example medical emergencies) and the Fire Service is not currently funded to carry such additional costs. Such unfunded activity is placing increasing pressure on the fiscal position and is likely to continue without some financial rebalancing.
- While savings may be generated from the proposed unified fire service, a lack of detail on the rural services baseline will make any savings difficult to assess without further analysis.
- While closing fire stations may reduce operating and capital costs there will be an adverse impact on many communities as the Fire Service is the only emergency services provider in the area and therefore reducing the Fire Service footprint will significantly erode national resilience.
- The Fire Service is highly dependent upon its network of fire stations, appliances and equipment for both service delivery and resilience. The level of capital committed is near \$800 million and a significant level of expenditure and investment is required to maintain this asset base. As a result constant reinvestment and critical replacement is essential to maintaining the Fire Service's infrastructure.
- In June 2018, it is forecast that the Fire Service cash balances will be overdrawn by \$28.7 million and will have exceeded the ability of the Fire Service to borrow (current facility of \$10 million long term and \$1 million short term). At this time in 2018 the forecast reflects that there are no reserves available to cover the overdrawn balance.

In terms of funding solutions there are both short-term and long-term financial levers that can assist in providing more sustainability in the financial position. These include:

Short-term solutions include:

- Reducing operating costs where possible
- Increase the level of short term borrowing above the current \$10 million to relieve pressure on cashflows until longer term solutions are in place
- Seek a capital injection to fund the non-fire services and the cost of the Transformation Programme either as a one-off funding solution or as an ongoing increase in baseline
- Review the costs in forming the new unified fire service to ensure such costs are robust and sufficient contingencies are in place to fund any unknown or unexpected costs
- Re-prioritise and re-phase capital expenditure to manage cash flows in the short term with minimal effect on the longer term sustainability of the service
- Manage the Transition over a longer period to reduce fiscal pressures in peak deficit periods.
- Repurpose cash reserves to meet short-term fiscal deficits.

Longer term options include:

- Source additional levy payment revenue or reimbursement from other agencies or emergency providers who receive a benefit from the Fire Services attendance as first responder to non-fire incident
- Broaden the Levy base and increase the Levy rate to all levy payers from 1 July 2018.

1.3 Overview

New Zealand Fire Service has the legislative mandate to deliver fire service response and training across New Zealand and in their role as first responder to fire related incidents have touched the lives of many New Zealanders over the years.

Over time the Fire Service has grown to:

- 13,500 staff (1,700 career firefighters , 11,800 volunteers)
- 437 fire stations
- 850 fire appliances
- \$800 million in total assets (2016)

Over the years the Fire Service has built a strong investment position. However, sustaining these investments will be challenging over the next two to four years with negative cash flows projected in the 2016 – 2020 period resulting from significant capital investment rising operating costs but with little growth in income. Levy growth has been steady over the last few years but there are ongoing challenges to ensure the amount collected remains not only stable but also grows in line with the demand for services.

Levy growth is dependent on factors such as new residential housing stocks, contract works, economic growth and new motor vehicles. However, it comes under pressure from organisations that choose not to insure for fire, those who fail to pay levy owing, and from those insured organisations, brokers and insurers in the industry who avoid paying their fair share of levy by exploiting perceived loopholes in the Act.

With the high demand for continued capital investment and continued growth in the cost and scope of operations, the Fire Service must maintain its levy base. This means challenging avoidance and minimisation arrangements and delivering growth with the current rate of levy.

1.4 Unified Services

In November 2015, the Minister for Internal Affairs announced that urban and rural fire services will merge to form one unified fire service organisation to provide modern fire services in New Zealand. This new organisation will be the result of combining the National Rural Fire Authority and the New Zealand Fire Service. This new unified body will be responsible for resourcing, training, maintaining professional standards and amalgamating volunteer, career, urban and rural teams into one integrated service.

The estimated transformation costs of \$112 million will need to be funded by the Crown to avoid a significant strain on the cash resources of the service. At the same time benefits estimated at \$47 million are not expected to accrue until the transformation has been completed.

1.5 Capital Funding

Buildings

The Fire Service operates 437 fire stations. All fire stations are on a long term maintenance and replacement schedule. While the Fire Service spends approximately \$24 million per year on its property portfolio (inclusive of the Christchurch rebuild and the national seismic strengthening programme) the building asset base is under financial pressure as properties grow older and become increasingly uneconomic to maintain, or need upgrade to newer standards and modern requirements.

Earlier estimates based on a 10-15 property year plan forecasting that forecast financial pressures on the Commission have been revisited to meet funding availability and are based on a plan not to exceed capital expenditure of \$20 million in any one year. This has resulted in some buildings being deferred to a 25-year programme.

Christchurch Rebuild and Seismic Programmes

After the devastation of the 2010/11 Christchurch earthquakes a total of seven replacement buildings are required. Property owners, including the Fire Service, are required by the new building standards to provide much greater earthquake resilience.

There is pressure to refurbish or redevelop sites throughout the country to meet modern seismic standards. While 80% of core Fire Service Buildings currently meet this standard there still remains a number of buildings (76 in total) that will need to be addressed but cannot be completed for a period of 10 years due to a lack of available funding. Under current service models, this is a potential risk to the operation of those stations, and this is a particular risk factor for consideration when the future state fire service transformation is implemented.

Fire Appliances

The Fire Service has around 850 appliances that are replaced on a longer term programme of 25 to 30 years, resulting in around 30 replacement engines per year at an estimated cost of \$30 million per year. This cost is not sustainable within the current capital plan and the need for the Fire Service to meet other priorities. It is important that constant investment and replacement of these assets is undertaken on a programmed basis. Failure to do so will result in ageing assets not meeting the modern demands of the service and also lead staff motivation issues.

While in most organisations the level capital investment would approximate the level of depreciation, this is greatly distorted in the case of the Fire Service with long replacement periods for fire appliances, undertaking extraordinary capital costs in the areas of seismic strengthening, exhaust extraction upgrades and the relocation and rebuild of the Christchurch properties.

Capital expenditure has been prudently planned but in order to meet the short term demands of the service, funding has been balance sheet focussed using cash and investment reserves to meet short term needs. However this approach cannot be sustained due to the finite level of such reserves. It is essential that alternate forms of funding be introduced to meet these shortfalls.

1.6 Next Steps

One of the key steps is a review the Transition funding costs to identify areas of fiscal risk, expenditure adequacy and timing together with analysis of potential benefits to determine the overall cost impacts on current projections.

Based on the proactive and prudent management of Fire Service funding, the introduction of capital expenditure prioritisation and capped spending limits together with establishment of cash reserves have helped reduce the looming fiscal challenge. In the future, the introduction of both short and long term funding, with the support of shareholders, will ensure that these challenges can be met by the new organisation, with improvements in capability, strategic decision making, organisational and operational systems and better support for communities, volunteers and rural fire services.

2. Introduction

New Zealand Fire Service Commission (NZFSC) oversees: NZ Fire Services (NZFS); Rural, and Industrial.

NZFS is preparing to undergo significant organisational transformation as it merges urban and rural fire services to one unified fire services organisation.

At present New Zealand Fire Services include: rural services whose main focus is to manage vegetation fire risks; services that operate in urban communities and rural towns; and privately funded services that operate on behalf of private business owners (industrial brigades).

On 13 November 2015, the Minister for Internal Affairs announced that urban and rural fire services will be brought together to form one organisation to provide modern fire services in New Zealand (excluding privately-funded industrial brigades).

The new organisation will be a merger of the National Rural Fire Authority and the New Zealand Fire Service (which are both part of the New Zealand Fire Service Commission), and the 52 rural fire authorities. Regional Committees will be established to meet the needs and representation of the regions.

The new national body will be responsible for resourcing, training, maintaining professional standards and amalgamating volunteer, career, urban and rural teams into one integrated service.

Legislation is planned to go before Parliament in 2016, with the new, merged organisation to be established in mid-2017.

An ideal future state and operating model for the new organisation is still being determined, and will entail a significant change programme. The challenge is to demonstrate that it will be **right-sized**, **optimised** to meet the needs of New Zealand communities, and **affordable** providing value for money through greater efficiencies over time.

The merger will have financial implications, with the new look, unified fire service operating in a modern environment where delivery expectations are vastly different to the era and funding mechanism under which the current service was set up.

This report provides background discussion on the NZ Fire Service operational and funding context. Expectations of fire services have changed and are expected to continue to evolve. In light of the fundamental scale of the planned transformation and impact on delivery of wider, non-fire related emergency services, discussion relating to costs and funding forms part of that dialogue between stakeholders and the Fire Service.

Modern day Fire Services' attend a growing numbers of non-fire emergency responses and provide a number of related activities such as training and community outreach programmes intersecting with wider sections of the community and emergency service providers than were envisaged when Fire Services were set up. This raises the inevitable questions: "what should fire services cost?" and "who should pay?" and leads to a broader issue of aligning the available funding with changing community needs.

2.1 Purpose

This document provides an independent assessment of the financial context, challenges faced and the opportunities available to the Fire Service, as it looks to transition to a single, unified fire services organisation.

Specifically, this report addresses the current state financial position of the Fire Service, including the historical background and the future impact. The report demonstrates that the current financial position, left unadjusted, is untenable. The report presents a broad range of options to address the current financial position and recommends a preferred option(s).

2.2 Scope

The scope of this document is to provide the framework, methodology, and tools to assist the NZ Fire Service to determine and understand the financial implications of implementing the 'One Service' Model. At the same time this report provides an analysis of the various funding options to ensure services are affordable in the future.

The scope of this report is limited to financial and funding affordability and does not include:

- comment on current or future operational aspects of the Fire Service
- a review or analysis of any financial information relating to the Rural Fire Service
- analysis or discussion on any alternative organisational models contained in the March 2016 Cabinet paper – *'Fire Services Review: New Funding Arrangements'*
- any analysis or review of the reports delivered by PwC, Deloitte and Martin Jenkins. Various comments have been included in this report to illustrate the degree of complexity in the nature of the issues faced by the Fire Service
- a detailed analytical review of the Fire Service financial results. However, in completing this report some analysis was undertaken to provide understanding and clarity on the financial position of the Fire Service

2.3 Approach

In compiling this report the following approach has been taken:

- review of various Fire Service documentation, including recent organisational reviews and financial statements
- reviewed the costs of the proposed change programme and the Fire Service capital expenditure plans
- considered the impact of the change programme on the organisational funding structure and confirmed the financial levers available to effect this change
- considered operational and capital funding options, determine feasibility and identify risks relating to these options
- consulted both Fire Service and Department of Internal Affairs representatives on a "straw man" scenario to provide evidence of factual accuracy
- considered the March 2016 Cabinet Paper – *'Fire Services Review: New Funding Arrangements'*

This report is based on the latest version of the Fire Services financial forecasts maintained in the TM1 financial system and provided by the Fire Service Management Accounting team in March 2016.

A range of sources, both published information and people, were referenced during the production of this report (refer “Appendix D – Sources” for details).

2.4 Assumptions

The following assumptions have been made when preparing this report:

- as this report is limited to financial and funding affordability matters, it relies on the information received and expert sources made available to inform the knowledge of the operational aspects of fire services delivery.
- documents and financial data provided by Fire Service and other sources are accurate and the latest version made available in March 2016. TDM is satisfied that what has been provided is a fair representation of Fire Services’ financial position, and represented a sound basis from which to establish a baseline of costs.
- sources interviewed were the most appropriate personnel and able to comment within the scope of their designated authority.
- review of the current financial state is drawn only from New Zealand Fire Service financial information, and excludes that of the Rural Fire Service.

3. Current State

3.1 Overview

New Zealand Fire Service has the legislative mandate to deliver fire service response and training across New Zealand and in their role as first responder to fire related incidents have touched the lives of many New Zealanders over the years.

Over time the Fire Service has grown to:

- 13,500 staff (1,700 career firefighters , 11,800 volunteers)
- 437 fire stations
- 850 fire appliances
- \$800 million in total assets (2016)

Over the years the Fire Service has built a strong investment position. However, sustaining these investments will be challenging over the next two to four years with negative cash flows projected in the 2016 – 2020 period resulting from significant capital investment rising operating costs but with little growth in income. Levy growth has been steady over the last few years but there are ongoing challenges to ensure the amount collected remains not only stable but also grows in line with the demand for services.

Demands will be driven by demographic changes, pressure on resources, climate change impacts and a need for people to play a greater role in their own protection and safety. This will require that NZFS become more flexible in its service delivery arrangements and resource allocation, work more collaboratively with other rescue and emergency services and help individuals and communities to become more prepared and self-sufficient in the face of emergencies and disasters.

Current Levy growth is dependent on factors such as new residential housing stocks, contract works, economic growth and new motor vehicles. However, it comes under pressure from organisations that choose not to insure for fire, those who fail to pay levy owing, and from those insured organisations, brokers and insurers in the industry who avoid paying their fair share of levy by exploiting perceived loopholes in the Act.

With the high demand for continued capital investment and continued growth in the cost and scope of operations, the Fire Service must not only maintain its levy base but look to changes in the levy formula and alternate sources of funding to meet the increasing cashflow shortfall.

The Fire Service operates a \$800 million asset base encompassing approximately 850 fire appliances, 437 fire stations and the associated operational plant, equipment and information and communications technology. All of these have to be maintained, upgraded and eventually replaced.

To meet the Fire Services' obligation to manage its finances responsibly, it has set strict financial parameters for senior management to prioritise spending. The Fire Service understands that it is currently dealing with capital demands well in excess of what it can reasonably afford on present revenues and continues to manage its prioritisation policy.

Over the last two years the Commission has spent \$51 million (2014) and \$62 million (2015 projected) on capital investment. After allowing for asset sales in each of these years the net capex spend is approximately \$50 million. The Commission considers \$50 million as reasonable in terms of affordability

at the current levy rate. It is inadequate however to meet the demands for capital funds to pay for the Christchurch rebuild, national seismic strengthening and the cost of the business transformation.

If the Christchurch rebuild programme were prioritised, the Fire Service would have no choice but to defer regular capital expenditure that it would otherwise undertake. Should this prioritisation policy be necessary, there will be some impacts that could present public difficulties.

Unfortunately, the current levy provisions do not provide sufficient revenue for both the regular ongoing capex spend as well as extraordinary non business-as-usual costs like the Christchurch rebuild and the national seismic strengthening programmes.

Fire Service fleet assets are well maintained and tend to enjoy long lives; on average fire trucks are replaced every thirty years. Book values reflect the original purchase price from prior years and therefore tend to be low. Because depreciation is calculated as a percentage of these low book values, accumulated depreciation is a poor proxy for actual replacement capital costs.

Any costs above depreciation have to be covered by the Fire Service's balance sheet. The consequent effect is to reduce the cash reserves, or when cash reserves are exhausted, to fund purchases through taking on debt or asset sales. If financial pressures leave no option for the Fire Service but to extend the life of the vehicle fleet and defer replacement of equipment, then firefighters will be working with increasingly obsolete equipment. The Fire Service would face both increased maintenance costs and greater risks to firefighters. At the same time this could make it increasingly difficult to attract and retain volunteers, already one of the biggest challenges facing the organisation.

As a result of these factors the projected capital spend in the period 2016 to 2018 is maintained at \$50 million and is therefore not considered as a significant increase or an unreasonable capital spend.

The Fire Service is forecasting operational deficits in the outyears. In the absence of new funding streams or restrictions in their ability to borrow further, the Fire Service might be forced to reduce their proposed expenditure to an amount less than the level of the annual depreciation cost.

3.2 Governments Strategic Intent

The Government is committed to a coherent and well-functioning structure that ensures the voices of the Rural Fire Authorities (RFAs) and the volunteer fire forces and brigades are heard. In recent years, this commitment has resulted in the Government directing and acting upon a series of reviews to examine the complexity of the fire services and to position the sector for change. This has been supported by some change within fire services.

Of particular note, in 2012,

- the Fire Review Panel released their report findings (Swain Report)
- the New Zealand Fire Service Board (Board) began a significant change process by setting out a new inclusive strategic direction (Vision 2020)¹, and
- with Enlarged Rural Fire Districts (ERFDs) now covering 70 per cent of the country, the increased integration in the rural fire sector began to demonstrate some of the benefits of amalgamation and improved coordination.

In 2014, Cabinet Ministers agreed to look again at fire services to ensure changes would also seek to address some of the known problems with rural fire services, funding matters and the need to

¹ New Zealand Fire Service Board Statement of intent 2014 – 2018 (pp5-6). Retrieved from www.fire.org.nz
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modernise the fire services legislation [CAB Min (15) 15/19 refers]. In 2015, Cabinet agreed to governance and support reform subject to funding decisions [CAB-15-Min-0207 refers].

Vision 2020

The Fire Service has adopted “Vision 2020”, which sets out Fire Service priorities and direction until 2020. Its four principles of leadership, integration, delivery of fire and emergency services and enhanced safety are the foundation for the establishment of the merged fire service and future state operating model.

3.3 Fire Service at a Glance

The following table highlights the key financial metrics of the NZ Fire Service over an eight year period 2015/16 – 2022/23.

Financial Metric ²	Forecast (\$ million)							
	2015/16	2016/17	2017/18	2018/19	2019/20	2020/21	2021/22	2022/23
FINANCIAL PERFORMANCE								
Total Revenue	386.7	379.6	383.8	388.8	394.4	400.1	405.8	411.6
Total Operating Expenditure	386.2	397.3	410.8	425.9	441.3	452.0	462.1	471.8
Net Surplus / (Deficit)	0.5	-17.7	-27.0	-37.1	-46.9	-51.9	-56.3	-60.2
FINANCIAL POSITION								
Current Assets	119.5	99.7	97.4	105.4	106.7	106.0	103.3	98.5
Non-Current Assets	669.4	674.1	683.8	682.6	678.9	672.5	666.0	659.0
Total Assets	788.9	773.8	781.2	788.0	785.6	778.5	769.3	757.5
Current Liabilities	60.7	63.6	98.1	142.1	186.8	231.7	279.0	327.4
Non-Current Liabilities	40.4	40.1	40.1	40.0	39.8	39.8	39.6	39.6
Total Liabilities	101.1	103.7	138.2	182.1	226.6	271.5	318.6	367.1
Equity	687.7	670.1	643.0	605.9	559.0	507.0	450.7	390.4
Total Liabilities and Equity	788.8	773.8	781.2	788.0	785.6	778.5	769.3	757.5
FINANCIAL CASH FLOWS								
Net Cash Operating Activity	38.3	13.8	9.3	7.2	14.8	15.9	17.1	18.9
Net Cash Investing Activity	-54.8	-37.7	-46.4	-46.1	-46.6	-43.9	-43.7	-43.2
Net Cash Financing Activity	-2.0	-1.9	-1.8	-3.7	-5.7	-7.5	-9.2	-11.0
Net Increase / (Decrease)	-18.5	-25.8	-38.9	-42.6	-37.5	-35.5	-35.8	-35.3
Cash at Year End	36.1	10.3	-28.7	-71.3	-108.8	-144.3	-180.1	-215.3

² Source - NZFS Financial Forecasts 26 February 2016 (CFIS)

The NZFS currently forecasts reserves to be \$36 million in 2015/16, made up of:

- Major Emergency Response Reserve - \$15 million
- Levy Variable Reserve - \$10 million
- Seismic Contingency Reserve - \$5 million
- Cash held for RFFF - \$5.6 million
- Minor cash held - \$0.4 million

As indicated earlier in the report these reserves are forecasted to be depleted over the 2016 – 2018 period.

Greater detail and further years financial outlook is included in Appendix B – *Financial Forecasts*.

Other key Facts

The following is a summary of other key metrics of the Fire Service

- Serviced by a mix of Urban, Rural and Industrial brigades
- Costs relate to provision of capability, rather than costings of incidents
- There are areas where fire services are first responder to an incident where police or ambulance are present focussing on capability rather than utilisation
- Provider of on call emergency response 24/7, 365 days of the year
- 850 fire appliances around New Zealand
- 437 fire stations around New Zealand
- 13,500 fire fighters made up of 1700 career fighters, 8300 urban volunteers and 3500 rural volunteers
- 71,000 incidents attended in were attended in 2012
- \$84.6 million for readiness and response to non-fire events
- \$789 million of total assets (in FY2016)
- Reserves FY 2016 estimated at \$36 million

3.4 Fire Protection and Response

Fire protection and response is one of the most essential public services. Losses caused by fire have a significant impact on the New Zealand economy. Fire also creates great risk of loss and damage to private property, and human life.

Fire protection and response services are required to: be available 24/7, every day of the year; have nationwide coverage including remote and rural communities and; work to critical yet unpredictable response times. Staffed by both career and volunteer firefighters, the cost structure of such a 'standing army' is predominantly fixed (circa 95 per cent). Services are capital intensive, with the requirements for a volunteer station being very similar to a paid fire station, i.e. a volunteer brigade still needs a building, fire appliance and equipment.

In line with international trends, the number of fires in New Zealand is declining. The reduction is due to a number of reasons, including better building standards and fire-safe materials, health and safety legislation, reduced combustibility of potential fire hazards such as cars, cooking and other appliances and prevention strategies. New Zealand fire services also assist in international situations such as search

and rescue and wildfire responses. Other legislation with a safety element impacts on the need for fire services.

Firefighters participate in programmes to educate the community and workplaces in fire risk reduction. They are themselves better trained than ever, and armed with modern equipment, are able to quickly extinguish fire related incidents.

Nonetheless, while the probability, or risk, of fire has reduced, the impact of the fires that do occur remains significant.

3.5 High-Impact Low-Probability Events

Traditionally the primary function of the Fire Service was to fight fires. While the timing and severity of these events cannot be predicted, there is an expectation³ that the Fire Service will respond to fire emergency call outs, regardless of the frequency (or infrequency). These fires are termed as high-impact, low probability events and fall into three categories:

1. **Unknown and unprepared for** – events which are beyond the realm of normal expectations and therefore impossible or extremely difficult to predict. Generic processes may enhance a level of preparedness but specific planning for these events is close to impossible.
2. **Known and prepared for**– rare events which pose a significant threat (real or perceived). This category includes earthquakes, flu pandemics, extreme weather conditions, flooding, wildfires and terrorist attacks. To some extent governments and businesses invest in preventative actions, warning systems and security measures to limit the impacts of an event that may not occur for years or decades.
3. **Known but unprepared for** – rare or extreme events which governments and businesses may have identified as a potential threat, but where little or no action is taken to prevent or mitigate the impacts. Reasons for lack of preparedness include extremely low perceived likelihood; low political sensitivity; a disconnect between scientific communities and decision-makers; socially ‘acceptable’ consequences (at least relative to the cost of preparedness); or a belief that, because the expected impacts are so extreme, preparedness measures are futile.

The Fire Service is prepared with a base capability to respond to events that occur infrequently, or are low in volume, but the potential impact of which is significant, and which cannot be predicted regardless of the number of events. Consideration of a future state fire service will require review of this capability in terms of affordability and appropriateness.

3.6 First Responder, Non-Fire Emergencies

Demands of the Fire Services have evolved, and such change will continue over time. Due to their state of readiness and wide geographic coverage, fire crews are often the first responder to life-threatening non-fire related health and safety incidents, such as emergencies resulting from storm damage and rescue from swift water or motor vehicle incidents. Notably, a greater number of responses are to medical emergencies, as fire teams respond in tandem with ambulance and paramedic services dedicated to this function.

While this effort undoubtedly results in fewer deaths and better outcomes, the costs of fire crews attending is not recorded in the books of any other emergency service provider. However, while the Fire service carries these costs, there is no corresponding cost saving in other areas of public service

³ Source “Chatham House Report” dated January 2012

spending. In effect, the true cost of these improved outcomes is hidden. Arguably, other emergency health responders benefit under a “free rider” scenario where they enjoy the benefits of a successful rescue without paying all the costs.

With the reduction in fires and fire risk, and an increasing demand to respond to non-fire emergencies, the perception arises that fire services are less efficient than they should be, providing a premium service that is out of step with, and more expensive than, their proper function. The result is a service that assists to save lives as well as fight fires, operating within community expectations but outside its legislated mandate.

While the operating conditions and expectations that give rise to non-fire responses is out of scope for this report, it is fair to say that in its current form and under the current funding model, fire services in New Zealand face escalating costs and will increasingly be under pressure to deliver more for less.

3.7 Buildings

The Fire Service operates 437 fire stations. All fire stations are on a long term maintenance and replacement schedule. In 2014/15 and each year thereafter, the Fire Service will spend approximately \$24 million per year on its property portfolio. This includes rebuilding stations in Christchurch and undertaking the wider national seismic strengthening programme.

Fire Service’s building asset base is under financial pressure as properties grow older and become increasingly uneconomic to maintain, or need upgrade to newer standards and modern requirements. In particular, fire stations have been slated for seismic strengthening and in Christchurch, the rebuild necessitates new buildings to replace those destroyed or rendered unusable in the earthquakes of 2010. New buildings or extensions are required where population centres have grown to warrant establishment of a local fire station or upsizing of the current one, while others may face downsize or decommission due to smaller and shifting populations.

The Fire Service Property Team previously prepared a 10-15-year plan that forecast financial pressures on the Commission. The Property Team was asked to revisit these forecasts, with the key planning assumption that capital expenditure was not to exceed \$20 million in any one year. This has resulted in some buildings that were included for action in the 10 – 15 year plan being deferred to a 25-year programme.

As the planning horizon is extended, there is increasing uncertainty regarding the possibility or likelihood of a property receiving the investment or maintenance required.

Key aspects of the Fire Service Property Plan:

- The only projects to be undertaken in the next 10 years relate to exhaust extraction, seismic and the Christchurch re-build, two new builds and land purchases for new stations in response to changing community location.
- At the end of 10 years, 42 stations will not be up to the IL4 seismic standard required by the Building Act for emergency service buildings.
- A number of Issues and risks arise from extending the property planning horizon to 25 years. These are: leases that come to an end, with no plans in place for the future of the station; buildings requiring upgrade to house modern trucks, install hot water and heating, provide toilet and change facilities for both genders.

3.8 Christchurch Rebuild Programme

The Christchurch earthquakes resulted in the loss of several fire stations. Seven new, replacement fire stations are required to be built, with land already purchased for this purpose. The total cost of these stations is estimated at \$12 million.

Following the earthquake, the Fire Service reviewed all Christchurch stations for earthquake resilience, and a decision was made that all core buildings be >67% nbs IL4, in line with Institute of Professional Engineers recommendations. A programme of earthquake strengthening is underway, with 80% of core Fire Service buildings across New Zealand now meeting this standard. Significant investment to complete these upgrades will be required over the next six years.

3.9 Seismic Resilience

Following the Christchurch events, earthquake resilience became a priority for all of the Fire Service. The planned seismic programme will resolve compliance and some architectural refurbishment issues as well as the fundamental issue of seismic resilience for a significant proportion of sites reaching end of life (current policy is 50-year service life) status over the next 15 years.

Currently however, some 76 sites (18%) forecast to reach a 50-year service life over the next 15 years are not part of the seismic programme or any other programme of refurbishment or redevelopment. In extending the planning horizon, these sites are not addressed for a further ten years. Under current service models, this is a potential risk to operation of those stations, and is a particular risk factor for consideration when the future state fire service transformation is implemented.

3.10 Obsolescence a Critical Concern

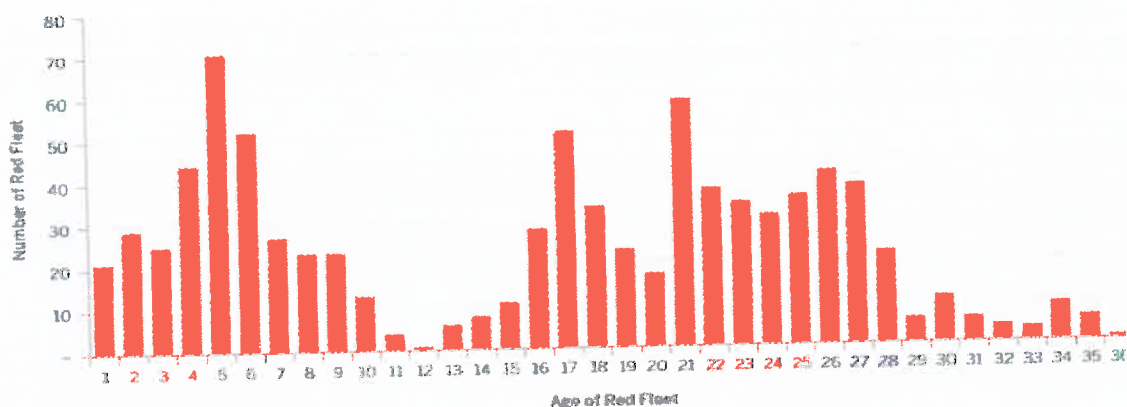
While improved seismic resilience is of high strategic importance, the Property Team note that a far bigger, upcoming issue with the building network is age-related economic obsolescence. As they get older, buildings will become too costly, to maintain; and functional obsolescence whereby buildings fail to perform, will be unable to meet operational requirements. Reference to the age profile of the network confirms that 20 per cent of the network currently exceeds the 50-year service life benchmark. This percentage will increase significantly over the next 15 years, and will not be addressed by the current limited capital works programme. The risk to the organisation is a very significant increase in maintenance operating expense and a degraded operating capability in future years.

3.11 Fire Appliance Replacement

The entire "red" fleet of 850 appliances is managed on a whole-of-life maintenance and replacement cycle. Each class of appliance has a projected useful life (25 to 30 years on average) based on anticipated work load, maintenance and repair cost, and obsolescence. To maximise their value, appliances are moved through the organisation as they age and are reassigned to stations which will place less demand or stress on fire trucks. The Fire Service expects to take delivery of an average of 30 - 40 new appliances per year over the next four years, each costing \$1 million.

When considering the Value Management approach to funding all decisions with financial implications are scrutinised to see if the net value to deliver a target result can be improved through cost efficiencies or service/asset specifications and to this extent such options as hybrid fire appliances, alternate purchasing, and ownership options should be considered.

Age profile of fire appliances



The fleet is aging and NZFS has a significant modernisation programme in place after a period of low investment between 2000 and 2005. An aging fleet may be less reliable and require more maintenance, be less optimal as older appliances are not moved on.

The age profile of the appliances illustrates the results of an earlier policy of discretionary based asset replacement rather than a planned lifecycle costing approach which underpins decisions whether to maintain and repair or to replace appliances. Age is an indicator of asset condition while remaining useful life is based on reliability and the consequences of failure posing an unacceptable risk.

To determine whether the planned replacement programme is appropriate would require a full condition assessment of the exiting stock of assets and matching that against need to determine fit for purpose.

A complicating factor is that as the Fire Service diversifies its service and responds to different types of incidents that require different equipment (e.g. medical equipment) there is the potential that appliance costs will increase to meet these changing demands and place further pressure on the overall cost of the service.

Overall while NZFS is undergoing the transition to a new organisation, it may be appropriate to reduce the pace of future replacement appliances, until the right sized service has been determined.

3.12 Union and Community Relationships

The shape of modern, future state fire services will be determined following wide consultation with key stakeholder groups including those representing the interests of paid firefighters and of volunteers. Firefighting as a profession is strongly unionised, represented by the New Zealand Professional Firefighters Union; while the United Fire Brigades' Association claims it 'unites and represents fire brigades of all kinds' and includes paid, urban, rural, and industrial brigades. Approximately 80 per cent of their 10,000-strong membership is volunteers.

Volunteer firefighters are motivated to join their local brigade as a service to their community, providing protection and emergency response capability where it would most likely not otherwise be available. Communities served by volunteer brigades vary greatly. Locations will differ in not only size, but socio-economic and demographic make-up, mix of commercial/industrial/agricultural activity, proximity to natural features that can pose emergency risks such as forests, lakes and volcanoes, and availability of fire fighters 24/7. With some 85% of New Zealand's firefighters being volunteers, genuine community

engagement that is mindful of the diversity of New Zealand communities served by volunteer brigades will be critical to the success of the transition to the future state fire service.

The importance of retaining the local identity of the fire services and their role in the community is very important. It is expected that the unified service will strengthen (not weaken) community relationships and the delivery of consistent fire services as required in New Zealand.

3.13 Career vs. Volunteer

One of the challenges facing the Fire Service in the upcoming merger of urban and rural services is that of instilling a common sense of purpose and culture across the organisation.

The transition process to the new organisation will involve the amalgamation of three separate and distinct cultures and while this will be a major challenge in terms of change management there will undoubtedly be an impact on the cost of this change. The cost structures of volunteer and career based services are very different (refer the case study in Section 3.17) which may influence decisions should fiscal pressures result in short term decision making and these decisions will need to be balanced against an objective to build long term sustainability of the Fire Service. As a result it will be critical for the organisation to be flexible in its decision making, exercising the right decisions with the right resources to ensure that the strategic objectives can be achieved with the right mix of urban and rural career/volunteers.

The volunteer model is coming under pressure as rural populations are becoming older and the trend of rural migration to urban areas rises. These pressures are increasingly making volunteerism harder to sustain as the volume of emergency calls and the range of incidents attended by fire services increases.

Some rural towns are serviced mainly by volunteer brigades and volunteer fire forces. In many small, rural communities fire services are sometimes the only resource available to respond quickly⁴. Fire services are a keystone of community resilience (especially in rural areas) and part of the case for change is to ensure that this is sustainably maintained in the future.

It is expected that new organisation's approach to volunteer management would include:

- direct organisational support. To provide direct support, volunteers and their local leaders would move into a direct relationship with the new organisation. Volunteer Rural Fire Forces (VRFF) and NZFS Volunteer Fire Brigades (Brigades) would broadly remain the means by which volunteers come together to deliver fire services to communities⁵
- commitment to volunteers' role and engagement in the new organisation; and
- development pathways for volunteers.

⁴ In 2014/15 NZFS volunteers were the first attendance at 25,481 incidents, up from 11,076 incidents in 1989/1990.

⁵ the changes are not expected to diminish the role of valuable organisations such as the United Fire Brigades' Association (UFBA) and the Forest and Rural Fire Association of New Zealand (FRFANZ); rather they create opportunities for new relationships and methods of engagement to form.

3.14 Better Public Services

Across all areas, the government is demanding better public services for less, greater efficiency and increased productivity for reduced cost. Fire services operate under predominantly fixed cost structures, due to their state of constant readiness and high capital costs. Improved productivity is being achieved through response to non-fire emergencies, particularly life-saving medical incidents. However, the costs of attending these events are borne by Fire Service, without any recognition of the affordability of these additional services.

The effect is that the true cost of saving these lives, protecting assets and communities is not recorded, with Fire Services' contribution being absorbed within its overall existing cost structure.

3.15 The Looming Financial Crisis

Provision of fire services in New Zealand is funded almost entirely by the fire service levy, which contributes 97% to Fire Service income. The levy is paid by property owners who insure their properties, contents or motor vehicles, and collected by insurance companies when insurance premiums are paid.

The level of funding received via the levy is now considered insufficient to cover the forecast operating and capital expenditure required to meet day to day needs of the existing Fire Service. This assessment is Based on NZFS' current financial projections and corroborated by the earlier reviews by Deloitte and PwC refer Appendix C – *Fiscal Perspectives*.

Funding of the fire services has not substantively changed since 1994 and yet the role of fire services has expanded considerably. This has resulted in inequities between funders and users of the fire services, and a prolonged and systemic under-investment in rural fire.

At the same time current funding projections will place pressure on the implementation of the change programme (if funded from baseline), to create a combined, national organisation. [See Appendix C – *Fiscal Perspectives* for the full letter outlining these issues from NZ Fire Services Commission Chair to Minister of DIA in '*NZFS – Looming Cost Pressures*'). This view is also supported by the Deloitte limited financial review that notes while the Fire Service can manage its fiscal position in the short term; something will need to change to ensure long term financial sustainability.

3.16 Purpose and Objectives of Funding

The purpose of new funding arrangements is to enable the new organisation to have sufficient funding to carry out its powers, duties, and functions.

The objectives of an appropriate funding structure are to:

- share the costs of the new organisation amongst all who benefit from the potential to use fire services
- ensure the levy paid by levy payers or the Crown appropriation matches, as much as is practicable, with the potential to use fire services
- ensure that everyone who benefits from the potential to use fire services contributes to the fire services using the same funding arrangement
- ensure the amount of the funding arrangements to be paid is clear and consistent for levy payers and the Crown
- enable the new organisation to predict the amount of its revenue from the funding arrangement and for levy collectors, levy payers and the Crown to be able to predict the amount they will need to pay

- ensure the levy can adapt to the changing risks and needs of users and communities, the expectations of the Crown and the strategic needs of the new organisation; and
- enable the new organisation to administer the funding arrangements in a straight forward manner.

3.17 Business Drivers

Fire Service Levy

Provision of fire services in New Zealand is funded almost entirely by the fire service levy. The levy is paid by property owners who insure their properties, contents or motor vehicles, and is collected by insurance companies when insurance premiums are paid.

Funding of the fire services has not substantively changed since 1994 and yet the role of fire services has expanded considerably. This has resulted in inequities between funders and users of the fire services. Current funding sources across the fire services, including a fire insurance levy, and a range of rural fire funding sources (including property rates), are not adequately aligned with costs. The current fire service levy is out of date and there are several issues with the levy:

- the levy does not reflect the risk that faces the various properties and assets which fire services protect
- some people and organisations do not take out fire insurance, and therefore do not contribute to the levy, but nonetheless enjoy the same degree of protection as the rest of the community
- the levy also does not reflect the range of non-fire activities that the service responds to, including medical and storm related emergencies
- calculation of the levy is based on the indemnity value of property, and this is open to interpretation. Some practices designed to reduce the amount of levy payable have been put before the courts, and while conditions have been tightened to make it more difficult to continue with those activities, the Fire Services Act is still open to interpretation and therefore property/asset owners will continue to try and minimise the levy paid.

In addition to the fire service levy, rural fire districts receive funding from local government, Department of Conservation, forest owners and a limited amount from New Zealand Defence Force.

3.18 Costs

The Fire Service is an emergency response organisation whose costs are driven by the following:

Cost Driver	Description
Coverage	The location of fire stations is determined by fire risk based on unique characteristics and local circumstances. The profile of a station servicing a downtown CBD in a large centre will differ to one in a smaller, urban centre and this will not look like a station based in a rural area surrounded by bush and forest.
Deployment	Target response times have been set by the Fire Service. In an emergency situation, the response time for career firefighters is within eight minutes of receiving the call, while for volunteer crews the target is within eleven minutes. Three types of volunteer crews operate: commercial and industrial, community and rural.
Readiness	Factors determining fire service readiness for response are vehicles, equipment, and ongoing fire fighter training and education both inside the classroom and in the field.
Response	A critical factor in the effectiveness of any emergency response agency is the ability to get personnel and equipment to the scene of the emergency in a timely manner. Responses can be

Cost Driver	Description
	categorised as: immediate trigger no notice such as fire, accident or medical emergency; just in time with notice such as precautionary activity (Helicopter landing); or programmed responses such as education or participation in a scheduled community activity.

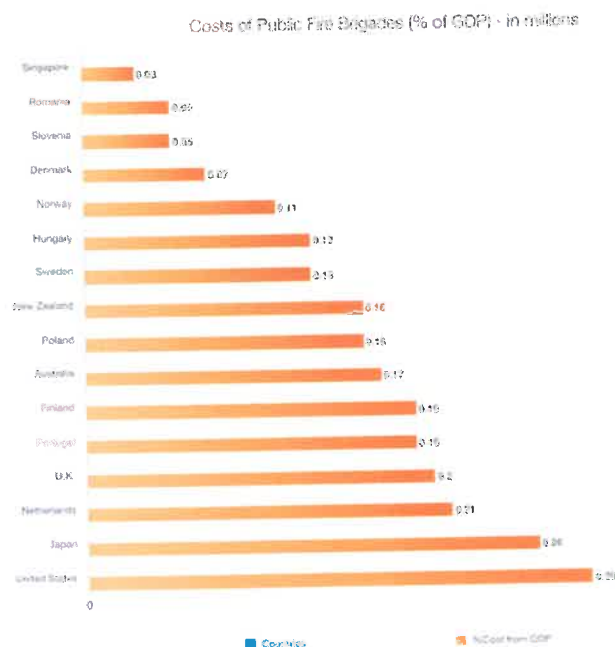
Levels of Service



International Cost Comparisons

International comparisons place the cost of the New Zealand Fire Service and estimated fire protection costs in the middle of the group of some 20 leading countries in world fire statistics. Expressed as a percentage of GDP, this suggests that fire services in New Zealand are neither expensive nor inexpensive. However, without information on the actual services provided in each country, no comparison can be made to conclude whether New Zealand fire services are of premium quality, of low standard or somewhere in between, relative to its peers in this group.

Figure 3.2: International Comparison - Costs of Public Fire brigades



3.19 Case Study

The following case study illustrates some key differences between a volunteer and a career station

Cost comparisons are complicated by several factors affecting brigades. These include the demographics and size of the service area, population size and density, type of services expected (e.g., fire only or both fire and emergency medical services), number of calls and responses, age and type of building stock, construction level, proximity to arterial routes, and whether the brigade is the main service provider or merely provides support or supplemental services to another brigade.

The following comparison is provided for illustrative purposes only to provide information on the relative cost of volunteer and a career stations.

Case study – Rolleston and Karori Stations

To illustrate contrasts and similarities between career brigades and volunteer brigades, we present a summary of the operations of two: Rolleston and Karori. The focus is on the nature of responses that each undertook in the 12 month period ending 1 December 2015, and costs to run each station. These comparisons are provided to highlight the differing nature of fire response, and are not intended to provide a view as to whether one approach is better or preferred to the other.

Rolleston is a volunteer brigade in an urban centre 22 kilometres south west of Christchurch. Its population is around 12,000. The surrounding area is predominantly used for water intensive grazing for dairying, and many vineyards are sited in this part of Canterbury⁶.

Karori is a career station in a suburb 4 kilometres from the centre of Wellington. It is one of New Zealand's biggest suburbs, having a population of over 14,000 at the time of the 2013 census⁷.

When considering the structure incidents there were 413 false alarms from a total of 431 recorded incidents

Top line figures for operations and annual costs for a volunteer station and a career station:

	Rolleston	Karori
Brigade type	Volunteer	Career
Total incidents responded	525	?
Total first responses	405	258
Structure incidents	78	431 ¹
Medical emergencies (first response)	205	22
Natural disasters		14
Opex excluding depreciation	\$58,000 pa	\$1,580,000 pa
Depreciation	\$51,400 pa	\$90,000 pa
Planned major refurbishment 2015 to 2030	\$4,600,000 ²	\$0
QV land value	0	\$570,000

¹ Of which 413 were false alarms

² \$1,400,000 2017/18 land, \$3,200,000 2027/28 build – not adjusted for CPI

The numbers of call outs and response types including first responder or follow up vary markedly between the stations. The high percentage of first responses at Rolleston is indicative of that station's distance from the next closest station. Meanwhile, Karori will have provided secondary or later response in support of, and following, other emergency responses in central Wellington. Its proximity to the CBD and the potential for those emergencies to worsen warrants more appliances turning out and a corresponding higher likelihood that those responses are not required or false alarms.

For bigger incidents, where it escalates from an ordinary response to a second, third, fourth or fifth alarm, the arrival order is important. For Karori, in three of these bigger incidents, they were the first responder, and without that station, there would have been a delay in fire services attending the incident. Equally, if Rolleston were not available, eight instances where they were the first arriving truck would have had delayed response. Brigades relieve other emergency responders during major incidents. Karori had 10-21 on third calls, the likely result of relieving other crews on big events – without this capability fire services health and safety performance would be dramatically affected. In effect, removal of a fire station and appliance would result in loss of capability in areas where back up and second or subsequent call out is needed.

⁶ Source: Wikipedia

⁷ Source: Wikipedia

4. The Future State

4.1 Path to the Future State

The Fire Service is a public service organisation that is highly regarded, trusted and respected by the New Zealand public. A recent independent survey of the public showed a public trust and confidence level of 94%. Therefore changes to the Fire Service need to be carefully managed to ensure public confidence is maintained both during the transition to the single fire services model and into the future.

4.2 Approved Change Programme

The move to a single Fire Service, bringing together both urban and rural fire services has been approved. This review is cognisant of this large change programme, including the provision of one-off funding of approximately \$112 million to complete this transformation and notes that this funding estimate has not yet been confirmed or approved.

TDM views this as first of a number of steps which will result in a right-sized, optimised and affordable fire service for New Zealand.

4.3 Future State Fire Services

The Fire Services Review (refer <https://www.dia.govt.nz/Fire-Services-Review>) was tasked with ensuring New Zealand's fire services are modern, efficient, maintaining a sustainable volunteer firefighter base and meeting the needs of both urban and rural communities. Fire services will be delivered against sound risk management principles and the risk profile of particular communities or industries.

Fit-for-purpose 21st century fire services are:

- flexible and adaptable
- coordinated with strong leadership
- able to provide a consistent and effective service
- contributing through partnerships to strong local communities.

Determining high performance strategies for the long term use and deployment of Fire Service resources in order to minimise the risk of loss of life and property is complex. It is important to understand the purpose of the Fire Service within a modern New Zealand society and shape the operating model within that context and within what is affordable.

The Fire Service prioritises its responses, to:

- Save lives
- Preserve economic capacity and capability (commercial and industrial infrastructure)
- Minimise damage to property
- Build community capacity and capability to minimise risk and impact of disaster.

The result of this order of priority is the need for a first response capability that addresses a wide variety of potential harms that people face from fire, natural disasters medical emergencies and other non-fire incidents. The consequence is a service that is both capital and people intensive, resulting in a high proportion of fixed costs (95%) and significant investment tied up in capital assets (station, appliances and equipment).

Given the largely fixed cost nature of providing a standing army of fire fighters to respond to emergency call outs, any future state fire service will be required to:

- optimise coverage, deployment, readiness and response
- maximise flexibility in resourcing levels (career v volunteer, generalist's v specialists)
- leverage the committed investment to meet other objectives (first responder to non-fire incidents) without losing sight of the core business of fire response
- access a broader range of revenue options
- build local community resilience (prevention, risk mitigation, capability and capacity for rapid response)
- be responsive to an aging population that generates increasing numbers of non-fire related emergency calls
- remain affordable.

4.4 Framework, Methodology and Tools

This report has looked at the current state, financial levers available and the viability of both short and long term solutions, to maintain the financial sustainability of the service as it undergoes transition to a new future state.

4.5 Current Funding Position

As a capital intensive public service agency with one major source of income and a significant proportion of its costs (95%) being fixed in the short term, the Fire Service has a limited number of fiscal management tools at its disposal. As a consequence, the Fire Service has adopted a relatively conservative approach to financial management designed to minimise risk to ensure that it is sustainable into the future.

The Fire Service is also constrained from leveraging its balance sheet to address long term asset replacement issues. Where it is considered unfair for current users to fund the full cost of the investment then it is appropriate for the Fire Service to borrow money specifically for that purpose - at present it only has access to a \$10 million borrowing facility to cover short term cash needs – this is not sufficient or sustainable to meet the ongoing organisational cost pressures.

The Fire Service is focused on operating safely and effectively. However, Cuts to funding (including the organisations imposed limit of \$50 million) will face challenges from both the public and firefighters. The Fire Service's conservative approach may reflect the experience of previous attempts to reform the service and a reflection of their limited experience in areas of significant change programmes. The Fire Service is certainly aware that their limited ability to borrow is a key constraint on their ability to perform operationally and as a result of this limitation the focus has been on careful management of limited available funding as the only real lever to managing the financial position.

Based on the available information, our view is that the Fire Service will complete 2015/16 and 2016/17 with relatively minor changes to their operational and capital budgets. This will lead to a reduction in funding reserves and likely result in expenditure timing risks around matching available levy income and expenditure. As a result the Fire Service is likely to need to draw on debt funding during 2016/17.

There is considerable risk that cash flow problems will arise during 2017/18.

Without additional funding and In order to maintain a positive cashflow it will be necessary to reduce capital expenditure programmes by some two-thirds unless operational savings can be found. Even if

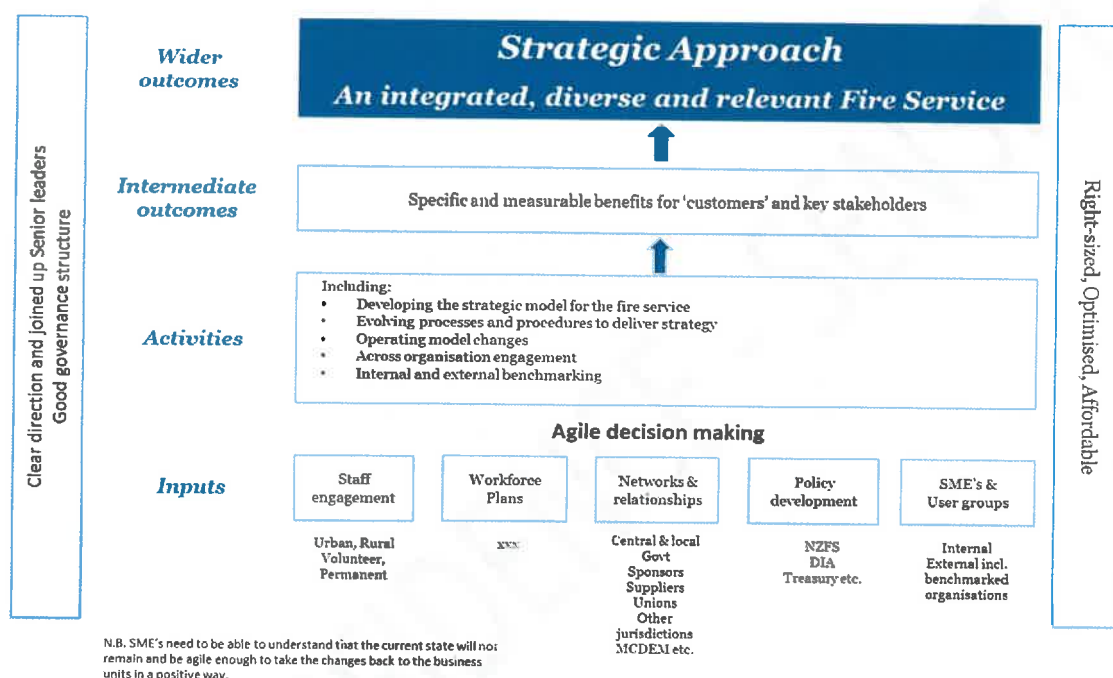
operating savings can be found there is still the likelihood that operating deficits will continue reflecting the impact of unfunded depreciation.

4.6 The Transformation Approach

The ideal state must be viewed within the key parameters of right-sized, optimised, and affordable. The solutions that deliver the wider outcome of an integrated, diverse and relevant fire service are framed within these boundaries.

The diagram below illustrates one approach to determining and transitioning to the ideal state.

Transformation Overview



4.7 Strategic Transformation Objectives

Right-sized, optimised and affordable providing value for money – these are the parameters for framing a relevant, integrated and a diverse fire service.

A Right-sized Organisation

“the right number of the right people in the right jobs to accomplish NZFS' goals and objectives”

The proposed change will bring all the various elements of New Zealand's fire services together into a single entity. The new organisation will unify urban and rural fire services with a new way of working, and with this transition brings a change to organisational culture. The establishment of regional committees is intended to provide a strong regional influence to ensure the regional voice balances the national direction.

The new organisation will have an expanded role – an amalgamation of the current New Zealand Fire Service, the National Rural Fire Authority, and the Rural Fire Authorities (including Enlarged Rural Fire Districts).

The right sizing of the operation can be achieved through the balance of broad need, risk identification and mitigation approach, resource availability (for example people, equipment/plant and funding) under a well governed and managed organisation supported by the right policy framework.

To determine the “right-size” will require the following:

- 1. Agree the primary purpose.** The key question relates to the determination as to whether the service is primarily a provider of around the clock, every day of the year response to fire emergencies. Once the purpose is confirmed, the service can determine the right number of people, equipment and locations necessary to deliver to this purpose, while also considering overarching aspects such as public safety, containment, urban vs. rural settings, the needs of our diverse communities and the balance of career vs. voluntary resource.
- 2. The secondary and subsequent priorities** such as being first responder and non-fire emergency response in search and rescue, education and medical events can then be overlaid.

Determination of the “right-size” will be informed by:

- fire service regulatory, strategic and policy environment
- organisational strategy
- alignment of workforce plans with aforementioned environments and strategy
- the diverse nature of the staff, being permanent, volunteer, urban and rural
- the needs of the wider stakeholders eg. Central and local government, funding agencies and organisations, unions etc.
- internal and external subject matter experts and benchmarked organisations.

Once the Fire Service’ ”core business” is understood and lessons are learned from the implementation of the ‘one service’ model, the next step is to move into optimising the operation.

The “affordable” yardstick is applied during both the right-sized stage (particularly around the cost of change) and is a key driver for determining how an optimised fire service will look.

Figure 5 - Organisational Overview



Optimisation

“Make the best or most effective use of (a situation or resource)”

Optimising an organisation can be achieved with a number (and combination) of means. Commonly, areas like funding, people resource, technology deployment and use and process are considered. Consultation with a multitude of stakeholders from Ministers, other Government agencies, leadership, staff and the wider community will help to determine or influence the measures taken.

Working parameters, performance indicators and success factors can only be defined after the necessary outcomes, key drivers and benefits (including measurement systems) are articulated, and understanding the experiences of benchmarked organisations in other jurisdictions that have undergone similar transformation will be valuable in the New Zealand context.

Optimisation of the Fire Service will require a new risk-based approach which would consider fire and non-fire responses such as road traffic accidents, flooding and other emergency incidents, and saving lives and property. This will require a new risk-based assessment methodology to assess the effectiveness of resource allocation and response strategies.

Any approach to optimisation must consider the strategic planning goals and objectives in fire protection and response, and detail modelling approaches to support fire station placement, crew deployment, level of readiness and response.

Affordability

“the universal challenge is to maximise value while living within our means”

The term ‘affordability’ is generally understood, but as a concept is hard to define. When referring to the affordability of an item, it usually means the amount of financial stress that a purchase puts the buyer under. For the purposes of this report, the term “afford” means being able to pay without incurring financial difficulties.

It is true that emergency response services need to be affordable. Under the existing model this is determined by a relationship between fire service levy rates and competing service expectations. Consequently, affordability is concerned with securing some given standard of emergency response service at a price which does not impose an unreasonable burden on those who pay for the service.

The concept of affordability applies similarly to emergency response services as it does to other goods and services. Where one stakeholder considers a particular level of service to be quite affordable, others may consider it very unaffordable. The position of each depends on how important they view fire services to be relative to other areas where they could spend the resources, and what they believe those funds should be spent on.

Fire service affordability can be viewed from the different perspectives of five key stakeholder groups:

- **The Fire Service**, given its desire to operate within existing state parameters and implement plans to sustain that level of service into the future.
- **Monitoring agencies** need assurance that where financial forecasts project operating deficits and cash shortfalls that these deficits are being driven by necessity and not through choice.
- **Ministers**, who have considered the need for the creation of a single fire service to deliver a more effective and efficient emergency response organisation may look to identify other options such as appropriations from other budgets, or to limit or slow the path to a possible levy increase.

- **Levy payers'** ability to pay is all-important, and must be viewed in the context of fairness, equity, transparency and ultimately their willingness to pay.
- **New Zealand society** that expects an emergency response capability to deal with low probability high impact events, with an understanding that there is a cost of maintaining a contingent capability of a standing army required to protect their communities.

Fiscal constraint invariably provides strong positive incentives for an organisation to make the best use of its existing resources while judiciously using the various financial levers at its disposal (see *Section 5 - Financial Levers*).

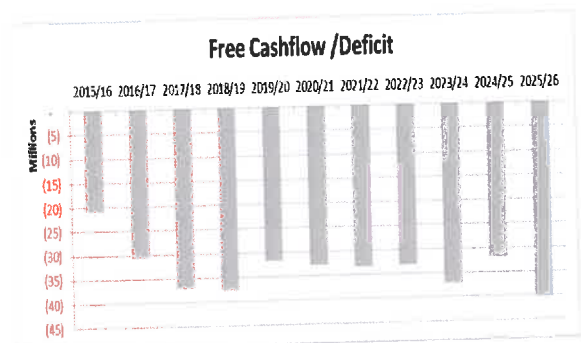
See also NZ Treasury supporting working paper⁸ on Housing affordability (refer <https://www.dia.govt.nz/Fire-Services-Review>)

4.8 Measures of Affordability

For the purpose of this report the fire service baseline was considered using several measures of affordability. All three measures show that the Fire Service is facing a looming fiscal crisis which will be exacerbated by the cost of the change programme without some fundamental changes being made to its funding strategy:

Short Term Affordability - the Operating Surplus/Deficit is the result of revenue minus expenses, and is the simplest measure of affordability. The objective is to ensure that on an annual basis, the Fire Service is able to live within its means by meeting the current year's operating expenditure from revenues. Current forecasts indicate that this is a looming financial problem.

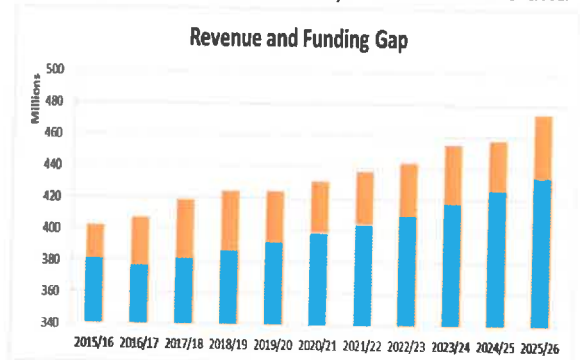
Medium Term Affordability – free cashflow is a longer term measure of affordability. This examines whether the Fire Service can meet debt and interest commitments, invests in the future capability, while having sufficient cash in reserve to meet any unplanned shocks. Cash forecasts indicate that the Fire Service will need a significant cash injection to operate at the current service levels now and into the future.



⁸ Affordability of Housing: Concepts, Measurement and Evidence, Published: March 2006

Long Term Affordability – Levy revenue is the long term determinant of affordability. A sustainable and resilient Fire Service needs sufficient future certainty that levy revenue can match projected operating costs, financing costs and investment requirements.

Projections indicate that the Fire Service will need to raise revenue through increased levies (orange) or offset this amount by reducing expenditure to be within projected revenue (blue) through a combination of financial levers, identified below, without a levy base change or rate increase.



In addition to these short/medium and long terms affordability issues there is the impact of the Transformation Change Programme that needs to be considered in light of the strategic decision to proceed with the 'One Service' integrated model.

Change costs - it is important to note that the Fire Service will incur further costs, in addition to existing costs, that will arise as the Fire Service transitions to a single organisation. The issue of intergenerational equity is directly relevant to dealing with these costs and will require either an equity injection or the ability to leverage its balance sheet by borrowing to meet the initial investment required to implement the change.



Summary – The costs of the Fire Service (assuming no change to the current footprint) will necessarily increase in to the future. The issue is that expenditure is increasing much faster that growth in levy funding. In the short-term this is putting pressure on the organisation and in the medium-term is simply not sustainable.

The reason for this difference is largely because:

- the rate of levy has only changed once in the last 10 years (an increase of 7.3c per \$100 insured to 7.6c per \$100 insured)
- the residential portion of the levy is capped at \$100K property value so (with the exception of new built property) there is effectively no growth in about half the levy base.

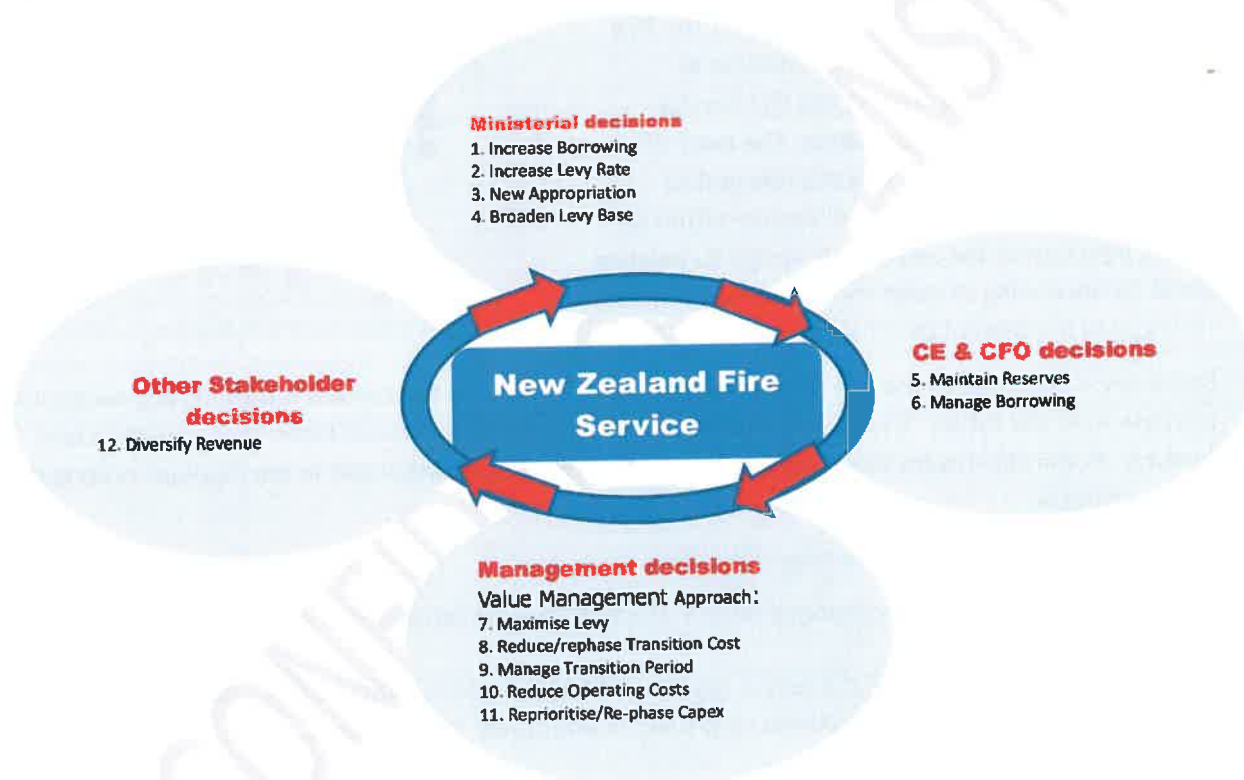
5. Financial Levers

Provision of fire services in New Zealand is funded almost entirely by the fire service levy. The levy is paid by property owners who insure their properties, contents or motor vehicles and collected by insurance companies when insurance premiums are paid. Due to costs rising faster than available levy funding the Fire Service will come under extreme financial pressure in the next few years, and it is necessary to look at options to address this.

5.1 The Funding Model

The following diagram illustrates a range of financial levers, or mechanisms, available to the Fire Service as they seek to address the looming financial shortfall – both short and longer term. It is likely that the Fire Service will need to employ some short term measures until longer term solutions are agreed.

Figure 5.1: Financial mechanisms to address funding shortfall



These Levers (shown in Figure 5.1) have been grouped into four categories:

Category	Description
1. Ministers decision	Responsible Minister/s in conjunction with the Minister of Finance
2. CEO / CFO decision	Strategic decisions made by the Chief Executive Office and Chief Financial Officer
3. Delivery decision	Operational decisions made by appropriate areas of the organisation
4. Other Stakeholders decision	Decisions on paid service made by external stakeholders eg. Other agencies, organisations, areas of community

5.2 Critical Success Factors

Achievability and affordability are key consideration in considering the likely funding option. The Critical Success Factors for evaluation of the various funding options are illustrated below in Table 5.1:

Table 5.1: Critical Success Factors

Critical Success Factor	Priority	Description
Enable fire services to better achieve the strategic direction;	1	How well the option meets the agreed investment objectives, related business needs and service requirements, and integrates with other strategies, programmes and projects.
Meet stakeholder expectations adequately	2	How well the option matches the needs of stakeholders to deliver the required level of financial sustainability.
Achievability	3	How well the option is likely to be delivered given the organisation's ability to respond to the changes required, and matches the level of available skills required for successful delivery.
Affordability	4	How well the option can be met from likely available funding, and matches other funding constraints.
Sustainability	5	How well the option can meet the enduring needs of the business both in the short term and the longer term

This report has identified four mechanisms (levers) that could be used to address the upcoming financial shortfall. The following analysis highlights the need for both shorter timeframe solutions to meet the immediate fiscal needs of 2016 – 2018 and also longer term solutions to provide a sustainable future for fire services in New Zealand.

5.3 Funding Options

Range of funding options

As part of the solution process, a view of the various options has included an assessment of: the approach objective, approval process, benefit, risk and impacts across a set of 12 identified options as shown in Table 5.2.

Table 5.2: Funding options considered

Mechanism	Implementation Options	Description
Ministerial Decisions	1. Increasing Borrowing (public or private)	Increase borrowing power to fund shortfall until other revenue means come into force.
	2. Increase the Levy Rate	Straight increase of the NZFS levy to all levy-payers with current base calculation method maintained.
	3. New Appropriation	Additional funding allocated by Government as a crown appropriation to cover public good component and levy equivalent for Public sector entities or as a one-off injection to cover the cost of the change and transformation programme.

Mechanism	Implementation Options	Description
	4. Broaden Levy Base and also Increase Levy Rate	An increase of the NZFS levy to all levy-payers through changing the base the levy is calculated on e.g. \$100,000 to \$300,00 threshold.
CE and CFO Decisions	5. Maintain Reserves	Use cash reserves that have been set aside for the likes of earthquake strengthening, appliance replacement etc. No additional funds into reserves for depreciation etc.
	6. Manage Borrowing	How and when lines of credit are utilised.
Management Decisions (Value Management)	7. Maximise Levy	Further work by the NZFS to collect levies from non-payers of the levy who have minimised their levy payments .
	8. Reduce Transition Costs	Reduction in level of funding required for the transition to a unified NZFS.
	9. Manage Transition Over a longer Period	Extension of the transition period to spread the funding over a longer time to reduce the fiscal pressure.
	10. Reduce Operating Costs	Scale back and/or cease activities NZFS would normally undertake eg. Education, prevention (eg. Safety checks, community events, building checks etc.), undertake station closures, National Office cutbacks etc.
	11. Reprioritise/Re-Phase Capital Expenditure	Reprioritising and in some cases deferring capital expenditure.
Other Stakeholders Decisions	12. Diversify Revenue	Opportunity for diversification of revenue streams eg. Payment by DHB's / Ministry of Health for first responder activity to non-fire incidents, payment for community interactions etc.

5.4 Funding Options Analysis

An assessment of the various options against the critical success factors was completed and is reflected in Table 5.3:

Table 5.3: Implementation options assessment

Funding Options	Critical Success Factors				
	1	2	3	4	5
	Achieve the strategic direction	Meet stakeholder expectations	Achievability	Affordability	Sustainability
1: Increasing Borrowing	Green	Green	Green	Yellow	Red
2: Increasing the Levy Rate	Green	Yellow	Green	Green	Green
3: New Appropriation	Green	Yellow	Yellow	Yellow	Green
4: Broaden Levy Base and Increase Levy Rate	Green	Yellow	Yellow	Yellow	Yellow
5: Maintain Reserves	Green	Yellow	Yellow	Yellow	Yellow

Funding Options	Critical Success Factors				
	1	2	3	4	5
	Achieve the strategic direction	Meet stakeholder expectations	Achievability	Affordability	Sustainability
6: Manage Borrowing	Good	Good	Good	Moderate	Poor
7: Maximise Levy	Good	Moderate	Good	Good	Good
8: Reduce Transition Costs	Moderate	Moderate	Moderate	Good	Moderate
9: Manage Transition Over a longer Period	Moderate	Moderate	Moderate	Moderate	Moderate
10: Reduce operating Costs	Poor	Moderate	Moderate	Good	Poor
11: Reprioritise/Re-Phase Capital Expenditure	Moderate	Moderate	Good	Good	Poor
12: Diversify Revenue	Good	Moderate	Poor	Good	Good

Key	Good Alignment / Support	Moderate Alignment / Support	Poor Alignment / Support
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Further detailed analysis of the individual 12 financial levers is discussed in *Appendix A – Funding Options Analysis*.

5.5 The Status Quo Option

Due to a large funding gap between available funding sources and planned/required expenditure, the status quo is not financially sustainable. This deficit is primarily due to significant interest and depreciation expenses arising from implementation of Fire Service’s capital plan. The Fire Service is projected to have negative cash flows from 2016/17 as a result of the planned capital expenditure.

One of the immediate solutions to resolve this shortfall issue is by utilising the current cash reserves and existing overdraft facilities. However such a solution is short term in nature and does not provide for a sustainable longer term solution.

5.6 The Impact of the Transition to the ‘One Service’

The proposed ‘one Service’ unified operations is also placing extreme pressure on the financial sustainability of the Fire Service. It is estimated that the deficits are the largest during the transition years (2016 to 2020) and decrease thereafter. It is estimated that the new entity will require additional funding to meet transition costs, totalling \$112 million on top of new contributions from the Crown and the National Land Transport Fund (NLTF) arising from implementation of the mixed funding model.

Unifying the sector into a single organisation will enable improved strategic decision making and planning based on risks and needs, more effective service delivery, and enable efficiencies and better value for money. It is considered that these benefits could be realised if the organisation improves its systems and processes, provides services based on national and regional risk and needs, engages with communities, and improves the support to volunteers and rural fire, and improves its capability. These changes should address the current state issues of the fire services not always being able to show economic value, not always having

the right investment for community needs, and the risk of making ad hoc operational decisions based on current systems, information and governance structures.

5.7 The Preferred Way Forward

The results of the options analysis reveal that there are a numbers of available solutions that can provide the necessary support to the operating and capital requirements of the Fire Service. These solutions fall into either short term or long term solutions and are shown in Table 5.4 below:

Table 5.4: Summary of available funding solutions

Funding Stages	Available Options
Short Term	<ul style="list-style-type: none"> ● Reducing operating costs ● Increase the level of short term borrowing above the current \$10 million to relieve pressure on cashflows until longer term solutions are in place ● Seek a capital injection to fund the non-fire services and the cost of the Transformation Programme either as a one-off funding solution or as an ongoing increase in baseline ● Review the costs in forming the new unified fire service to ensure such costs are robust and sufficient contingencies are in place to fund any unknown or unexpected costs ● Re-prioritise and re-phase capital expenditure to manage cash flows in the short term with minimal effect on the longer term sustainability of the service ● Manage the Transition over a longer period to reduce fiscal pressures in peak deficit periods ● repurpose cash reserves to meet short-term fiscal deficits.
Long Term	<ul style="list-style-type: none"> ● Increasing the Fire Levy rate from 2017 with retention of the base calculation method ● Source additional levy payment revenue or reimbursement from other agencies or emergency providers who receive a benefit from the Fire Services attendance as first responder to non-fire incident ● Broaden the Levy base and increase the Levy rate to all levy payers.

The preferred way forward is based on a combination of short term and longer term solutions enabling the fiscal pressures to be addressed immediately while longer term funding initiatives are developed further. These solutions are:

In the **short term** it is suggested that Ministers allow NZFS to increase its level of borrowing both to cover working capital as well as continue to invest in its capital programme, including the reconstruction of the Christchurch Fire Stations and the National Seismic Strengthening programme. Such funding could be achieved through either public or private borrowing.

Looking at the **longer term**, the solution is to ensure that the Fire Levy is set at a rate with appropriate thresholds that ensures the service has security of income and is able to generate sufficient cashflow to invest in capability into the foreseeable future.

5.8 Sensitivity Analysis

While it might be considered that flexing the transition costs does not have a material effect on the financial projections of the Fire Service there are however, situations that could have a material effect on the funding requirement under the 'One Service' option including:

- circumstances in which rural properties and assets are required to be purchased rather than gifted to a new entity or sold at nominal values
- the level of Operating expenditure efficiencies achieved from operating under one entity. At this stage no financial analysis has been done on benefit realisation following the formation of the 'One Service' model because it is considered that operating efficiencies (benefits) cannot be identified in the short term as the focus will initially be developing a new organisation and embedding the culture of a single unified fire service with regional influence. However, following transition it is reasonable to assume there is merit to assess the efficiency of the new model and whether there is scope for savings
- it is also suggests that NZFS' capital plan would need to significantly reduce to be affordable under the current operating model. There has been no assessment of the impact on the business of such a reduction. However, any material reduction in the planned capital spend is not considered plausible or realistic. For example, the current property programme is based on a capped annual spend and reducing capital funding would extend the replacement programme timeframes.

6. Conclusion

As a capital intensive public service agency with one major source of income (Insurance Levy is 97% of total revenues) and a significant proportion of its costs (95%) being fixed in the short term, the Fire Service has a limited number of fiscal management tools at its disposal. As a consequence, the Fire Service has adopted a relatively conservative approach to financial management designed to minimise risk to ensure that the Fire Service was able to live within its means while also being sustainable into the future.

Current financial forecasts indicate that the Fire Service is facing a looming financial crisis which past approaches to financial management will not be able to resolve. This situation will be further exacerbated by the recent decision to create a unified fire service and the significant short-term cost of change and longer term transformation to create a modern fit for purpose fire service that is right-sized, optimised and affordable.

The Fire Service will be unable to resolve this on its own and will need to work closely with key partners, notably the monitoring agency, to identify a package of funding options for Ministers that will address this looming financial crisis in the short-term while ensuring longer term financial resilience and addressing issues of intergenerational equity.

The analysis indicates that the preferred way forward is based on a combination of short term and longer term solutions enabling the fiscal pressures to be addressed immediately while longer term funding initiatives are developed further. These solutions include:

- Allowing NZFS in the short term to increase its level of borrowing both to cover working capital as well as continue to invest in its capital programme, including the reconstruction of the Christchurch Fire Stations and the national seismic strengthening programme. Such funding could be achieved through either public or private borrowing.
- Looking at the longer term, the solution is to ensure that the Fire Levy is both relevant and appropriate for the organisation and is set at a rate with appropriate thresholds that ensures the service has security of income and is able to generate sufficient cashflow to carry out its duties, powers and functions while investing in capability for the foreseeable future

7. Next Steps

One of the key steps is a review the Transition funding costs to identify areas of fiscal risk, expenditure adequacy and timing together with analysis of potential benefits to determine the overall cost impacts on current projections.

Based on the proactive and prudent management of Fire Service funding, the introduction of capital expenditure prioritisation and capped spending limits together with establishment of cash reserves have helped reduce the looming fiscal challenge. In the future, the introduction of both short and long term funding, with the support of shareholders, will ensure that these challenges can be met by the new organisation, with improvements in capability, strategic decision making, organisational and operational systems and better support for communities, volunteers and rural fire services.

Appendix A - Funding Options Analysis

The following describes each of the available options identified in Section 5 – Financial Levers:

Option	Approval	Short/Long Term	Benefits	Impact	Risks
<p>1 Increase Borrowing Increase borrowing power to fund shortfall until other funding streams come into force This would allow the Fire Service to deal with short-run cash shortfalls similar to an overdraft facility that is expected to be repaid as soon as revenue increases or expenditure cuts take effect. At the same time the use of additional borrowing would allow the Fire Service to leverage their balance sheet allowing it to borrow money to implement the change and transformation programme. Private sector organisations use gearing (the right level of equity and debt) to deliver appropriate returns on investment while public sector organisations address intergenerational equity considerations by ensuring those that benefit make an appropriate contribution to the cost. There is an assumption that in the long term a right sized national fire service will have revenue certainty such that its ability to meet interest and principal payments does not place the organisation at risk.</p>	<p>Policy decision in consultation with the Board and DIA followed by joint approval of the responsible Minister and Minister of Finance.</p>	<p>Short</p>	<p>Quick and easy to implement once approval is obtained In the case of private based borrowings there is the rigour of bank involvement to scrutinise credit worthiness and manage credit risk</p>	<p>Provides short term flexibility to Fire Service management to deal with fiscal pressures while also providing a means to transfer the impact across generations</p>	<p>The level of borrowing allowed must not exceed NZFS' capacity to meet interest costs and capability to make repayments.</p>
<p>2 Increase Levy rate Straight increase of the NZFS levy to all levy-payers with current base calculation method maintained The levy rate was last increased in 2008 and has been reviewed annually since, with a</p>	<p>DIA recommendation to Ministers to increase the levy from 2017</p>	<p>Long</p>	<p>Administratively straightforward to implement using existing process. Also when done right and once will minimise resistance.</p>	<p>A properly implemented process to change the levy that is well timed and of an acceptable quantum provides NZFS with the best long term sustainable solution to managing fiscal</p>	<p>Changes to the levy need to be managed to ensure they are acceptable to levy collectors (insurance companies) and payers (insurers). There are two distinct risks firstly the</p>

Option	Approval	Short/Long Term	Benefits	Impact	Risks
<p>recommendation that it remain unchanged. While administratively straightforward to implement, any change to the rate will be closely scrutinised by the sector. There would be significant pressure to minimise any increases, and to ensure all other avenues to reduce the cost have been considered first. Consequently, while this may appear to be the preferred method in achieving the necessary revenue for the Fire Service, all other options must first be evaluated and judged less suitable before adjustment to the levy is undertaken. Timing is important and Ministers are unlikely to want to change the levy twice. Firstly, to deal with current fiscal pressures and in advance of determining the right sized, optimised and affordable national fire service.</p>				<p>pressures and to maintain its financial independence. However, done hurriedly and/or poorly risks alienating key stakeholders</p>	<p>quantum of any levy increase and secondly the frequency of the change to the levy.</p>
<p>3 New Appropriation Additional funding allocated by Government as a crown appropriation to cover public good component and levy equivalent for Public sector entities or as a one-off injection to cover the cost of the change and the Transformation Programme. The introduction of a direct appropriation for NZFS would be a significant departure from current policy. While on the face of it there is rational policy objective to underpin this contribution in terms of fairness and transparency it is at the expense of financial independence for NZFS. The alternative is to require other public sector entities to pay the same as any other organisation and meet that through their</p>	<p>Decision required of other parties eg. DIA, The Treasury, Minister/s etc.</p>	<p>Long</p>	<p>Treats all organisations (private and public) the same and makes the cost of NZFS explicit and transparent.</p>	<p>The net impact of this option would result in the transfer of government appropriations from other public sector agencies to NZFS, resulting in NZFS having a corresponding reduction in its financial independence.</p>	<p>NZFS Fiscal pressures are simply passed on to other public sector agencies or back to Government. An appropriation reduces financial independence and introduces a greater risk of political intervention.</p>

Option	Approval	Short/Long Term	Benefits	Impact	Risks
<p>baseline (the fiscal pressure has been socialised across the public sector.</p> <p>A one-off appropriation to meet the additional capital investment required to cover the rebuilding of capability in Christchurch is the same as a shareholder in a private sector company providing "capability capital" has some merit. Given the low level of debt NZFS already has this would be less optimal than allowing NZFS to increase its gearing by borrowing more.</p> <p>An annual operating expenditure appropriation to cover "public benefit" would require agreement on a set of subjective assumptions followed by detailed analysis to determine the value of those benefits in order to calculate the corresponding level of appropriation. Calculating public benefit is more of an art than a science.</p>					
<p>4 Broaden Levy Base and also increase Levy Rate</p>	<p>DIA recommendation to Ministers to increase the levy from 2017</p>	<p>Long</p>	<p>Administratively straightforward to implement using existing process. Also when done right and once will minimise resistance.</p>	<p>A properly implemented process to change the levy that is well timed and of an acceptable quantum provides NZFS with the best long term sustainable solution to managing fiscal pressures and to maintain its financial independence. However, done hurriedly and/or poorly risks alienating key stakeholders</p>	<p>Changes to the levy need to be managed to ensure they are acceptable to levy collectors (insurance companies) and payers (insurers). There are two distinct risks firstly the quantum of any levy increase and secondly the frequency of the change to the levy.</p>
<p>5 Maintain Reserves</p> <p>The Fire Service has proactively and prudently provisioned and accumulated cash reserves designed to provide a measured response to known fiscal risks. These include Rural Fire Fighting Fund (\$2.1m), Major Emergencies</p>	<p>Policy decision in consultation with the Board and DIA</p>	<p>Short/Long</p>	<p>Quick and easy to implement</p>	<p>Transfers a contingent liability back to the Crown where a previous held reserve is no longer held.</p>	<p>Reduces future financial capability to deal with identified fiscal risks and unidentified future financial shocks</p>

Option	Approval	Short/Long Term	Benefits	Impact	Risks
<p>Response Reserve (\$15m), Levy Variability Reserve (\$10m), Christchurch Insurance Reserve (\$12m) and Seismic Contingency Reserve (\$5m). In the short term the Fire Service could repurpose these reserves to meet short-term fiscal deficits. Not funding depreciation is a short term solution to a cash crisis but is not sustainable long term and may be an appropriate solution where the future capital investment requirements for a transformed Fire Service are significantly different from current operations.</p>					
<p>6 Manage Borrowing Borrowing has two purposes. The first would allow the Fire Service to deal with short-run cash shortfalls similar to an overdraft facility that is expected to be repaid as soon as revenue increases or expenditure cuts take effect. The second is to leverage the Fire Service's balance sheet allowing it to borrow money to implement the change and transformation programme. Private sector organisations use gearing (the right level of equity and debt) to deliver appropriate returns on investment while public sector organisations address intergenerational equity considerations by ensuring those that benefit make an appropriate contribution to the cost. There is an assumption that in the long term a right sized national fire service will have revenue certainty such that its ability to meet interest and principal payments does not put NZFS at risk.</p>	<p>Cash management is the responsibility of the Chief Financial Officer in consultation with the Chief Executive (having the required level of delegation)</p>	<p>Short</p>	<p>Quick and easy to implement once approval is obtained Rigour of bank involvement to scrutinise credit worthiness and manage credit risk</p>	<p>Provides short term flexibility to Fire Service management to deal with fiscal pressures while also providing a means to transfer the impact across generations</p>	<p>The level of borrowing allowed must not exceed NZFS' capacity to meet interest costs and capability to make repayments.</p>
<p>7 Maximise Levy</p>	<p>Mixture of court decisions, debt</p>	<p>Long</p>	<p>Better collection rates reduce the need for the</p>	<p>Maximises the levy available without headline</p>	<p>Maximising to the levy needs to be managed to</p>

Option	Approval	Short/Long Term	Benefits	Impact	Risks
<p>The Fire Service has proactively targeted levy avoidance including success through the court process. There is an incentive for insurers and the insured to minimise the levy through avoidance strategies and self-insurance. There appear to be few opportunities left to squeeze further levies and those opportunities that do remain will become increasingly expensive to collect.</p>	<p>collectors and impassioned pleas</p>		<p>quantum of the levy to increase</p>	<p>changes to the levy base or levy rate. However, there appears to be limited scope to find significant additional revenue.</p>	<p>ensure they are equitable The key risks relates to the quantum, effort and reward for collection of levies where there is limited scope</p>
<p>8 Reduce Transition Costs There is a need to ensure that the Fire Service manages costs as it shifts to a new unified service, through significant change while retaining flexibility.</p>	<p>Management decision to reduce costs / defer some activities until the NZFS is in a better financial state.</p>	<p>Short</p>	<p>Continued scrutiny of costs leading to more robust estimates</p>	<p>Refined cost estimates as implementation occurs but it may cost more than planned</p>	<p>Reduction in costs could place successful transformation at risk If work planned re-phased could cost more over longer term Loss of goodwill among staff and stakeholders</p>
<p>9 Manage Transition Over a Longer period</p>	<p>Management decision to extend the transition programme with support of DIA and Ministers.</p>	<p>Long</p>	<p>A longer timeframe will enable greater perspective, more review time and enhanced view of financial/non-financial benefits</p>	<p>implementation may cost more than planned over the longer timeframe and result in a watered down result.</p>	<p>Could cost more over the longer timeframe Loss of goodwill from staff, volunteers and the community Could impact on resources involved in the transformation resulting in 'burn out' and reduced delivery focus Actual benefits could be reduced or lost of focus</p>
<p>10 Reduce Operating Costs Scale back and/or cease activities NZFS would normally undertake eg. Education, prevention (eg. Safety checks, community events, building</p>	<p>Management decision</p>	<p>Short</p>	<p>This will reduce the cost of the fire service by the amount identified and in the timeframes set.</p>	<p>There are a number of consequences arising from cost cutting including loss of capability that would take time to reinstate and</p>	<p>There are significant risks with either of these approaches that may result in negative public reaction and potential</p>

Option	Approval	Short/Long Term	Benefits	Impact	Risks
<p>checks etc.), station closures, National Office cutbacks etc.</p> <p>There are two routes to reducing expenditure - cost cutting or financial transformation. The former is quicker and simpler to implement but is prone to arbitrary cost savings that have unintended consequences. The latter offers a measured approach that, while requiring more time to implement, will produce a more sustainable solution in the long term.</p> <p>Targeted cost cutting, with tightly focused initiatives to realign the cost structure in a particular location, function or process may be a useful approach. It might include trimming indirect costs, outsourcing business processes or eliminating waste. This tried-and-true approach to realigning costs works under normal business as usual circumstances. Arbitrary percentage targets and with budget managers asked to find the required savings is the other savings strategy usually employed when time is of the essence.</p>				<p>the negative impact of staff, volunteer goodwill and community relations during the change programme</p>	<p>unrest amongst career and volunteer forces depending on where the cuts are made. Loss of confidence with staff that this is just a cost cutting exercise that puts lives at risk</p>
<p>11</p> <p>Reprioritise / Re-Phase Capex</p> <p>As a capital intensive agency with a significant capital investment programme, this remains the most significant opportunity for the Fire Service to manage cashflows now and into the future. It is always possible to reprioritise and defer capital expenditure with minimal short term impact while freeing up significant cash.</p>	<p>Management decision</p>	<p>Short</p>	<p>Any reduction or deferral frees up cashflow for other purposes, and may also buy time to modify the future capital investment programme so that it is fit for purpose</p>	<p>Reduced cash outflows but at the expense of an aging asset base</p>	<p>While the consequences are rarely immediately apparent the long term impacts may significantly undermine future capability and a capacity as assets age and fail</p>
<p>12</p> <p>Diversify Revenue</p> <p>The Fire Service has traditionally been funded from a levy on fire insurance. There have been suggestions that the Fire Service looks to diversify its revenue sources to reduce dependency on the levy. This may be</p>	<p>Decision required of other parties</p>	<p>Long</p>	<p>Reduced dependence on the Fire Service Levy</p>	<p>Diversify of the revenue base which mitigates the risks associated of being dependent of a single source of income</p>	

Option	Approval	Short/Long Term	Benefits	Impact	Risks
<p>appropriate in cases of non-fire responses, such as medical and evacuation emergencies, where the costs are not on-charged to those budgets.</p> <p>The Commission maintains a comprehensive dataset relating to its firefighter's responses to fire and other emergency incidents. The accounting systems also provide detailed business unit and account category information as well as output class allocations for the purposes of year end reporting. Together, the accounting and incident reporting systems make it possible to complete a comprehensive and relatively robust cost allocation exercise.</p> <p>On the other hand, information on levy revenue is only collected at a relatively high level so the ability to do detailed comparisons between cost types and revenues is quite restricted.</p> <p>An average cost versus marginal cost approach to support a change to the funding approach would see revenues diversified from largely being based on the levy on insurance cover to a broader range of options. However, the Fire Service would need to overcome opposition to seeking payment and cost recovery from other services, which currently receive non-fire response services for free.</p> <p>Look at opportunity for diversification eg. Payment by DHB's / Ministry of Health for first responder activity, paid community interactions etc.</p> <p>Options that have been identified for new revenue sources include:</p> <ul style="list-style-type: none"> • Extend Levy to material damage perils • Apply differential rate to residential and non-residential 					

Option	Approval	Short/Long Term	Benefits	Impact	Risks
<ul style="list-style-type: none"> • Increase cap on residential but no cap on non-residential • Retains fixed rate for residential and non-residential • Road user levy extended more broadly under the NLTF. 					

Appendix B - Financial Forecasts

Short Term Cash Flow Impact

Detailed analysis of the NZFS financial position for the period 2016 – 2026 is included in this appendix to illustrate the impacts of meeting planned expenditure, completing the Transformation Programme and retaining current revenue streams.

Key Assumptions include:

Business Assumptions surrounding the 2016/17 budget, as well as the 2017/18 and 2018/19 forecasts

	2016/17	2017/18	2018/19
Salaries and wages	2.8%	2.8%	2.8%
New Recruits	96	96	96

Regions and Areas remain unchanged.

Economic Assumptions surrounding the 2016/17 budget, as well as the 2017/18 and 2018/19 forecasts

	2016/17	2017/18	2018/19
Levy Rate	7.6c	7.6c	7.6c
Cash Rate (1)	2.25%	2.0%	2.75%
CPI (1)	0.3%	1.7%	1.9%
US 10 year Treasury rates	2.0%	2.75%	2.75%
USD /NZD (1)	0.65	0.61	0.66
EUR /NZD (1)	0.60	0.56	0.59
AUD /NZD (1)	0.90	0.88	0.89
Diesel price (excl GST)	\$0.80	\$1.00	\$1.20
Petrol price (excl GST)	\$1.70	\$1.90	\$1.90

Base data from BNZ Strategist 17 March 2016 March Year

The following Statements of Financial Performance, Financial Position and Cashflows are based on the current combined organisation and have been provided by NZFS as at 26 February 2016⁹

New Zealand Fire Service: Statement of Financial Performance

STATEMENT OF FINANCIAL PERFORMANCE

	Forecast 2015/16	Forecast 2016/17	Forecast 2017/18	Forecast 2018/19	Forecast 2019/20	Forecast 2020/21	Forecast 2021/22	Forecast 2022/23	Forecast 2023/24	Forecast 2024/25	Forecast 2025/26
Levy	370,548,126	363,449,000	369,694,000	375,132,000	380,735,000	386,405,000	392,140,000	397,944,000	405,902,880	414,020,938	422,301,356
Levy funding RFF	-241,150	-886,456	-1,397,527	-1,397,527	-1,397,527	-1,397,527	-1,397,527	-1,397,527	-1,397,527	-1,397,527	-1,397,527
Interest Income	2,230,249	1,102,020	471,846	0	0	0	0	0	0	0	0
Sundry Income	10,532,080	11,882,346	11,790,106	11,790,106	11,790,483	11,790,208	11,790,106	11,790,286	11,790,581	11,790,106	11,790,106
Funds Income	3,682,426	4,095,008	3,288,710	3,288,710	3,288,710	3,288,710	3,288,710	3,288,710	3,288,710	3,288,710	3,288,710
TOTAL REVENUE	386,731,730	379,641,918	383,847,135	388,813,289	394,416,666	400,086,389	405,821,289	411,825,469	419,584,624	427,702,227	435,982,845
Employee and Volunteer Benefits	257,909,756	260,550,871	271,943,261	282,832,974	292,605,010	300,347,034	308,070,146	315,827,744	323,515,834	330,811,142	338,980,778
Fleet Expenses	13,706,982	14,215,518	15,872,865	15,381,980	15,678,121	16,346,775	16,275,772	16,600,822	16,654,735	16,530,499	16,530,499
Clothing/Operation Equip/Consumables	12,890,560	12,867,502	13,368,984	12,991,484	13,269,284	13,527,984	13,763,284	13,485,324	13,763,124	13,485,324	13,763,124
Occupancy	16,159,218	16,718,594	16,705,193	16,872,637	17,066,775	17,327,018	17,645,125	17,961,871	17,808,371	17,797,173	17,797,173
Communications and Computer Costs	16,516,508	20,461,794	16,497,128	16,497,128	16,497,128	16,497,128	16,497,128	16,497,128	16,497,128	16,497,128	16,497,128
Office Equipment and Consumables	1,359,029	1,266,799	1,265,323	1,265,323	1,265,323	1,265,323	1,265,323	1,265,323	1,265,323	1,265,323	1,265,323
Promotional Activities	4,797,573	4,884,034	4,884,034	4,884,034	4,884,034	4,884,034	4,884,034	4,884,034	4,884,034	4,884,034	4,884,034
Travel	8,078,485	9,274,799	10,139,651	10,359,469	10,158,140	10,008,850	10,091,790	10,008,850	10,091,790	10,008,850	10,040,035
Professional fees	4,359,623	3,172,658	3,180,921	3,189,515	3,198,453	3,207,748	3,217,415	3,227,469	3,227,469	3,227,469	3,227,469
Research and Development	1,059,771	1,155,714	1,155,714	1,155,714	1,155,714	1,155,714	1,155,714	1,155,714	1,155,714	1,155,714	1,155,714
Other operating costs	1,622,983	1,850,191	1,453,235	1,456,340	1,459,507	1,462,737	1,466,032	1,469,393	1,469,393	1,469,393	1,469,393
Insurance Costs	1,873,277	2,121,475	2,206,334	2,294,587	2,386,371	2,481,826	2,581,099	2,684,342	2,684,342	2,684,342	2,684,342
Finance Costs	342,978	624,634	1,699,694	3,702,497	5,672,298	7,463,935	9,212,358	10,955,851	9,835,851	9,835,851	9,835,851
Grants and Donations	4,475,870	4,569,734	4,593,614	4,618,091	4,643,180	4,668,896	4,695,255	4,722,273	4,749,967	4,749,967	4,749,967
Audit fees for financial statement audit	0	0	0	0	0	0	0	0	0	0	0
Audit related fees for assurance and related services	0	0	0	0	0	0	0	0	0	0	0
Expenditure Recoveries	0	0	0	0	0	0	0	0	0	0	0
Depreciation and Amortisation	38,118,027	39,985,196	42,756,235	45,306,069	48,271,400	48,251,647	48,182,388	48,182,388	48,182,388	48,182,388	48,182,388
Impairment of Property Plant and Equipment	0	0	0	0	0	0	0	0	0	0	0
Change in make good provision	0	0	0	0	0	0	0	0	0	0	0
Fund Expenditure	2,920,889	3,598,820	3,142,020	3,142,020	3,142,020	3,142,020	3,142,020	3,142,020	3,142,020	3,142,020	3,142,020
TOTAL OPERATING EXPENDITURE	386,191,511	387,318,329	410,864,206	425,949,863	441,352,757	452,038,669	462,144,883	471,870,546	478,927,483	485,726,616	494,205,237
NET SURPLUS / (DEFICIT)	540,219	-17,676,411	-27,017,071	-37,136,574	-46,936,091	-51,952,280	-56,323,594	-60,245,077	-59,342,859	-58,024,390	-58,222,592

New Zealand Fire Service: Statement of Financial Position

STATEMENT OF FINANCIAL POSITION

	Forecast 2015/16	Forecast 2016/17	Forecast 2017/18	Forecast 2018/19	Forecast 2019/20	Forecast 2020/21	Forecast 2021/22	Forecast 2022/23	Forecast 2023/24	Forecast 2024/25	Forecast 2025/26
Balance	0.00	0	0	0	0	0	0	0	0	0	0
Bank	36,066,353	10,267,265	0	0	0	0	0	0	0	0	0
Inventories	0	0	0	0	0	0	0	0	0	0	0
Trade and other Receivables	81,851,375	87,869,290	95,860,965	103,870,385	105,098,332	104,400,068	101,687,817	96,875,607	91,695,510	86,547,146	89,679,238
Prepayments	1,580,191	1,580,191	1,580,191	1,580,191	1,580,191	1,580,191	1,580,191	1,580,191	1,580,191	1,580,191	1,580,191
Derivative financial instruments	0	0	0	0	0	0	0	0	0	0	0
Non-current assets held for sale	0	0	0	0	0	0	0	0	0	0	0
TOTAL CURRENT ASSETS	119,497,919	99,716,746	97,441,155	105,450,575	106,678,523	105,980,258	103,288,007	98,455,797	93,275,700	88,127,337	91,259,428
Property plant and equipment	664,098,699	665,624,842	675,965,291	675,257,560	672,005,473	666,028,969	660,035,934	653,535,011	648,542,402	643,452,500	622,088,374
Intangible Assets	5,257,794	8,447,548	7,774,762	7,296,953	6,884,408	6,488,864	5,993,499	5,498,135	4,502,770	4,447,406	4,402,042
TOTAL NON-CURRENT ASSETS	669,356,393	674,072,390	683,760,052	682,554,513	678,889,881	672,517,833	666,029,433	659,033,146	653,045,172	647,899,906	626,490,416
TOTAL ASSETS	788,854,312	773,789,135	781,201,208	788,005,088	785,568,404	778,498,091	769,297,440	757,488,944	746,320,872	736,027,242	717,749,844
Bank Overdraft	0	0	28,682,206	71,275,501	108,771,058	144,262,547	180,053,939	215,335,396	255,714,894	290,456,683.53	316,332,713.52
Employee and Volunteer Benefit Liabilities	30,214,422	30,409,422	30,804,422	32,230,422	36,980,272	41,848,868	46,839,179	51,954,248	57,069,317	62,184,386	67,299,455
Borrowings	1,362,276	7,237,719	13,110,914	11,094,875	9,104,213	7,102,772	5,101,010	3,021,441	1,021,441	21,441	21,441
Derivative financial instruments	0	0	0	0	0	0	0	0	0	0	0
Unamortised gain on sale and leaseback	183,918	183,918	183,918	183,918	183,918	183,918	183,918	183,918	183,918	183,918	183,918
Provisions	1,749,513	1,749,513	1,749,513	1,749,513	1,749,513	1,749,513	1,749,513	1,749,513	1,749,513	1,749,513	1,749,513
Trade and Other Payables	27,215,535	23,994,045	23,583,703	25,615,776	29,964,650	36,590,745	45,034,756	55,175,821	59,877,682	68,751,383	77,705,478
Total Current Liabilities	60,725,663	63,574,617	98,114,675	142,150,004	186,753,623	231,738,362	278,962,315	327,420,336	375,616,564	423,347,323	463,292,517
Employee and Volunteer Benefit Liabilities Term	37,108,000	37,108,000	37,108,000	37,108,000	37,108,000	37,108,000	37,108,000	37,108,000	37,108,000	37,108,000	37,108,000
Provisions term	2,526,807	2,526,807	2,526,807	2,526,807	2,526,807	2,526,807	2,526,807	2,526,807	2,526,807	2,526,807	2,526,807
Borrowings - Term	772,942	535,223	424,309	329,434	225,222	122,450	21,440	0	-21,441	-21,441	-21,441
Total Non-Current Liabilities	40,407,749	40,170,030	40,059,116	39,964,241	39,860,028	39,757,257	39,656,247	39,634,807	39,613,366	39,613,366	39,613,366
TOTAL LIABILITIES	101,133,412	103,744,647	138,173,791	182,114,245	226,613,651	271,495,619	318,618,562	367,055,142	415,229,930	462,960,690	502,905,883
Retained earnings	579,815,050	561,642,451	534,478,690	497,195,426	450,112,646	398,013,676	341,543,392	281,151,626	221,662,077	163,490,998	105,121,716
Rural Fire Fighting Fund	1,598,490	2,094,678	2,241,368	2,388,057	2,534,747	2,681,437	2,828,126	2,974,816	3,121,505	3,268,195	3,414,885
Revaluation Reserves	106,307,360	106,307,360	106,307,360	106,307,360	106,307,360	106,307,360	106,307,360	106,307,360	106,307,360	106,307,360	106,307,360
TOTAL EQUITY	687,720,899	670,044,489	643,027,417	605,890,843	558,954,752	507,002,472	450,678,878	390,433,801	331,090,942	273,066,553	214,843,961
TOTAL LIABILITIES and EQUITY	788,854,312	773,789,135	781,201,208	788,005,088	785,568,404	778,498,091	769,297,440	757,488,944	746,320,872	736,027,242	717,749,844

New Zealand Fire Service: Statement of CashFlows

CONFIDENTIAL - SENSITIVE

	Forecast 2015/16	Forecast 2016/17	Forecast 2017/18	Forecast 2018/19	Forecast 2019/20	Forecast 2020/21	Forecast 2021/22	Forecast 2022/23	Forecast 2023/24	Forecast 2024/25	Forecast 2025/26
STATEMENT OF CASHFLOWS											
Receipts from levy	0	0	0	0	0	0	0	0	0	0	0
Receipts from other revenue	370,126,639	362,412,670	368,641,190	374,064,963	379,632,357	385,302,357	391,037,357	396,841,357	404,800,237	412,918,295	421,198,713
Interest Received	7,797,531	8,069,314	4,692,424	4,688,906	11,506,362	13,432,296	15,446,183	17,546,322	17,914,484	17,882,295	9,601,840
Net GST received/(paid)	2,327,328	1,152,020	521,846	50,000	50,000	50,000	50,000	50,000	50,000	50,000	50,000
Payments to employees and volunteers	1,375,111	1,830,529	-822,444	62,492	140,258	120,608	86,008	99,590	-3,137,699	0	0
Payments to suppliers for goods and services	-255,124,023	-260,297,295	-271,489,685	-281,348,398	-287,796,584	-295,419,862	-303,021,259	-310,454,099	-318,342,189	-325,637,497	-333,807,133
Grants Paid	-88,211,046	-99,364,724	-92,207,991	-90,293,818	-88,750,509	-87,625,642	-86,477,064	-85,218,164	-87,708,925	-86,178,611	-86,407,202
Other	0	0	0	0	0	0	0	0	0	0	0
Net cash generated from/(used) in operating activities	38,291,539	13,792,514	9,335,340	7,224,145	14,781,885	15,859,757	17,121,225	18,865,006	13,575,908	19,034,482	10,636,219
Proceeds from sale of property plant and equipment	72,332	11,700,000	1,100,000	6,300,000	2,800,000	2,700,000	2,100,000	5,600,000	1,600,000	2,200,000	0
Proceeds from sale of intangible assets	0	0	0	0	0	0	0	0	0	0	0
Proceeds from sale of Property Plant and Equipment - finc	0	0	0	0	0	0	0	0	0	0	0
Disposal of investments	0	0	0	0	0	0	0	0	0	0	0
Purchase of intangible assets	-2,468,200	-6,098,825	-1,720,600	-2,020,600	-1,803,600	-1,820,600	-1,720,780	-1,720,780	-1,270,780	-2,160,780	-2,170,780
Purchase of property plant and equipment	-52,392,131	-43,302,368	-45,823,298	-50,379,929	-47,603,169	-44,758,989	-44,073,208	-47,065,321	-44,573,634	-44,076,341	-24,602,118
Net cash generated from/(used) in investing activities	-54,785,999	-37,701,192	-46,443,898	-46,100,529	-46,806,769	-43,879,599	-43,693,988	-43,186,101	-44,194,414	-44,037,121	-26,772,898
Payments on borrowing	0	0	0	0	0	0	0	0	0	0	0
Proceeds from borrowings	0	0	0	0	0	0	0	0	0	0	0
Interest Paid	-246,478	-528,133	-1,603,194	-3,605,997	-5,575,798	-7,367,435	-9,115,858	-10,859,351	-9,739,351	-9,739,351	-9,739,351
Payments on finance leases	-1,741,449	-1,362,276	-237,719	-110,914	-94,875	-104,213	-102,772	-101,010	-21,441	0	0
Sale and leaseback of assets	0	0	0	0	0	0	0	0	0	0	0
Net cash generated from/(used) in financing activities	-1,987,927	-1,890,409	-1,840,913	-3,716,911	-5,670,673	-7,471,648	-9,218,630	-10,960,361	-9,760,792	-9,739,351	-9,739,351
Net increase/(decrease) in cash and cash equivalents	-18,488,387	-25,799,088	-38,949,471	-42,893,296	-37,495,557	-35,491,489	-35,791,393	-35,281,456	-40,379,298	-34,741,990	-25,876,030
Cash and cash equivalents at the beginning of the year	54,548,740	36,066,353	10,267,265	-28,682,206	-71,275,501	-108,771,058	-144,262,547	-180,053,939	-215,335,396	-255,714,694	-290,456,684
Cash and cash equivalents at the end of the year	36,066,353	10,267,265	-28,682,206	-71,275,501	-108,771,058	-144,262,547	-180,053,939	-215,335,396	-255,714,694	-290,456,684	-316,332,714
Major Emergency Response Reserve	15,000,000	15,000,000	15,000,000	15,000,000	15,000,000	15,000,000	15,000,000	15,000,000	15,000,000	15,000,000	15,000,000
Levy Variability Reserve	10,000,000	10,000,000	10,000,000	10,000,000	10,000,000	10,000,000	10,000,000	10,000,000	10,000,000	10,000,000	10,000,000
Seismic Contingency Reserve	5,000,000	5,000,000	5,000,000	5,000,000	5,000,000	5,000,000	5,000,000	5,000,000	5,000,000	5,000,000	5,000,000
Cash held for RFFF	5,622,046	6,118,234	6,284,924	6,411,613	6,558,303	6,704,993	6,851,682	6,998,372	7,145,061	7,291,751	7,438,441
General cash holdings	444,307	-25,850,969	-64,947,129	-107,687,114	-145,329,361	-180,967,539	-216,905,622	-252,333,767	-292,859,755	-327,748,434	-363,771,154
Cash and cash equivalents	36,066,353	10,267,265	-28,682,206	-71,275,501	-108,771,058	-144,262,547	-180,053,939	-215,335,396	-255,714,694	-290,456,684	-316,332,714
Net Current liabilities to be funded (excl cash & OD)	-22,705,903	-25,874,864	-28,008,686	-34,576,073	-28,695,958	-18,504,443	-4,359,632	13,629,143	26,626,170	44,763,303	55,700,375
Total Cash reserves required	35,622,046	36,118,234	36,284,924	36,411,613	36,558,303	36,704,993	36,851,682	36,998,372	37,145,061	37,291,751	37,438,441
Required cash balance	12,916,143	10,243,371	8,256,238	1,835,541	7,862,345	18,200,549	32,492,050	50,627,514	63,771,232	82,085,064	93,136,816
Difference between cash required an available	23,150,210	23,895	-36,938,443	-73,111,042	-116,633,403	-162,463,096	-212,545,990	-268,962,910	-319,485,925	-372,511,738	-409,471,529

Appendix C - Fiscal Perspectives

This section summarises the Fire Services finances from a variety of perspectives to provide a balanced view of the current state of financial performance and position. Included are:

- NZ Fire Service (2014)
 - Statement of Intent 2014 to 2018
 - Annual Report for the year ended 30 June 2014
 - Looming Cost Pressures
- External Reviews (2015)
 - PriceWaterHouse Programme Business Case
 - Deloitte Limited Scope Financial Review

Statement of Intent 2014 to 2018

Financial sustainability

The Fire Service is acutely aware that the demands on emergency services in New Zealand may be significantly different in the future.

Demands will be driven by demographic changes, pressure on resources, climate change impacts and a need for people to play a greater role in their own protection and safety. This will require that we become more flexible in our service delivery arrangements and resource allocation, work more collaboratively with other rescue and emergency services and help individuals and communities to become more prepared and self-sufficient in the face of emergencies and disasters.

The Commission operates a \$614 million asset base encompassing approximately 850 fire appliances, 437 fire stations and the associated operational plant, equipment and information and communications technology. All of these have to be maintained, upgraded and eventually replaced.

To meet the Commission's obligation to manage its finances responsibly, it has set strict financial parameters for senior management to prioritise spending. The Commission notes it is currently dealing with capital demands well in excess of what it can reasonably afford on present revenues and is working now on a prioritisation policy.

Over the last two years the Commission has spent \$51 million (2014) and \$62 million (2015 projected) on capital investment. After allowing for asset sales in each of these years the net capex spend is approximately \$50 million. The Commission considers \$50 million as reasonable in terms of affordability at the current levy rate. It is inadequate however to meet the demands for capital funds to pay for the Christchurch rebuild and national seismic strengthening.

If Christchurch were prioritised, the Commission would have no choice but defer regular capital expenditure that it would otherwise undertake. Should this prioritisation policy be necessary, there will be some impacts as it bites that could present public difficulties.

Unfortunately, the current levy provisions do not provide sufficient revenue for both our regular ongoing capex spend as well as extraordinary non business-as-usual costs like Christchurch and the national seismic strengthening programme.

The Commission has sought a temporary (five years) small levy surcharge (surcharge of 0.4 cents taking levy from 7.6 cents to 8 cents) to cover the cost of the above business-as-usual capital expenditure programme.

If approved, the prioritisation programme mentioned above will be unnecessary.

Fire Service fleet assets are well maintained and tend to enjoy long lives; on average fire trucks are replaced every thirty years. Book values reflect the original purchase price from years back and therefore tend to be low.

Because depreciation is calculated as a percentage of these low book values, accumulated depreciation is a poor proxy for actual replacement capital costs.

Costs above depreciation have to be covered by the Fire Service's balance sheet. The consequent effect is to reduce the cash reserves, or when cash reserves are exhausted, to fund purchases through taking on debt or asset sales. If financial pressures leave no option for the Fire Service but to extend the life of our vehicle fleet and defer replacement of equipment, firefighters will be working with increasingly obsolete equipment. The Commission would face increased maintenance costs and risks to firefighters. Importantly, too, it would make it increasingly difficult to attract and retain volunteers, already one of the biggest challenges facing the organisation.

The projected capital spend in 2016, 2017 and 2018 is maintained at \$50 million and therefore not a significant increase nor unreasonable.

The Commission is forecasting operational deficits in the outyears. In the absence of new funding or the ability to borrow, the Commission might be forced to reduce this expenditure to an amount not exceeding the depreciation cost.

Assets

To be effective the Fire Service must provide its people with the right equipment. The Fire Service is a capital-intensive business holding more than \$500 million in property, vehicles, plant and equipment.

The work programme outlined in this document requires significant capital investment over the next five years. The Commission has decided to maintain a sufficient cash reserve to ensure that this work can proceed effectively and without delay.

Fire Appliances - The entire "red" fleet of over 800 appliances is managed on a whole-of-life maintenance and replacement cycle. Each class of appliance has a projected useful life based on anticipated work load, maintenance and repair cost, and obsolescence. To maximize their value, appliances are moved through the organisation as they age and are assigned to stations using established resource modelling. The Commission expects to take delivery of an average of 30 - 40 new appliances per year over the next four years.

Fire Stations - The Fire Service operates 437 fire stations. All fire stations are on a long term maintenance and replacement schedule. In 2014/15 and out-years the Commission will spend approximately \$24 million a year on its property portfolio. This includes rebuilding stations in Christchurch and the wider national seismic strengthening programme.

Fire Service 2014 Annual Report

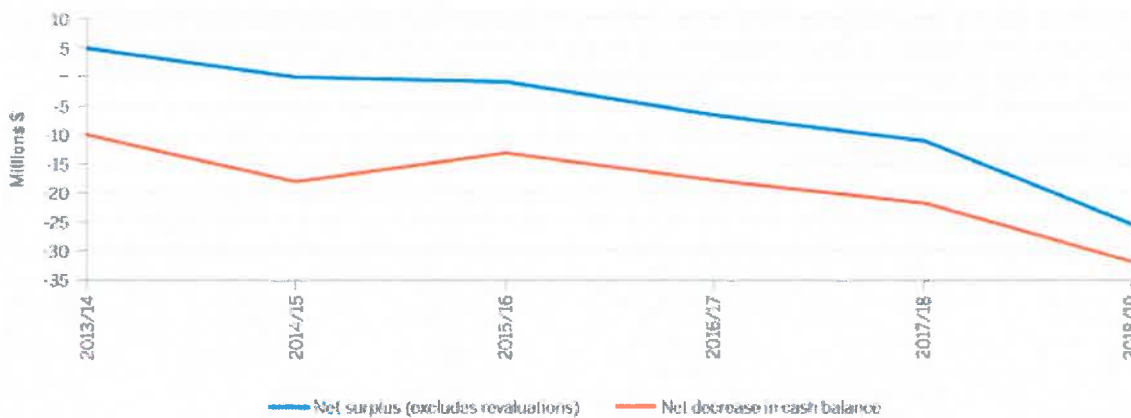
Any simple analysis of financial statements often focuses on two issues:

- Surplus / (deficit) – How the organisation has performed
- Equity – How the owners’ equity (being the communities that receive our services) has changed during the year.

Based simply upon this analysis, the New Zealand Fire Service Commission (‘the Commission’) is in a strong financial position. It had a modest surplus of \$4.8 million during the year. The next few years are also expected to generate modest surpluses. Due to the location of its stations, the Commission has also benefited from increasing property values over the past few years (\$31.4 million compared to \$16.8 million in previous year).

However this fails to recognise the challenges the Commission faces where it looks at maintaining its operational capability against the prospect of continued decline in its cash balances. The challenge is depicted in the table below:

Net surplus vs cash balance



The Commission’s surplus of \$4.8 million should be considered against the reduction in cash and investments of \$10.1 million. Last year there was an increase in its cash and investment of \$17.1 million. All of this year’s \$10 million reduction is due to the gap between depreciation and amortisation (\$34.8 million) and its capital expenditure (\$50.2 million). The table below shows that this situation is not expected to change over the next five years:

\$millions	2013/2014	2014/2015	2015/2016	2016/2017	2017/2018	2018/2019
Depreciation/Amortisation	34.8	36.7	38.9	38.4	38.2	40.5
Capital spend cash flow	50.2	50.0	50.0	50.0	50.0	50.0
Net cash (outflows)	(10.1)	(18.2)	(13.3)	(17.9)	(21.7)	(31.9)

The Commission has built a solid cash and investment position in anticipation of the additional capital investment. Sustaining these investments will be challenging over the next three to five years with negative cash flows projected (refer above) as a result of significant capital investment and as the growth in income is less than the estimated growth in operating expenditure. Levy growth has been

steady over the last few years but there are ongoing challenges to ensure the amount collected remains not only stable but also grows in line with the demand for services.

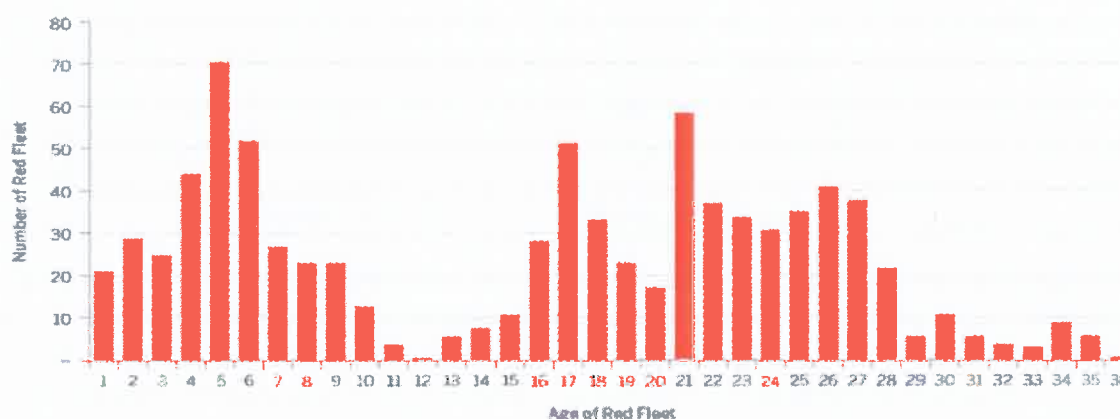
Levy growth is dependent on factors such as new residential housing stocks, contract works, economic growth and new motor vehicles. However, it comes under pressure from organisations that choose not to insure for fire, those who fail to pay levy owing, and from those insured organisations, brokers and insurers in the industry who avoid paying their fair share of levy by exploiting perceived loopholes in the Act.

With the high demand for continued capital investment and continued growth in the cost and scope of operations, the Commission must maintain its levy base. This means challenging avoidance and minimisation and delivering growth with the current rate of levy.

The rate of levy has only changed once in the last 10 years (an increase of 7.3c per \$100 insured to 7.6c per \$100 insured). The charge for a third or subsequent unwanted false alarm has also not altered in this time (\$1,000 plus GST).

The New Zealand Fire Service Commission is highly dependent upon its network of fire stations, appliances and equipment for both service delivery and resilience. This network ties up over \$600 million of capital, and a significant amount of expenditure and reinvestment is required to maintain it. The graph and the table below show why constant reinvestment and strategic replacement is critical to maintaining the Commission’s infrastructure. Failure to do this ages the infrastructure and creates issues for future Commissions and management.

Age profile of fire appliances

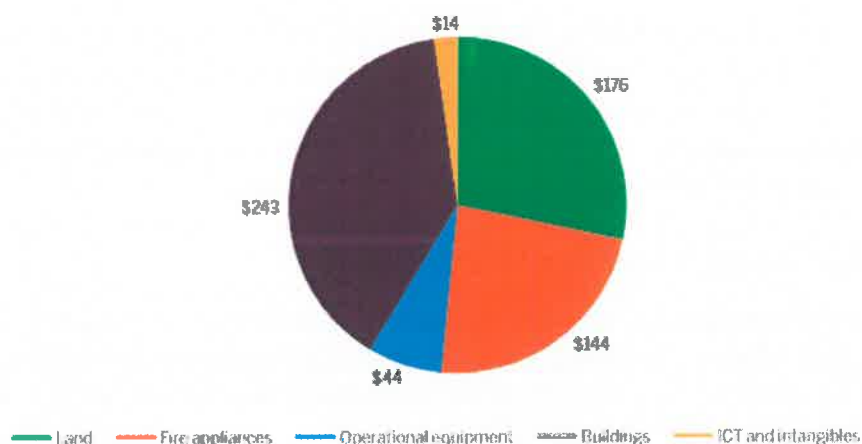


As at September 2014

Fire Stations	Age
230	37 years and under
120	38-50 years old
87	Over 50 years old

During 2013/2014 over \$50 million was reinvested in this network, one of the largest ever capital spends by the Commission. This level of investment is not expected to reduce in the foreseeable future given the Commission priorities are to seismically strengthen its properties along with the rebuild of its Christchurch infrastructure.

Snapshot of assets at year end – assets' carrying value (\$M)



In

most organisations, the level of capital investment in any one year would approximate the amount of depreciation expense. However, this is currently not the case for the Commission due to:

1. The historical purchase price being vastly different from today's purchase price (e.g. appliances have a life between 25 and 30 years)
2. The Commission undertaking more than just renewal of assets (e.g. seismic strengthening of buildings, installation of exhaust extraction)
3. Extraordinary expenditure as a result of the relocation and rebuild of stations following the Christchurch earthquakes.

During the current year, the additional funding of the capital investment programme is being managed from the Commission's balance sheet by using its reserves in cash and investments (\$60.4 million at year end compared to \$70.5 million the year before) to meet the level of investment required in the short term. With finite levels of cash reserves this is not sustainable in the medium to long term and other forms of funding will be required.

\$millions	2013/2014	2014/2015	2015/2016	2016/2017	2017/2018	2018/2019
Investments	60.4	42.2	28.9	11.0	-	-
Debt	-	-	-	-	10.7	42.6

The current strength of the balance sheet (net current assets of \$10.5 million and net long-term assets of \$582.4 million) is reflected in the equity of \$592.9 million. The Commission has significant equity in the Fire Service infrastructure but very little of it is freely available given the operational and strategic nature of those assets. The net portion of its balance sheet as at 30 June 2014 shows it has \$1.20 in assets for every \$1 in liabilities (\$1.40 in the previous year). This is driven by the Commission's investments but as these are reduced (due to capital reinvestment) this ratio will weaken. The long-term portion of the balance sheet is very different with long-term assets covering its liabilities 15.9 : 1 (14.3 : 1 in previous year).

The Commission has established a number of reserves to reflect the immediate demands and first call on its equity. These reserves (both cash and equity) reflect the challenges and uncertainties that the Commission faces, as well as the demands, in excess of business as usual activities, which will require funding. Two of these reserves, the Major Emergencies Response Reserve (\$15 million) and Levy Variability Reserve (\$10 million) were established as a result of the Commission's experiences during the

global financial crisis, the Christchurch earthquakes, the Rena disaster and the Pike River tragedy, when resources far beyond standard operational requirements were needed.

In 2013, the Commission established two further reserves – the Christchurch Rebuild (\$12.0 million) and Seismic Resilience Reserve (\$31.6 million). These reserves differ as they did not involve any specific cash being ring-fenced. Instead, these were separated out from the general equity reserves in the balance sheet to reflect the amounts that will be required to seismically strengthen fire stations, and reflect the amount received from the Commission’s settlement with its insurer.

PriceWaterHouseCoopers - Financial Case (2015)

PwC developed the financial case and cost model used to support the Cabinet paper. The purpose of this financial case is to look at the changes of the governance and support and funding options. The implications of the current status quo funding position is being considered separately outside of this financial case. Key findings from the report were:

- **The status quo is currently not financially viable** - The analysis suggests that the status quo is not financially sustainable due to a funding gap of \$360 million over the projection period. This deficit is primarily due to significant interest and depreciation expenses arising from implementation of NZFS’ capital plan. NZFS is projected to have negative cash flows from 2016/17 as a result of the planned capital expenditure.
- **The enhanced status quo** is the most financially viable option. Under the enhanced status quo option NZFS will experience cash deficits in FY2016 and FY2017. However this shortfall can be covered by the current cash reserves and overdraft facilities. Furthermore, the analysis suggests that NZFS will post annual surpluses from FY2018. This is a result of increased funding under the mixed funding model.
- **The One National Fire Service Regional influence option** requires additional levy funding. Under this option, the new entity will experience cash deficits from 2016/17 and totalling \$192 million by the projection period (2025). This is largely driven by implementation of the NZFS capital plan and the cost of transition. The deficits are the largest during the transition years (2016 to 2020) and decrease throughout the projection period. It is estimated that the new entity will require additional levy funding totalling \$142 million on top of new contributions from the Crown and the National Land Transport Fund (NLTF) arising from implementation of the mixed funding model.
- **Sensitivity analysis** suggests that flexing the transition costs does not have a material effect on the financial projections. However, situations that would have a material effect on the funding requirement and closing cash balances under the One National Fire Service – Regional influence option include:
 - Circumstances in which rural properties and assets are required to be purchased rather than gifted to a new entity.
 - Operating expenditure efficiencies of 10% are achieved from operating under one entity. Note that no financial analysis has been done on how operating efficiencies may be achieved because it is unlikely that operating efficiencies can be identified in the short term as the focus will initially be on transitioning to and embedding a single unified fire service with regional influence and these are not feasible in the short-term. However, following transition it is reasonable to assume there is merit to assess the efficiency of the new model and whether there is scope for savings.

- Sensitivity analysis also suggests that NZFS' capital plan would need to reduce by around 58% to be affordable under the status quo. There has been no assessment of the impact on the business of such a reduction. However, any material reduction in the planned capital spend is not plausible. For example, the current property programme is based on a capped annual spend of \$24.1m. Reducing funding available for capex would extend these timeframes, so the seismic programme may extend from twelve to say fifteen years, a period of time which may exceed mandated maximums for emergency buildings in high risk areas (although these have not been confirmed yet). Decreasing annual property capex spend to \$19m has already been mooted by the Fire Service but would not materially impact the overall capital spend.

Deloitte - NZFS Limited Scope Financial Review (2015)

Deloitte reviewed the current financial position of NZFS including the manner in which it forecasts revenue, expenditure and its significant programme of capex over the next decade, including whether this programme is realistic and evidence based. The key findings were:

- Forecasts of revenue appear to be reasonable and based upon previous experience as well as economic trends and projections
- The operating expenditure of the Fire Service is increasing at a faster rate than income. Most expenditure (66%) relates to personnel costs, with depreciation (10%) the next higher cost.
- The Fire Service has invested significantly in its asset base in recent years, and total assets have increased from \$650 million in 2013/14 to \$784 million in 2014/15, projected to grow to \$881 million by 2019/20 (this assumes funding is available to support that growth)
- The Fire Service has a self imposed cap of \$50 million on net capex each year.
- Based on current forecasts earnings before interest, tax depreciation and amortisation (EBITDA) would drop to \$14 million in 2018/19 and \$16 million in 2019/2020. If this used as a proxy for operating cashflow funded depreciation would have to drop to less than \$15 million in 2018/2019.

NZFS - Looming Cost Pressures

The following comments are taken as an extract from the full letter outlining these issues from NZ Fire Services Commission Chair to Minister of DIA in 'NZFS – Looming Cost Pressures'.

.....I noted in the Fire Services Review cabinet paper that there is reference to the Commission providing advice to you regarding the options to address current state cost pressures. In my letter to you on the 29th of May I noted that the Commission is committed to living within its means but it also had a responsibility to maintain its operational base and secure its asset base for future Commissions. You will be aware that the Commission's preference to meet these demands has been for a temporary levy rate increase with supporting revision to our borrowing powers. Our Officials have been discussing this now for over two years and we were notified recently your Officials would not support either change.

Growth in levy receipts are clearly not keeping pace with the growth in operating expenditure and the level of funded depreciation along with the investments held is not meeting the demand for either business as usual capital replacement or the extraordinary capital demands off the back of the Christchurch rebuild or the seismic strengthening of our fire stations. With the investments also required to help support the reserves that the Commission are committed to holding for major emergencies and levy fluctuations the demands then the financial pressure get even tighter.

There are two very different financial issues affecting the Commission, both requiring a different response. The first being the projected operating deficits and the second being the outflow of net cash.

In dealing with the first issue, the operating deficits, the Commission has two options, secure its income base and then grow its income or reduce its operating expenditure. With 97% of the Commission's income coming from levy the ruling by the Supreme Court helped secure the income base and even though we have seen some growth it is not expected to be ongoing as these organizations reorganize their insurance arrangements to reduce their ongoing levy obligations. Other than the growth that would arise from residential housing, motor vehicles or increased economic activity, the only other option was an increase in the rate of levy.

Reducing operating expenditure in order to reduce the projected deficits can in the short term come only from the variable costs. The current split between fixed and variable costs is 96% fixed or semi fixed and 4% variable. The reasoning behind why I say the concentration has to be on variable is because of the additional expense of reducing fixed costs. With 75% of the cost base relating to personal and 11% relating to depreciation the fixed cost base can only be achieved through the reduction in headcount or the sale of assets with no replacement.

With variable costs at 4% or approximately \$15 million reduction in these costs would impact areas such as travel, internal communication research and development and grants.

With an operational crew costing \$1.7 million a year there are some stations that in the long term can be looked to close, Lookout Point, Washdyke, Karau and Kingswall. There are however other operational demands which mean looking at increased resourcing in the future such as Queenstown, Gisborne and Auckland.

The management of the net cash has two impacts, it slows the:

1. reduction in investments and this helps support the liquidity of the Fire Service and helps the Commission support its reserves
2. transition to debt which the Commission has limited powers to incur and puts extra strain on the deficits through increased expense in the form of interest.

The Commission is mindful that the driver of the cash flowing out of the organisation is not from operating purposes but from the size of the Commission's capital program. Being highly capitalized the program is driven by the need to continually reinvest in the asset base in order to keep it operationally sound, the base currently sits at \$650 million (gross). The Commission is reluctant to provide trade-offs given the risks that it poses to a new/future Commission and would in no way recommend that what we propose here are viable options and are provided for no other reason than to demonstrate that the Commission has at least considered the option and understands the impact if this was ever adopted.

The impacts from the capital decisions proposed can be summarized as follows:

4. reducing fleet construction will increase the age of the fleet (as well as increasing mechanical issues and increased maintenance costs) which shifts the replacement to future Commission's and management. It will also prevent the National Commander aligning more appropriate vehicles to match risk.
5. slowing the reconstruction of Christchurch Fire Stations which will increase industrial unrest given the amount of time Christchurch staff have been living in temporary accommodation, means that Fire Stations are not aligned to the new risk profile in the area, go back on the word given the National Commander and the Commission that Christchurch was a high priority.

6. slowing and therefore spreading the seismic programme over a greater number of years. The current programme is based upon regulatory guidelines and even the current programme pushes completion for a small number outside of current regulations. Territorial Authorities have the power to shut our stations if they do not meet the regulatory timeframes leading to potential operational difficulties and adverse internal and external criticism. In addition it means keeping career and volunteer firefighters in buildings which do not meet seismic standards – a Health and Safety risk. Any further slowing of the programme exposures everyone to increased risk in these areas.
7. the Commission wont land bank for future developments and could sell land it has banked to help offset capital costs. While appearing attractive this will highlight to firefighters that construction of their stations will be delayed, that future acquisition of land in the appropriate area may not be available or come at an increased price thus putting the burden onto future Commissions and management. This is solely a deferral option.
8. project work set aside for the five year Vision2020 programme could be halted and focus stays solely on the programmes linked to legislative transition. The advantage to this is that it saves both operating and capital expenditure. The disadvantage is that the organisation may consider that the Commission and management have failed to live up to its promises made during the consultation process in 2014.
9. the Commission did consider, but rejected slowing or deferring the replacement of the incident ground radio and the yet to be included replacement of the paging network but due to both operational and safety considerations and the lack of alternatives

To demonstrate the financial but not the organizational impact of the decisions above I have constructed a table below for illustrative purposes.

These two following tables are not populated ??

\$m	2016/17	2017/18	2018/19	2019/20	2020/21
Current programme	73	63	56		
	(20)				
Slowing fleet construction					
Slowing Christchurch rebuild					
Slowing Seismic works					
Selling land banks					
Removing project					
Potential Programme					

If the above was undertaken the impact on the operating deficits would be negligible but the impact on the net cash flows and hence investment/debt is shown below.

\$m	2016/17	2017/18	2018/19	2019/20	2020/21
Investments / debt before					
Investments / Debt after					

The impact from making the capital adjustments improves the retention of investments and staves off burgeoning debt and from a short term fiscal perspective is sound. But from a governance perspective and management perspective the decisions are poor and create issues for successive Commissions, management and Minister's. The Commission's position still is that a temporary increase in the rate of

levy to deal with Christchurch rebuild and seismic strengthening is still the most appropriate decision to be made. I have highlighted the risks above but do so again below for clarity.

The risks from the Commission's perspective are:

1. running investments down to zero and having no change to borrowing powers means that reserves are no longer funded, i.e. the major emergency reserve and the levy variability reserve. This effectively transfers the risk to the government to provide funding in the event of another Christchurch or global financial crisis as the Commission would have no means of dealing with these.
2. slowing seismic and the Christchurch rebuild will create industrial issues for the Commission and put at jeopardy the cooperative environment we operate in as well as the structural reforms that we are looking to and have achieved to date. This is also impacts our relationship with volunteers given many of the seismic projects outstanding. Relate to volunteer stations and the Commission is concerned about the message that would send to volunteers about our commitment to theirs and their community's health and safety.
3. the age of the fleet is already high given the failure in the 90's to build an appropriate level of appliances. Slowing the build programme now not only increases the average age and pushes operating costs up

Appendix D - Sources of Information

The following sources were consulted in the production of this document:

Source	Description
Published financial information	<ul style="list-style-type: none"> Annual report 2014/2015 Statement of Intent 2016-2021 Financial statements March 2016 forecasts
External reviews of financial position or performance	<ul style="list-style-type: none"> MartinJenkins Report on Expenditure and Service Delivery Deloitte Limited Scope Financial Review PwC Programme Business Case in support of the Cabinet paper
The programme business case	in support of the review Cabinet paper
Looming cost pressures reported to the Minister in the "Initiatives to reduce projected deficits" dated 27 January 2016	Extract included in Appendix C
NZ Fire Services Property strategy	
Various sources of Management information	<ul style="list-style-type: none"> Extracted from the financial system TM1 (2002 to 2025) <ul style="list-style-type: none"> Profit and loss Balance sheet Cashflow <ul style="list-style-type: none"> NZFS Reconciliation of annual movements NZFS Capital Plan KPMG Transition Costing Model PwC Financial Model
Meetings were held with a number of stakeholders including, but not limited to	<ul style="list-style-type: none"> NZ Fire Service <ul style="list-style-type: none"> Bridget Carter Fraser Fyfe Brett Warwick Darren Stafford Barry Shuurmans Wayne Goodfellow Department of Internal Affairs <ul style="list-style-type: none"> Jodie Caroline Other <ul style="list-style-type: none"> Alf Kirk

