Extraordinary Whangarei District Council Meeting Agenda

Date:	27 September, 2021
Time:	11:00 am
Location:	Council Chamber Forum North, Rust Avenue Whangarei
Elected Members:	Her Worship the Mayor Sheryl Mai (Chairperson) Cr Gavin Benney Cr Vince Cocurullo Cr Nicholas Connop Cr Ken Couper Cr Tricia Cutforth Cr Shelley Deeming Cr Jayne Golightly Cr Phil Halse Cr Greg Innes Cr Greg Martin Cr Anna Murphy Cr Carol Peters Cr Simon Reid

For any queries regarding this meeting please contact the Whangarei District Council on (09) 430-4200.

Pages

1. Karakia/Prayer

2. Declarations of Interest

3. Apologies

4. Decision Reports

4.1. DIA Three Waters Reform - Service Delivery Next Stages 1

5. Closure of Meeting

Recommendations contained in the Council agenda may not be the final decision of Council.

Please refer to Council minutes for final resolution.

4.1 DIA Three Waters Reform – Service Delivery Next Stages

Meeting:	Extra Ordinary Council Meeting
Date of meeting:	27 September 2021
Reporting officer:	Simon Weston (General Manager Infrastructure)
	Rob Forlong (Chief Executive)

1 Purpose

To provide feedback to government on its proposed three waters reforms.

1. Recommendation

That the Whangarei District Council:

2. **Supports** the need to lift the standards of water supply quality and wastewater treatment across New Zealand;

3. **Supports** the need for government to genuinely partner with councils;

4. **Supports** the need to introduce an economic regulator to improve efficiency and productivity and ensure there is appropriate oversight, notes that the economic regulator can apply to Council owned and operated Three Waters infrastructure without amalgamation;

5. **Notes** the need for some Councils to achieve greater scale and capability in the delivery of water services, and/or alternative funding sources;

6. **Agrees** that there are alternative governance and financial models to that proposed which will achieve most of the government's water reform objectives and outcomes that should receive further consideration by the government;

7. **Agrees** to continue to work with the government to consider these alternative options
8. **Agrees** that water service entities should have the same accountability mechanisms as provided under the Local Government Act for council-controlled organisations;

9. **Agrees** that ownership of waters assets, in the traditional sense, should continue to reside with Council;

10. **Agrees** that the set-up of any new entities should specify the requirements or principles for consultation, as they are set out in the Local Government Act 2002;

11. **Does not support** the government's proposed ownership and governance arrangements for the entities;

12. **Supports** a pause on the reforms until further work has been undertaken to the satisfaction of Council;

13. **Seeks** further engagement and information on the aspects of the water reform proposals; **Or confirms** its decision of 29 June 2021 to provisionally opt-out of the reforms.

2 Executive Summary

The government intends to reform local government water services into four entities. The government claims of large cost savings, extra employment, increased GDP, and better water and wastewater services are overly optimistic. Council assessment is that there may be some financial benefit to ratepayers in the very long term if the entities operate efficiently. There are also risks of potential loss of service levels and local control. Contrary to WICS assertions we expect that there will be increased costs for the waters regardless of the organizational structure. These cost increases will be required to fund the increased quality standards as a result of improving regulation of the three waters.

Government has informed local government that this is not the time to opt-in or opt-out, but to provide feedback on the reform proposal. Council would hope that government will explore alternatives before making its decision on the reform. However, a concern of many Councils is that the reform will be mandated without further exploration. Council should consider its current position in this light.

3 Background

Following the serious campylobacter outbreak in 2016 and the Government's Inquiry into Havelock North Drinking Water, central and local government have been considering the issues and opportunities facing the system for regulating and managing the Three Waters (drinking water, wastewater, and stormwater).

The focus has been on how to ensure safe drinking water, improve the environmental performance and transparency of wastewater and stormwater networks and deal with funding and affordability challenges, particularly for communities with small rating bases or high-growth areas that have reached their prudential borrowing limits.

The Government's stated direction of travel has been for publicly owned multi-regional entities. The Department of Internal Affairs (DIA), in partnership with Local Government NZ (LGNZ) have formed the Three Waters Steering Committee (which includes elected members and staff from local government commissioned specialist economic, financial, regulatory and technical expertise) to support the Three Waters Reform Programme and inform policy advice to ministers.

3.1 Stage 1 of the Reforms

The initial stage (Tranche 1 - MOU, Funding Agreement, Delivery Plan and RFI process) was an opt-in, non-binding approach. It did not require councils to commit to future phases of the reform programme, to transfer their assets and/or liabilities, or establish new water entities and was described as a "no regrets" engagement.

Council completed the RFI process over Christmas and New Year 2020/21 and the Government has used this information, evidence, and modelling to make decisions on the next stages of reform and has concluded that the case for change has been made. Modelling was undertaken by the Water Industry Commission for Scotland (WICS).

In June 2021 a suite of information was released by Government that covered estimated potential investment requirements for New Zealand, scope for efficiency gains from transformation of the Three Waters service and the potential economic (efficiency) impacts of various aggregation scenarios.

In summary the WICS modelling indicated a likely range for future investment requirements at a national level in the order of $120 billion to $185 billion, an average household cost for most councils on a standalone basis to be between $1,910 and $8,690 by 2051. It also estimated these average household costs could be reduced to between $800 and $1,640 per household and efficiencies in the range of 50% plus over 15-30 years if the reform process went ahead.

3.2 Stage 2 of the Reforms

As a result of this modelling, the Government has decided to:

- establish four statutory, publicly owned water services entities that own and operate Three Waters infrastructure on behalf of local authorities. Local Authorities will own the entities but in name only. There will be no shareholding, and no financial recognition of ownership. Figure 1 shows the structure of the new entity.
- establish independent, competency-based boards to govern
- set a clear national policy direction for the Three Waters sector, including integration with any new spatial / resource management planning processes
- establish an economic regulation regime
- develop an industry transformation strategy.
- The Whangarei District Council have been placed in Water Services Entity A, Northland and Auckland, although the precise southern boundaries are still up for discussion. Figure 2 shows the boundaries for Entity A.

Figure 1: Structure of the new Water Entity

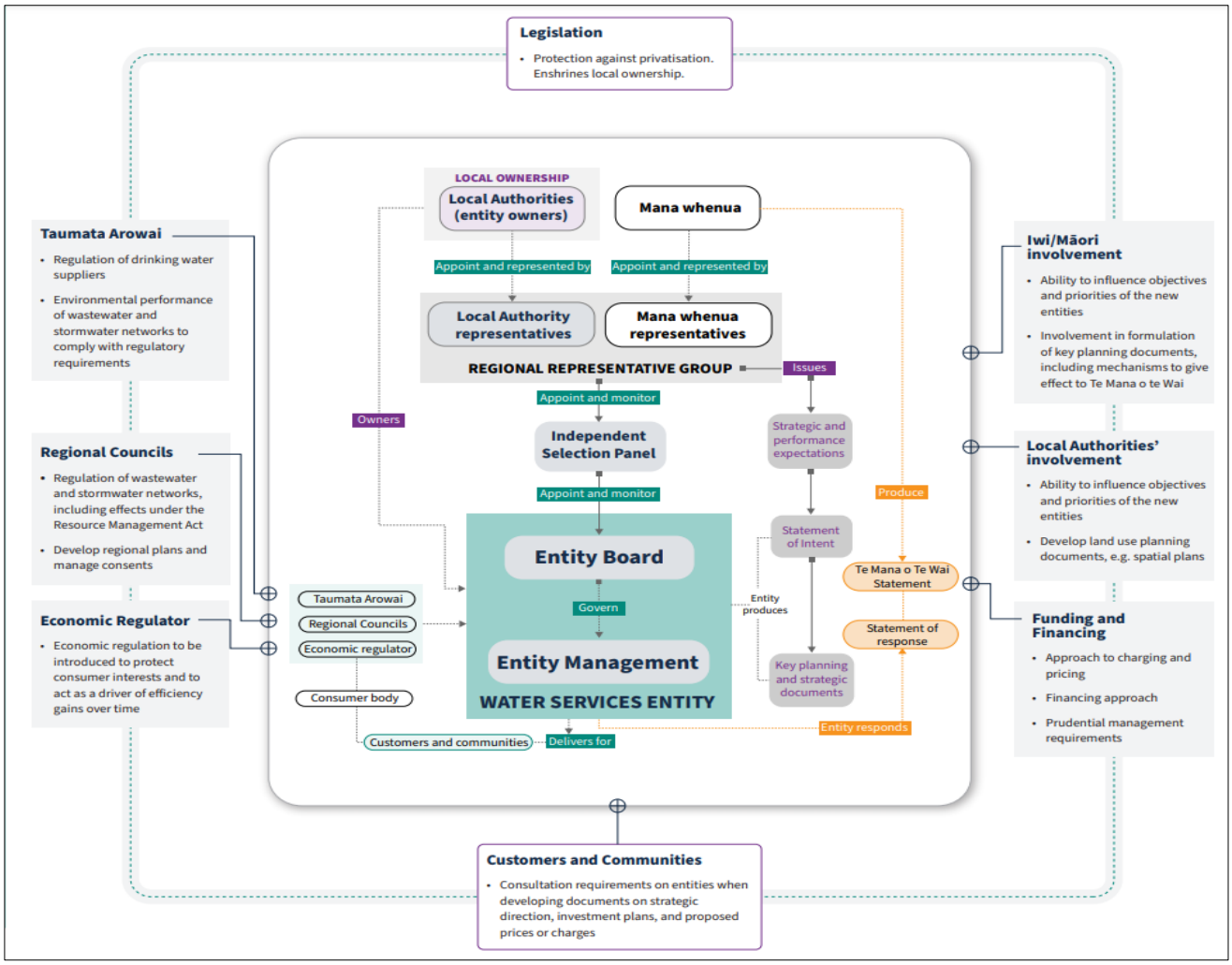
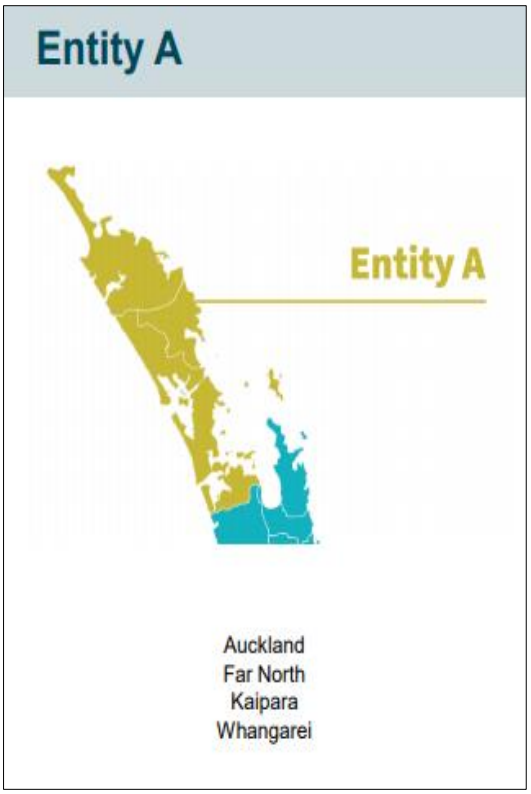


Figure 2: Entity A



3.3 DIA / LGNZ Partnership

On 15 July 2021, in partnership with LGNZ under a Heads of Agreement, the Government announced a package of $2.5 billion to support councils to transition to the new water entities and to invest in community wellbeing. This funding is made up of a 'better off' element ($500 million will be available from 1 July 2022 with the investment funded $1 billion from the Crown and $1 billion from the new Water Services Entities) and 'no council worse off' element (available from July 2024 and funded by the Water Services Entities). The "better off" funding can be used to support the delivery of local wellbeing outcomes associated with climate change and resilience, housing and local placemaking, and there is an expectation that councils will engage with iwi/Māori in determining how to use their funding allocation.

3.4 Engagement with Councils

In addition to the funding announcements, the Government has committed to further discussions with local government and iwi/Māori during an eight-week period commencing 1 August 2021 regarding:

- the boundaries of the Water Service Entities
- how local authorities can continue to have influence on service outcomes and other issues of importance to their communities (e.g., chlorine-free water)
- ensuring there is appropriate integration between the needs, planning and priorities of local authorities and those of the Water Service Entities
- how to strengthen the accountability of the Water Service Entities to the communities that they serve, for example through a water ombudsman.

As a result, the original timetable for implementing the reform and for councils to consult on a decision to opt-in (or not), no longer applies.

Next steps are expected to be announced after 30 September 2021, which would include the timeframes and responsibilities for any community or public consultation.

It is also important to note that the Government has not ruled out legislating for an "all-in" approach to reform to realise the national interest benefits of the reform. As part of the Heads of Agreement LGNZ has agreed not to oppose compulsory amalgamation of Three Waters assets, although they may express "disappointment". In the interim the DIA continues to engage with council staff on transition matters on a 'no regrets' basis should the reform proceed. These discussions do not pre-empt any decisions about whether to progress the reforms or whether any individual council will transition.

On the assumption that the reform goes ahead, it is anticipated that councils will continue to deliver water services until at least early 2024 and council involvement in transition will be required throughout.

3.5 Whangarei District Council's Current Position

At the Council 29 June 2021 meeting the Council Resolved the following:

That the Whangarei District Council:

1. *Notes that participation in the Government's Three Waters reform is voluntary with the ability for Councils to "opt out" of the reform process;*

2. *Notes that the Memorandum of Understanding with government which provides for WDC to be part of the Three Waters reform process expires on 30 June 2021;*

3. *Notes that the Department of Internal Affairs has refused an Official Information Act (OIA) request to provide WDC with specific information which shows that Whangarei ratepayers would be better off under the reform programme;*

4. *Provisionally exercises its right to "opt-out" of the Governments Three Waters reform process until new information, that confirms ratepayers would be better off by Council participating in the reforms, is provided.*

5. *Requests the Mayor and Chief Executive write to the Chief Executive of the Department of Internal Affairs advising that WDC intends to formally withdraw from the Three Waters reforms.*

In addition to the above Council resolution Council has provided media communications and HWM has discussed Council's position with the Minister of Local Government. See attachment 1, 2 and 3 for the Council report, minutes and presentation.

3.6 Government's Eight-Week Review Period

Councils have been given an eight-week period ending 30 September 2021 to review the information provided by the government. The purpose of this period is to understand the proposal and how it affects the Council and its community and to identify issues of local concern and suggest possible ways to address those concerns. It's an opportunity for the sector to engage with the model and the proposal, at both the national level and very specifically as it relates to our community.

Councils have been asked to analyse the potential impact of reform as follows:

- *Understand the key features of the proposed model and how it is intended to work*
- *Apply the proposed model to our circumstances, both today and in the future.*
- *Consider the model holistically – in terms of service, finance and funding, economic development and growth, workforce, delivery and capability and social, cultural and environmental wellbeing.*

- *Taituarā has provided a pro forma report framework for Councils to use. This is shown within Attachment 4.*

DIA/LGNZ encouraged councils to share feedback as it arises over this period – that way they can share insights and ideas on common issues across the sector and help each other to benefit from each other's work.

As part of the agreement between LGNZ and the Government, DIA/LGNZ are looking for feedback on and potential solutions to issues that councils have raised that aren't fully resolved:

1. Ensuring all communities have both a voice in the system and influence over local decisions. At any time, ask LGNZ for help, including if you want to test whether your approach is focusing on the things that will create the most value for you from this stage of the process.
2. Effective representation on the new water service entities' oversight boards so that there is strong strategic guidance from, and accountability to, the communities they serve, including iwi/mana whenua participation. This includes effective assurance that entities, which will remain in public ownership, cannot be privatised in future.
3. Making sure councils' plans economic development and growth for growth, as reflected in spatial plans, district plans or LTPs, are appropriately integrated with water services planning.

DIA provided LGNZ with funding for Councils to hire consultants to assist in assessing the government figures. Unfortunately LGNZ has chosen not to fund WDC to assess the government proposal.

4 Discussion

The Whangarei District Council had approximately 35 reports and workshops on the Three Waters Reform since the Havelock North outbreak in 2016. In addition, councillors have been provided with written material from DIA/LGNZ and invited to DIA/LGNZ webinars. Council has asked staff to undertake analysis on its individual position. Staff have commissioned consultants (Castalia; Rationale; PWC; SRH Consulting) to assist with this work. Council has also commissioned work jointly with the other councils of Northland exploring Northland region options ranging from three water's shared services through to a Northland Infrastructure Unit (NIU), providing a range of services, building on the experience of the Northland Transportation Alliance.

4.1 General issues with the three waters reform process

In assessing the government's proposals there are a number of issues that require further work or clarification. They are :-

i) Representation from and on behalf of mana whenua
ii) Integration with other local government reform processes
iii) Integration with spatial and local planning processes and growth
iv) The nature, role and timing of economic regulation
v) Process for and decision-making regarding prioritisation of investment
vi) The transfer of stormwater assets and functions
vii) Process for local authority decision-making on 'opting in or out' of the Three Waters Reform
viii) Conditions associated with the Government's package of funding for local government
ix) Transition arrangements, including for the council group workforce, information sharing and due diligence for asset transfers
x) Support local authorities being able to make the final decision on whether to 'opt-in' to or to 'opt-out' of the government's final Three Water Reform proposal, and that the Reform is not made mandatory

xi) Note these recommendations were formed with the government's advice on stormwater yet to be received

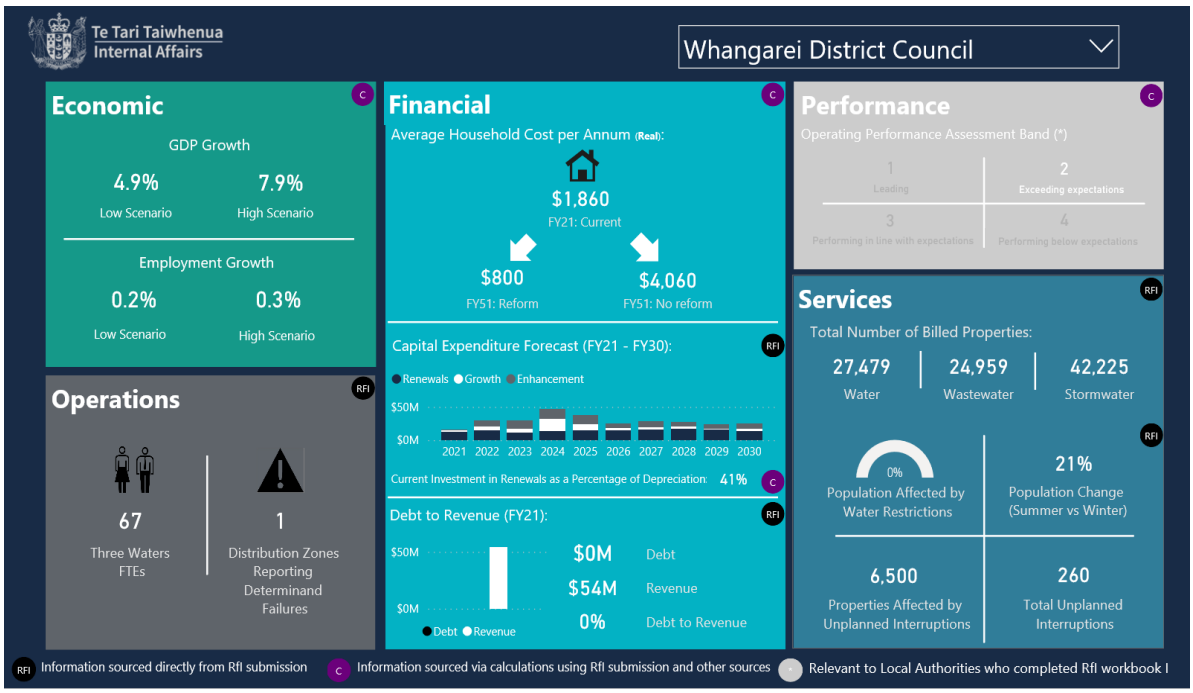
xii) The nature of borrowing and debt in relation to LGFA (Attachment 5 and 6)

4.2 WICS Analysis for the Government

Government has provided tools to examine at a high level the WICS analysis Opt-in and Opt-out scenarios based on information provided during the RFI process.

Table 1 shows the WICS modeled average household cost per Annum for 2021 and for the year 2051. Table 1 also shows the current financial years household cost as being $1,860 however, this figure is incorrect with the real figure being closer to $1,089. Table 1 also shows that WDC is currently exceeding expectations in terms of current performance, together with other statistics on the Councils Three Waters.

Table 1: WICS Modelled Household Costs



4.3 Castalia Review

The Castalia report examined the key question – will the reform deliver the claimed benefits? Castalia identified several shortcomings of the WICS analysis with key statements from their analysis shown below:

1. The government is promising that household bills will be four times lower in the Reform scenario than in the Opt-Out scenario.
2. The Reform scenario is based on faulty assumptions and flawed analysis.
3. Required investment for WDC, and for New Zealand as a whole, is overstated.
4. Efficiency assumptions are implausible.
5. WDC is likely to improve water service delivery if it opts-out, yet WICS assumes no such improvements.

Castalia concluded that WDC should examine how it can provide a constructive counterproposal to the government.

Although DIA disagreed with the Castalia analysis, other consultants reviewing the WICS work for other councils have drawn similar conclusions. The Castalia report is shown within

Attachment 7 and 8. It is reasonable to conclude that the Castalia report presents compelling evidence that WICS over states the benefits of the reforms.

4.4 Rationale Review

Rationale were initially commissioned to undertake Investment Logic Mapping for the four Northland Councils, as part of evaluating a continuum of options for a Northland 'three waters entity'. Rationale were later commissioned by WDC to evaluate a WDC only option and a comparison was drawn between the two pieces of work.

The Northland options providing scale and the best fit with the governments objectives was a Northland Infrastructure Unit (Regional asset owning CCO) that would incorporate the Northland Transportation Alliance, Three Waters and potentially Parks and Solid Waste services for the four Northland Councils. This is an innovative approach that has not been examined as an option by the government. Other high-ranking Whangarei District Council only options included a Whangarei three waters enterprise model. Rationale concluded that there was a shortlist of potential options that require further assessment.

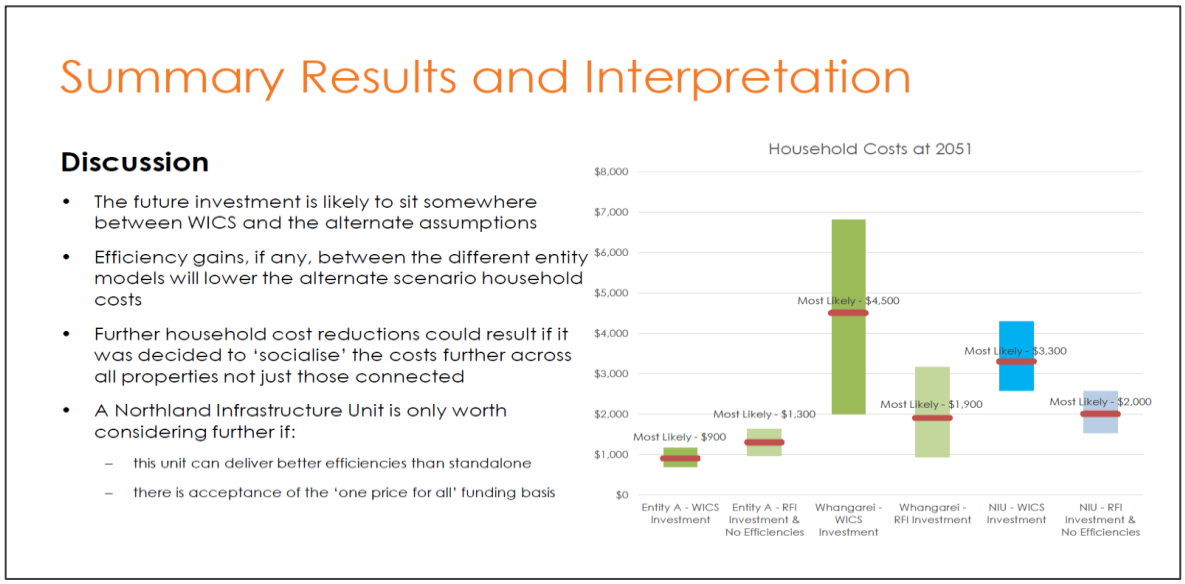
Notable was that Rationale's observations of the WICS modelling was similar to that of Castalia, and is summarised below:

1. The future investment to bring three water services up to standard (referred to as enhancement costs) appears to be over inflated.
2. WICS Modelling is based on United Kingdom models and values which have questionable relevance to New Zealand.
3. Enhancement costs are added on top of replacement costs rather than enhancement being included in the replacement of assets.
4. Significant questions over whether the resources (people) are available to deliver the investment.
5. WICS suggest overly optimistic efficiency gains for the new entities.
6. Efficiency assumptions are severely biased towards Entity A.
7. Questionable evidence that gains observed in Scotland will be achievable in New Zealand.

Rationale used the WICS model to assess and compare Entity A against a Northland Infrastructure Unit, based on the RFI information used by WICS, with and without the WICS efficiency assumptions. The results are shown below in Figure 3 for household costs in 2051. The broad bands show the range of likely outcomes with the red line showing (in terms of probability analysis) the most likely outcome. Entity A (the government's proposal), without biased assumptions is shown having a most likely outcome of $1,300pa per household in 2051; The Whangarei only 'Three Waters' option showing a most likely outcome of $1,900pa per property and a Northland Infrastructure Unit at $2,000pa per property. The Northland modelled outcomes are higher than for Entity A, however, are significantly closer than that modelled by WICS. The actual efficiency achieved by these structures will influence these figures and estimating household costs over a thirty-year period is only indicative.

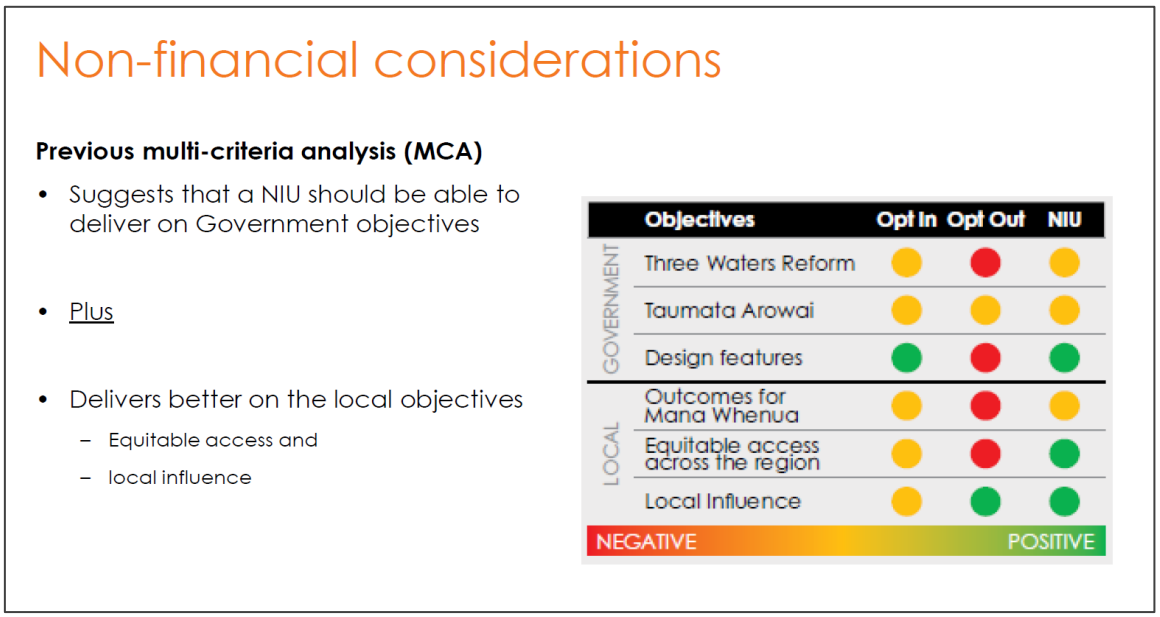
Hence, Rationale conclude that the government's proposal to put Whangarei in Entity A may result in cost savings for ratepayers, albeit dramatically smaller savings than WICS indicated.

Figure 3: Household Costs in 2051 for different service Delivery Options



Rationale also undertook an Investment Logic mapping process examining various service delivery options. This analysis is shown within Attachment 9, 10 and 11. The outcome of the exercise was that there are various service delivery mechanisms that could be considered for Whangarei and Northland that provide a broader range of benefits to the region. Figure 4 shows the assessment of non-financial considerations for 'Entity A' 'opt-in', 'opt-out' and a 'Northland Infrastructure Unit'.

Figure 4: Non-Financial Benefits



4.5 PWC Report – (Entity A Transition Group Information)

PWC have been assisting the Entity A Transition Working Group, providing assistance for the Councils involved to understand the assets being managed as part of the transition process should the water reform occur.

PWC have provided a report (Attachment 12) that shows the average cost per household is forecast to be higher with regulated reform amalgamation (Entity A) than the status quo, and slightly above the estimated range if council were to undertake the reform itself (Opt-out). The modelling does not indicate significant financial benefits as shown within the WICS

model. The PWC 10 year data suggests that ratepayers would be better off opting out of Entity A. Over a longer 30 year period this may change.

4.6 Other matters to consider

As well as the financial advantages and disadvantages Councillors need to consider issues of local control, service levels, and community expectations.

Clearly with most of the Entity A population living in Auckland local control from Whangarei will be lost. Councillors have had feedback for the community so are in the best position to judge their views.

Service levels is also a significant issue. Currently, Whangarei enjoys generally better three waters outcomes than Auckland. We rarely (if ever) need to close beaches because of wastewater contamination, we rarely have water use restrictions, and our response time for faults are generally quicker. If WDC joined with Entity A there is a reasonable chance that service levels would decrease to match those found in Auckland.

4.7 Council Overall Assessment

WDC has done exactly as requested by DIA/LGNZ, that is we have explored the DIA/WICS data and evaluated the DIA/LGNZ reports in relation to our district.

The WICS analysis assessment by Castalia and Rationale shows a bias towards the proposed entities and overstates the benefits of the entities. Other Councils undertaking a similar assessment of the WICS work also draw similar conclusions. On balance, we think you should give little value to the WICS assessment as its assumptions are biased towards the government's proposals.

Undertaking long term financial analysis, with many of WICS' fundamental assumptions being questionable detracts from the case for change. The modelling can only be described as imprecise and its difficult to draw definite conclusions regarding the benefits of being part of the reform. However, for many councils where remodeling using reasonable assumptions shows a compelling case for change, the choice may be easier.

Our assessment using the Rationale and PWC models suggests that there may be financial benefits to ratepayers over the very long term but over 10 years the reforms will cost ratepayers more.

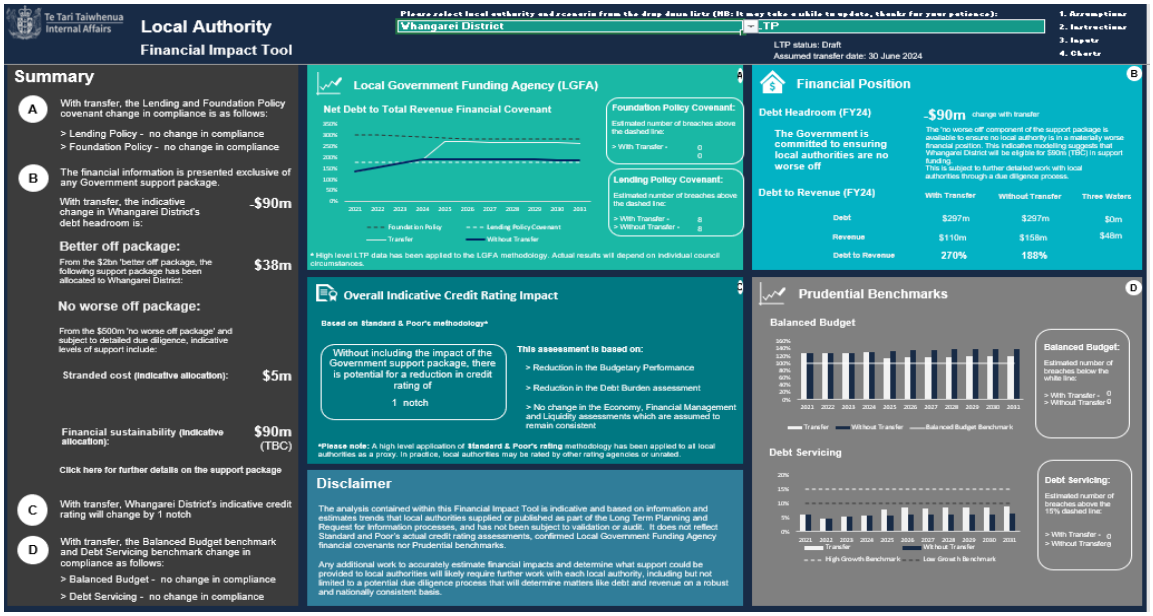
Regardless of the debatable long-term financial benefits for WDC, it would be expected that a larger entity will provide three waters focused benefits and would present a lower overall risk profile for the service regarding performance. However, this may also result in negative outcomes for the council as a whole.

WDC is in an unusual situation in that the espoused benefits of reform will be less than for the majority of councils.

4.8 Government Financial Incentives

The government has offered an incentive package to councils to voluntarily join the Three Waters reforms. Government has promised that no council will be "worse off" as a result of the reforms as well as allocating a sum of money to allow councils to be "better off". This information is shown within Table 2 below:

Table 2: Financial Impact Tool



The incentive has three packages;

- a sum of money to be provided to Councils to spend on joint central and local government priorities (such as housing) – known as the "better off" package
- a sum of money to compensate councils for stranded overheads (part of the "no worse off" package)
- a sum of money called the financial sustainability package to compensate those Councils who will have reduced borrowing capacity as a result of losing Three Waters revenue (also part of the "no worse off" package)

In the case of Whangarei District Council, the sums are as follows:

- $38M for the "better off" package
- $5M for stranded overheads ("no worse off")
- $90M for financial sustainability ("no worse off")

4.9 SRH Report – Assessing the financial impact on WDC

SRH Consulting was commissioned to quantify the opportunity cost that results from the reduction in WDC's borrowing capacity once the Three Waters revenue is removed.

The opportunity cost is an intangible amount, and the analysis applies financial principles to calculate the 'enterprise value' of WDC with the water assets included and excluded. It has used Transpower as a proxy for comparison purposes, noting that with its capital structure it can leverage its revenues to generate debt in a very similar way to that proposed for the new water entities.

The analysis is based on net revenue figures in WDC's LTP, and also takes into account the repayment of $36M in reserves at the time the reforms are enacted. See attachment 13.

4.10 Incentive Package Assessment

The better off component of the support package has been allocated to territorial authorities from a $1 billion pool using a nationally consistent formula based on:

- a 75% allocation based on population size
- a 20% allocation based on the New Zealand deprivation index
- a 5% allocation based on land area (excluding national parks)

Government has indicated the two “no worse off” sums are subject to further due diligence from government so that they can independently verify the money is justified. However, they have not provided any information to support how the ‘no worse off’ amounts provisionally allocated to WDC were calculated.

As a cautionary note, our experience with government suggests that these sums may come with as yet undisclosed “strings”. With both PGF and CIP funding we have found there to be additional requirements which were not identified at the time the initial announcement of the funding was made. It is important that we understand the requirements that go with any government funding before accepting it.

As requested by the DIA and LGNZ, WDC has done due diligence on the funding support to determine whether it meets the principles of “better off” or “no worse off”.

Firstly, it should be noted that as phase one of these reforms’ government has already provided WDC with $11.8M in 2020/21 for improvements to Three Waters infrastructure. This was provided under a Memorandum of Understanding that has since expired and was essentially a “gift” to councils. We thank the government for these funds.

Likewise, the $38M (better off funding) promised is essentially a gift to Council, albeit one with a requirement that the money be spent on joint government / local government priorities. The only aspect that Council needs to consider is that if these funds are spent on Infrastructure owned by Council then Council will incur additional operating costs to maintain and run the infrastructure.

We conclude that the “better off” funding would leave Council better off.

The “no worse off” funding is more complicated. The allocation of $5M is intended to compensate Council for stranded overheads. The Castalia report estimates that the cost to WDC of stranded overheads is around $1.9M per annum. Hence the DIA offer would mean that WDC was “no worse off” for a period of 2 ½ years. We understand that the expectation is that Councils would have that money to allow them to restructure as smaller entities without the Three Waters functions.

The larger financial sustainability component of $90M is intended to compensate WDC for a loss of borrowing capacity.

We could argue that for WDC to be no worse off, then the government should purchase WDC’s waters assets which are valued between $600M to $1.4B. The Government has ruled out purchase of the assets arguing that the assets will still be “owned” by councils, so no purchase is necessary. The government’s definition of ownership is a unique one, namely that the statute will state that the councils own the assets. However, under this unique form of ownership, Councils will have few, if any, of the normal rights and privileges associated with the usual definition of ownership.

If Council considers that ownership must be in the conventional sense, then the governments offer is short by hundreds of millions of dollars. However, if Council agrees that it retains ownership of the assets then it can consider the government’s offer.

The government’s approach is that once the assets are transferred to the new entities Councils should at least enjoy the same level of borrowing capacity as they would have had if the waters asset remained. In most cases, transferring the debt associated with the Three Waters assets will achieve that objective. In fact, a number of councils will see their

borrowing capacity increase, as their water assets are more highly leveraged than their other assets.

WDC is rare in that it has no debt allocated to its Three Waters infrastructure (we will have $36M in reserves at the time of proposed reform) and would lose out if the Three Waters revenues were removed. The government has made a preliminary assessment of WDCs waters revenue and concluded that to retain WDC's debt headroom a total of $90M should be paid to the Council.

To assess that offer, WDC commissioned SRH consulting to make an assessment of what would be required to make WDC "no worse off". SRH concludes that the appropriate sum is $153M. Hence, we can conclude that the governments indicative offer, whilst not unreasonable, falls short of meeting the promise of WDC being no worse off under the Three Waters reforms.

Finally, the government's model suggests that WDC will have a credit rating reduction of 1 notch. While this is unlikely to affect the cost of borrowing there is a small possibility that it will increase our borrowing rate by 5 basis points (0.05%).

In summary, if councillors accept the government's unique definition of ownership, then the total offer of $133M to WDC is still less than required to leave WDC "no worse off". Our assessment is that for WDC to be no worse off, the government would need to pay WDC $196M (made up of $38M better off, $5M stranded overheads and $153M financial sustainability package). If government were prepared to negotiate further, then the gap may be able to be closed.

If Council chooses to progress, we would recommend that Council seek a contract with the Crown rather than relying on ministerial announcements or agreements. Our recent experience with the Marsden four laneing project shows that Ministerial announcements can be overturned without notice, leaving Council in a difficult position.

4.11 Opting In, Opting out or Compulsion

At the start of the water reforms process the Cabinet Papers referred to an "opt in" process for councils in which participation in the reform programme would be voluntary. However, as the DIA/LGNZ reforms have steadily lost the confidence of more and more councils the government is not ruling out making the reforms.

At this stage the government has only asked that Councils provide feedback on the proposals. They contend that it is not the time to opt in or opt out so Councils should not make those decisions.

While we must act in good faith, we are concerned that Government will receive the Councils feedback, make some minor changes to the reform proposal, state that they have addressed councils concerns and make the reforms mandatory. This would avoid the potential embarrassment of many Council's opting out of the reforms, which in turn make the reforms difficult or impossible to implement.

Hence it is quite possible that Council will not get a further chance to opt out of the reforms. Even if Council chooses to confirm its current position of opting out of the reforms it may simply be a "gesture" should government make them compulsory.

4.12 Conclusion

Over the past four years central and local government have been considering the issues and opportunities facing the system for regulating and managing the Three Waters (drinking water, wastewater, and stormwater) – Three Waters Reform.

The Government has concluded that a notational case for change to the Three Waters service delivery system has been made and during June and July 2021 it released information and made announcements on:

- The direction and form of Three Waters Reform, including proposals for new Water Service Entities (WSE), their governance arrangements and public ownership
- Individual Council data based on the information supplied by councils under the Request for Information (RFI) process and Water Industry Commission Scotland (WICS) analysis of that data
- A package of investment for councils ($2.5B, Auckland's share would be $509M half funded by debt from the new WSE) to invest in the future for local government, urban development, and the wellbeing of communities, attempt to ensure no council is worse off as a result of the reforms, and to provide funding support for transition
- An eight-week process for councils to understand the implications of the reform announcements, ask questions and propose alternative solutions and for government to work with councils and mana whenua on key aspects of the reform (including governance, integrated planning and community voice)

While the DIA/LGNZ consider that a national case for change has been made, the WICS figures are at best overoptimistic and at worst unrealistic.

There is no expectation that councils will make a decision to opt-in (or out) or commence community engagement or consultation over the eight-week period. Councils at this stage are simply being asked for feedback on the government's proposal, identify areas of concern, and suggest ways to improve the government's proposal.

Government decisions on entity boundaries, governance and transition and implementation arrangements will occur after the eight week-process ends on 30 September 2021.

We agree that economies of scale and greater efficiencies could be achieved by amalgamating the 67 different water authorities, and that there is a need to determine alternative funding arrangements for capital expenditure. Staff also support the introduction of an economic regulator to protect the interests of consumers.

We do not support the governance model proposed. It is overly complex, with no direct democratic accountability and we are concerned that it will not achieve the efficiencies anticipated. Council requires a genuine governance role for council and an ownership model where ownership comes with accountability and direction.

In assessing the impacts of reform, it is clear that increased standards and regulation are likely to increase costs for WDC. DIA/LGNZ claim these will be more than offset by increased efficiencies. Staff do not consider that to be realistic. There will be increased investment costs and while efficiencies may help, we should expect users to pay more.

The government proposal is to manage the additional costs by creating the Entity A to cover the large population base with the ability to borrow more than local councils. Their modelling states that there is an economic benefit for Whangarei residents, and a larger economic benefit to residents of smaller councils.

Staff and most independent consultants have little confidence in the price/cost conclusions drawn by the government. We would further note that the benefits of creating a new Water Service Entity whose balance sheet is separated from Council Diminishes borrowing capacity for Council.

We believe that there are alternative models which could meet both the government's outcomes for water service delivery in New Zealand and deliver benefits to Whangarei.

These require a willingness by government to partner with local government and individual councils.

5 Significance and engagement

The decision or matters of this Agenda do not trigger the significance criteria outlined in Council's Significance and Engagement Policy and the public will be informed via Agenda publication of the website.

5.1 Engagement with Hapu

We are aware of limited engagement from DIA with Whangarei hapu but not much has occurred since the proposals were announced. Council has sought to keep our hapu partners informed through Te Karearea but the three waters reforms are government proposals, so it is not Council's place to undertake consultation with Hapu on Government's behalf. What Council has done has made its position clear to hapu through Te Karearea hui.

6 Attachments

1. Council Report & attachments – 29 June 2021 – page 17
2. Council Minutes – 29 June 2021 – page 55
3. Council Workshop Presentation – 29 June 2021 – page 57
4. Model report (for distribution Taituara to Chief Executive) August 2021 – page 67
5. LGFA Assessment letter of the proposed Water Entities – 11 August 2021 – page 109
6. LGFA Board Response to Shareholder Council Request on Three Waters Entities – page 111
7. Castalia Report – August 2021 – page 117
8. Castalia Addendum Report to WDC Report – 24 September 2024 – page 151
9. Rationale - Northland Infrastructure Unit – Financial Modelling and Comparisons to WICS – page 161
10. Rationale – Te Tai Tokerau Water Collaboration – Initial Options Analysis – page 207
11. Rationale – Whangarei Water – Options Analysis – page 229
12. PWC Report – Phase 2 WDC Auckland/Northland 3WR – page 251
13. SRH Report – Quantifying Value of WDC Water Asset Revenues – page 283

4.1 Three Waters Reform – Council's Next Steps

Meeting: Whangarei District Council
Date of meeting: 29 June 2021
Reporting officer: Rob Forlong (Chief Executive)

1 Purpose

To decide whether the Whangarei District Council continues with the Government's three waters reform programme.

2 Recommendations

That the Whangarei District Council

1. Notes that participation in the Government's three waters reform is voluntary with the ability for Councils to "opt out" of the reform process;

2. Notes that the Memorandum of Understanding with government which provides for WDC to be part of the three waters reform process expires on 30 June 2021;

3. Notes that the Department of Internal Affairs has refused and Official Information Act (OIA) request to provide WDC with specific information which shows that Whangarei ratepayers would be better off under the reform programme;

4. Exercises its right to "opt-out" of the Governments three waters reform proposals (i.e. ceases to be part of the three waters reform process) effective 1 July 2021;

5. Requests the Mayor and Chief Executive to write to the Chief Executive of the Department of Internal Affairs advising that WDC has formally withdrawn from the three waters reforms.

3 Background

In August 2020, Whangarei District Council (WDC) signed a memorandum of understanding (MoU) with the Chief Executive of the Department of Internal Affairs to voluntarily participate in good faith in the first phase of the government's three waters reforms (attachment 1). In exchange, WDC was provided with $11.8M in stimulus funding and required to provide information to the government to assist it to compile an evidence base around the reforms. WDC has met the requirements of the MoU which expires on 30 June 2021.

4 Discussion

Government has collected extremely detailed information from local government on the state of three waters assets and compiled a number of Cabinet papers and technical reports to make the case for amalgamation of councils' three waters functions into a small number (3 to 5) of large water entities.

Most recently on 2 June 2021 Government released seven reports from the Water Industry Commission of Scotland (WICS 4 reports), Farrierswier (1 Report), and Deloittes (2 reports) which government consider make a compelling case for change. Councillors have been provided with the links to these reports. Unfortunately, the reports provide aggregated national-level data only and do not allow councils to determine the effects on them or their ratepayers.

Of most consequence is that Farrierswier report, which acts as a peer review of the WICS reports. Farrierswier conclude that the WICS reports "…. should give reasonable estimates in terms of *direction* and *order of magnitude".* Interestingly, Farrierswier state (page iv) that they cannot provide an opinion on whether the forecasts and estimates generated by WICS in applying its methodology and assumptions are reasonable. They can only conclude that the modelling is likely to provide positive benefits to a similar order of magnitude. An order of magnitude is a factor of 10. So the logical conclusion from the Farrierswier report, is that the benefits could be up to 10 times greater or 10 times less than the WICS estimates.

WDC has been concerned that Council specific data has not been disclosed at this stage. In order to obtain that data, and to assess the potential effects of the reforms on the Council and its ratepayers, on 13 May 2021 WDC requested relevant information from DIA. Most of this request was declined on 8 June 2021 on the basis that this information was not held by DIA (see attachment 2). We know that the information must exist as WDC (and other Councils) disclosed the relevant data to WICS at DIA's request. The DIA response is of concern as it does not seem to meet the 'good faith' obligations of the MoU and the data was supplied to DIA's agent (WICS) some months earlier. We are currently considering whether to take the matter to the ombudsman.

4.1 Whangarei District Council's Position

Councillors have been briefed at least nine times since February 2020 on the water reform process. The most recent was at a confidential Council workshop on 25 May 2021. The papers from the workshop are attached (attachment 3). These papers plus the government reports referred to above, represent our most complete understanding of the current situation. At that workshop Councillors asked that this paper be developed to enable WDC to opt-out of the reforms before 30 June 2021.

While we recognize that a single burst sewage or water pipe failure could mean that the public loses confidence in WDC's ability to provide safe and appropriate water services, our results suggest that WDC's water and wastewater services work well. WDC has invested strongly in its water infrastructure over many years. Earlier this year WDC completed an upgrade on our water source infrastructure and completed a new water treatment plant for Whangarei. Last year WDC completed the last of the wastewater/stormwater storage and treatment facilities effectively preventing sewage into the Whangarei Harbour. WDC also does not have any debt attached to its water's infrastructure. Hence WDC's situation is dissimilar to many local authorities.

The Government's case for change is based around the premise that only very large suppliers can develop the economies of scale and capability required for the future investment in the waters system. Auckland's Watercare is currently the only New Zealand body large enough to have that scale. However, in terms of outcomes it is easy to argue that WDC's three waters performance is far better than Auckland's. For example, WDC dealt

with the 2019 drought without significant problems (Aucklanders still have to conserve water), our response time to faults are more rapid, and WDC does not have to close beaches because of wastewater overflows during normal rainfall events. While WDC currently charges more for drinking water than Watercare, Watercare has signaled that their prices will double over the next 10 years. For the reforms to be helpful to Whangarei Ratepayers their outcomes would need to be significantly better than those currently achieved by Watercare.

Financially the reforms also do not look positive for WDC. From our preliminary analysis, we know that the removal of the three waters revenue will adversely affect our ability to deliver a balance budget in future years. If WDC cannot deliver a balanced budget it will need to increase rates to compensate.

Removing the three waters would also reduce WDC's debt headroom by a little over $150M (year 1) to $350M (year 10). While that would not create too many problems based on current debt projections, it has the potential to constrain Whangarei's growth if WDC cannot borrow to meet needs generated by that growth.

Hence, unless the government was able to provide a substantial compensation package to WDC it is likely that the Council would be worse off under the proposals. Further, our ratepayers currently have better three waters outcomes than Auckland so they may become worse off.

The wider issue of reducing capacity and capability within Local Government has not been at the forefront of discussion, however, staff resources that are likely to be transferred out of local government are also involved in other areas of council providing the ability to add value and reduce cost in other aspects of local government service provision. How this will be managed moving forward is yet to be fully understood across the sector.

4.2 Opting out and Councils "no worse off"

Councils have previously been told by both officials and Ministers that the process is voluntary, and no council will be worse off as a result of it. However, recently there has been considerable press and other coverage suggesting that the Government is considering making the reforms compulsory. That would go against the previous promise that the reforms would be voluntary which would be disappointing. While we would normally discount this type of media speculation, the recent cancelling of the four-lane highway between Marsden Point and Whangarei suggests that the Government is prepared to "walk back" its promises. In short, Council may have the government three waters proposals forced on them.

Our initial analysis suggests that WDC could be worse off under the government's reforms (Noting that government has not supplied WDC data). To protect WDC and it's ratepayers Council has little option other than to opt out.

4.3 Where to from here

The lack of Council specific data means that government has not shown a coherent case for reform for Whangarei. That data may eventually be provided but Council wants to make a formal decision before the MoU expires on 30 June 2021. Hence our recommendation must be to 'opt-out' of the reforms at this stage. Regardless, WDC should continue to engage with Government officials to progress discussions.

If the Government does make a case for waters reform, then Council could seek to negotiate a compensation package for its future participation. That compensation could be for WDC (e.g. a financial package for WDC) or compensation for our ratepayers (e.g. the reinstatement of the four-lane highway and/or Port development).

4.4 Financial/budget considerations

Should the government go ahead with the reform, financial implications to WDC are unknown at this point. However, if the status quo remains WDC has built the necessary capex and opex into our 2021 to 2031 Long Term Plan.

4.5 Policy and planning implications

There are no policy and planning implications.

5 Significance and engagement

The decisions or matters of this Agenda do not trigger the significance criteria outlined in Council's Significance and Engagement Policy, and the public will be informed via Agenda publication on the website.

6 Attachments

1. Whangarei DC – MoU DIA CE Signed 27 August 2020
2. Response to OIA Request for Information
3. Agenda Report Council Workshop 25 May 2021
4. Presentation – Council Meeting – 3 Waters Reform Update - 29 June

Memorandum of Understanding

Three Waters Services Reform

Between the Sovereign in right of New Zealand acting by and through the Department of Internal Affairs and

Whangarei District Council

PURPOSE

This Memorandum of Understanding (Memorandum) sets out the principles and objectives that the Parties agree will underpin their ongoing relationship to support the improvement in three waters service delivery for communities with the aim of realising significant public health, environmental, economic, and other benefits over the medium to long term. It describes, in general terms, the key features of the proposed reform programme and the Government funding arrangements that will support investment in three waters infrastructure as part of the COVID 19 economic recovery.

BACKGROUND

Over the past three years central and local government have been considering solutions to challenges facing the regulation and delivery of three water services. This has seen the development of new legislation to create Taumata Arowai, the new Water Services Regulator, to oversee and enforce a new drinking water regulatory framework, with an additional oversight role for wastewater and stormwater networks.

While addressing the regulatory issues, both central and local government acknowledge that there are broader challenges facing the delivery of water services and infrastructure, and the communities that fund and rely on these services. There has been regulatory failure, underinvestment in three waters infrastructure in parts of the country, and persistent affordability challenges, and additional investment is required to increase public confidence in the safety of drinking water and to improve freshwater outcomes. Furthermore, investment in water service delivery infrastructure is a critical component of a collective response to climate change and increasing resilience of local communities.

The Parties to this Memorandum consider it is timely to apply targeted infrastructure stimulus investment to enable improvements to water service delivery, progress reform in partnership, and ensure the period of economic recovery following COVID-19 supports a transition to a productive, sustainable economy. Additional funding will be subject to Government decision-making and reliant on the Parties demonstrating substantive progress against the reform objectives. The quantum, timing, conditions, and any other information relating to future funding will be advised at the appropriate time but will likely comprise additional tranches of funding and more specific agreement to key reform milestones.

The reform process and stimulus funding, proposed by Government, is designed to support economic recovery post COVID-19 and address persistent systemic issues facing the three waters sector, through a combination of:

- stimulating investment, to assist economic recovery through job creation, and maintain investment in water infrastructure renewals and maintenance; and
- reforming current water service delivery, into larger scale providers, to realise significant economic, public health, environmental, and other benefits over the medium to long term.

There is a shared understanding that a partnership approach will best support the wider community and ensure that the transition to any eventual new arrangements is well managed and as smooth as possible. This requires undertaking the reform in a manner that enables local government to continue and, where possible, enhance delivery of its broad "wellbeing mandates" under the Local Government Act 2002, while recognising the potential impacts that changes to three waters service delivery may have on the role and functions of territorial authorities.

PRINCIPLES FOR WORKING TOGETHER

The Parties shall promote a relationship in their dealings with each other, and other Parties related to the three waters services reform, based on:

- mutual trust and respect; and
- openness, promptness, consistency and fairness in all dealings and communication including through adopting a no-surprises approach to any matters or dealings related to the reform programme; and
- non-adversarial dealings and constructive problem-solving approaches; and
- working co-operatively and helpfully to facilitate the other Parties perform their roles; and
- openly sharing information and analysis undertaken to date on the state of the system for delivering three waters services and the quality of the asset base.

This Memorandum is intended to be non-binding in so far as it does not give rise to legally enforceable obligations between the Parties.

REFORM OBJECTIVES AND CORE DESIGN FEATURES

By agreeing to this Memorandum, the Parties agree to work constructively together to support the objectives of the three waters service delivery reform programme.

The Parties agree that the following objectives will underpin the reform programme and inform the development of reform options/proposals:

- significantly improving the safety and quality of drinking water services, and the environmental performance of drinking water and wastewater systems (which are crucial to good public health and wellbeing, and achieving good environmental outcomes);
- ensuring all New Zealanders have equitable access to affordable three waters services;
- improving the coordination of resources, planning, and unlocking strategic opportunities to consider New Zealand's infrastructure and environmental needs at a larger scale;
- increasing the resilience of three waters service provision to both short- and long-term risks and events, particularly climate change and natural hazards;
- moving the supply of three waters services to a more financially sustainable footing, and addressing the affordability and capability challenges faced by small suppliers and councils;
- improving transparency about, and accountability for, the delivery and costs of three waters services, including the ability to benchmark the performance of service providers; and
- undertaking the reform in a manner that enables local government to further enhance the way in which it can deliver on its broader "wellbeing mandates" as set out in the Local Government Act 2002.

In addition to these objectives, the Parties recognise that any consideration of changes to, or new models for, water service delivery arrangements must include the following fundamental requirements and safeguards:

- mechanisms that provide for continued public ownership of water service delivery infrastructure, and protect against privatisation; and
- mechanisms that provide for the exercise of ownership rights in water services entities that consider the interests and wellbeing of local communities, and which provide for local service delivery.

The Parties also recognise the reform programme will give rise to rights and interests under the Treaty of Waitangi and both Parties acknowledge the role of the Treaty partner. This includes maintaining Treaty settlement obligations and other statutory rights including under the Resource Management Act 1991 and the Local Government Act 2002. The outcome of discussions with iwi/Māori will inform design of appropriate mechanisms to reflect Treaty interests. This will include clarity of roles and responsibilities.

The Parties agree to work together to identify an approach to service delivery reform that incorporates the objectives and safeguards noted above, and considers the following design features as a minimum:

- water service delivery entities, that are:
  - of significant scale (most likely multi-regional) to enable benefits from aggregation to be achieved over the medium to long-term;
  - asset owning entities, with balance sheet separation to support improved access to capital, alternative funding instruments and improved balance sheet strength; and
  - structured as statutory entities with appropriate and relevant commercial disciplines and competency-based boards;
- delivery of drinking water and wastewater services as a priority, with the ability to extend to stormwater service provision only where effective and efficient to do so; and
- publicly owned entities, with a preference for collective council ownership;
- mechanisms for enabling communities to provide input in relation to the new entities.

The Parties acknowledge that work will also be undertaken to develop a regulatory framework, including mechanisms to protect the interests of consumers.

FUNDING ARRANGEMENTS

The Government has indicated its intention to provide funding to stimulate investment to enable improvements in water service delivery, support economic recovery and progress Three Waters Services Reform. The quantum of funding available for the Council (and each participating Council) will be notified by Government prior to signing this Memorandum.

Funding will be provided as soon as practicable following agreement to this Memorandum and the associated Funding Agreement and Delivery Plan. The Delivery Plan will need to show that the funding is to be applied to operating or capital expenditure on three waters service delivery (with the mix to be determined by the Council) that:

- supports economic recovery through job creation; and
- maintains, increases and/or accelerates investment in core water infrastructure renewals and maintenance.[1]

The Delivery Plan will be based on a simple template and will include a summary of projects, relevant milestones, costs, location of physical works, number of people employed in works, reporting milestones and an assessment of how it supports the reform objectives set out in this Memorandum.

The Delivery Plan will be supplied to Crown Infrastructure Partners, and other organisations as agreed between the Parties, who will monitor progress of application of funding against the Delivery Plan to ensure spending has been undertaken consistent with public sector financial management requirements.

Agreement to this Memorandum and associated Funding Agreement and Delivery Plan are required prior to the release of Government funding. The Council will have the right to choose whether or not they wish to continue to participate in the reform programme beyond the term of the Memorandum.

FUTURE AGREEMENTS

The Parties may choose to enter other agreements that support the reform programme. These agreements will be expected to set out the terms on which the Council will partner with other councils to deliver on the reform objectives and core design features, and will include key reform milestones and detailed plans for transition to and establishment of new three waters service delivery entities.

PROGRAMME MANAGEMENT

The Government will establish a programme management office and the Council will be able to access funding support to participate in the reform process.

The Government will provide further guidance on the approach to programme support, central and regional support functions and activities and criteria for determining eligibility for funding support. This guidance will also include the specifics of any information required to progress the reform that may be related to asset quality, asset value, costs, and funding arrangements.

TERM

This Memorandum is effective from the date of agreement until 30 June 2021 unless terminated by agreement or by replacement with another agreement related to the reform programme.

[1] Maintains previously planned investment that may have otherwise deferred as a result of COVID-19.

INTERACTIONS, MONITORING, INFORMATION AND RECORDS

The Parties nominate the following representatives to act as the primary point of communication for the purposes of this Memorandum and any other purpose related to the reform programme.

Government's representative	Territorial Authority's representative
Allan Prangnell threewaters@dia.govt.nz CC. Chief Legal Advisor Legal.notices@dia.govt.nz	Rob Forlong rob.forlong@wdc.govt.nz

It is the responsibility of these representatives to:

- work collaboratively to support the reform objectives;
- keep both Parties fully informed;
- act as a first point of reference between Parties and as liaison persons for external contacts; and
- communicate between Parties on matters that arise that may be of interest to either party.

If the contact person changes in either organisation, the other party's contact person must be informed of the new contact person immediately and there should be an efficient transition to ensure the momentum of the reform process is not undermined.

CONFIDENTIALITY

Neither of the Parties is to disclose, directly or indirectly, any confidential information received from the other party to any third party without written consent from the other party, unless required by processes under the Official Information Act 1982 or the Local Government Official Information and Meetings Act 1987 (whichever applies), or under a Parliamentary process- such as following a Parliamentary question, in which case the relevant party is to inform the other party prior to disclosure. Protocols will be established to enable exchange information between Councils where that is consistent with progressing reform objectives.

DISPUTE RESOLUTION

Any dispute concerning the subject matter of this document is to be settled by full and frank discussion and negotiation between the Parties.

SIGNED by The Sovereign in right of New Zealand acting by and through the Chief Executive of the Department of Internal Affairs

Date 27 August 2020

SIGNED by

Her Worship the Mayor Sheryl Mai

on behalf of

Whangarei District Coucnil

Date 27/8/2020

SIGNED by

Chie Executive, Rob Forlong

on behalf of

Whangarei District Coucnil

Date 27-8-2020

Witness signature

Witness name

Simon Weston

Witness occupation

General Manager Infrastructure

Witness address

Rust Avenue, Whangarei

Date 27.8.2020

Te Tari Taiwhenua
Internal Affairs

45 Pipitea Street
Wellington
Phone 0800 25 78 87
dia.govt.nz

08 June 2021

Rebecca Rowsell
Legal Counsel
Whangarei District Council
rebecca.rowsell@wdc.govt.nz

Tēnā koe Rebecca

Your official information request, reference OIA2021-0558

Thank you for your email of 13 May 2021 requesting the following information under the Official Information Act 1982 (the Act):

- ***Request 1****. Could we please have the estimated OPA points for Watercare and each of the councils in NZ by way of comparison? We would be grateful if each council could be specifically named alongside this data rather than simply providing anonymised or collated data.*
- ***Request 2.*** *Could we please have the estimated weighted average annual expenditure per connected citizen for Watercare and each of the councils in NZ by way of comparison? We would be grateful if each council could be specifically named alongside this data rather than simply providing anonymised or collated data.*
- ***Request 3.*** *Could we please have the WICS assessed economic depreciation per connected citizen for Watercare and each of the councils in NZ by way of comparison? We would be grateful if each council could be specifically named alongside this data rather than simply providing anonymised or collated data.*
- ***Request 4.*** *Could we please have the Scenario 1 WICS analysis of required underlying depreciations for Watercare and each of the councils in NZ by way of comparison? We would be grateful if each council could be specifically named alongside this data rather than simply providing anonymised or collated data.*
- ***Request 5.*** *Could we please have the Scenario 2 analysis adjusted for high end growth and enhancement for Watercare and each of the councils in NZ by way of comparison? We would be grateful if each council could be specifically named alongside this data rather than simply providing anonymised or collated data.*
- ***Request 6.*** *Could we please have the Scenario 3 analysis adjusted for low end enhancement for Watercare and each of the councils in NZ by way of comparison? We would be grateful if each council could be specifically named alongside this data rather than simply providing anonymised or collated data.*
- ***Request 7****. Could we please have a copy of the first Farrier Swier report on the WICS model.*

I am therefore refusing parts one to six of your request under section 18(g)(i) of the Act- *as that the information requested is not held by the Department of Internal Affairs (the Department) and I have no grounds to believe that the information is held by another department or Minister.*

The reports and data we have received from the Water Industry Commission for Scotland (WICS) to date are primarily presented at an aggregated level to inform advice to ministers as part of the Three Waters reform programme. Responding to your request would require us create information and we are under no obligation under the Act to do so.

As you may be aware, the Department has recently published the outcomes of the analysis undertaken by the Water Industry Commission for Scotland, among other independent reports commissioned for the Three Waters Reform Programme. This information can be accessed via www.dia.govt.nz/Three-Waters-Reform-Programme#latest-information.

Further information will be released in the coming months, which will include information at a local authority level. This future release is likely to be broadly consistent with the type of information you have requested. At present, the Department working closely with the Joint Central/Local Government Steering Committee on shaping up the contents and process for this release, including creating information to support individual local authorities' understanding of the pending reform proposals and potential implications for their communities. We will inform you of this release when it happens.

In relation to part seven of your request, I note that you have asked for the "first Farrier Swier report". However, Farriersweir has only been commissioned to provide one report to the Department, so I've interpreted your request as seeking that report. Since your request, this report has become available online, and is available by visiting the Three Waters Reform Programme page on the Department's website via the link above and clicking the link below the "Farrierswier report" heading.

As you are able to access this information through the link above, I am refusing your request under section 18(d) of the Act as the information you have requested is publicly available.

You have the right, under section 28(3) of the Act, to seek an investigation and review of this decision by the Office of the Ombudsman. The postal address of the Office of the Ombudsman is PO Box 10152, Wellington. Alternatively, you can phone 0800 802 602 or email info@ombudsman.parliament.nz.

Ngā mihi

Richard Ward
Programme Lead Three Waters

Confidential – Not for publication

DIA Three Waters Reform – Where to from here

Meeting:	Council Workshop
Date of meeting:	25 May 2021
Reporting officer:	Rob Forlong (Chief Executive) Simon Weston (General Manager Infrastructure)
Reason for Confidentiality:	S7(2)(h) To enable Council to carry on without prejudice or disadvantage commercial activities.

1 Purpose

To provide an update on:

- Key information from the Government's 'Three Waters Service Delivery Reform',
- The Investment Logic Mapping process involving consultants Rationale; and
- Discussion workshop on the way forward.

2 Background

Staff have reported on the Government's Three Waters Reform since 2017. Several Cabinet papers have been presented along with information provided by the Department of Internal Affairs.

In July 2020, the Government announced a $761 million funding package to provide post COVID-19 stimulus to support a three-year programme of reform of local government water service delivery arrangements (reform programme).

Initial funding from the stimulus package has been made available to those councils that agreed to participate in the first stage of the reform programme through a Memorandum of Understanding (MoU). The MoU required Council to co-operate with the government's reform programme in 'good faith' for a period of one year and included a request for information from Councils.

On 27 August 2020 Council resolved to:

1. *Sign a Memorandum of Understanding with the Crown, agreeing to participate in the initial stage of a central/local government three waters service delivery reform programme (Appendix A).*
2. *Authorise the Chief Executive to enter into the Funding Agreement and a delivery plan, to accept a grant from the Crown to spend on operating and/or capital expenditure relating to three waters infrastructure and service delivery (Appendix B).*
3. *Note that signing the MoU does not obligate Council to continue participation beyond the term of the MoU.*

As a result of signing the MoU, WDC has received funding of $11.8M towards our three waters programme as well as responding to a very large Request for Information (RFI) from the Department of Internal Affairs (DIA). The RFI was to determine;

- The current state of councils water assets;
- To estimate any under investment in water assets;
- To estimate the costs of bringing those assets up to modern standards; and
- The size of entity that would be required to do that.

The information was analysed by the Water Industry Commission of Scotland (WICS). While we have received a high-level briefing from WICS **(Attachment 1)** we are yet to see the analysis for WDC. What we have been told is that Watercare is NZ's top performing waters organisation and WDC is in the upper quartile. Given that the MoU expires on 30 June 2021, on 13 May 2021 we made an urgent Official Information Act request to DIA to provide us with WDC's data from the RFI. At the time of preparing the report we had not received the data.

3 Discussion

3.1 Progress

The Minister for Local Government proactively released Cabinet papers dated 14 December 2020.

Within Government, the reform programme has been proceeding at pace. However, little information has been made available publicly or to Councils. It is fair to say that government officials are using a 'carrot and stick' approach to prevent councils from opting-out. The 'carrot' is likely to be council debt reduction and possibly some cash payments as compensation for the water assets and the 'stick' is strong and heavily enforced regulation.

It is also noted that the likelihood of a voluntary approach to the three waters reforms succeeding may depend on central government support for the parallel reform entitled 'future of local government' work and the potential provision of a 'package' for local government.

Government officials will test with S&P and stakeholders two main ownership options that are consistent with the Cabinet's June 2020 positions:

- A collective (non-share based) ownership model, where assets are owned by water services entities on behalf of the relevant local authorities; and
- A share-based ownership model, where assets are owned by water services entities, and relevant local authorities hold shares in the entities. Shareholding would reflect relative governance rights, rather than asset values.

At the time of writing, the governance and ownership model has not been provided but we understand the former option may be preferable.

One of the key issues for WDC has been obtaining information on how much we will be paid for the assets that are transferred to the new water entity. We have written to the Minister of Local Government twice on this topic and have received a response along the lines of – "decisions will be made in due course". Government provided a further $296M in Budget 2021 for three waters reform. While we were advised that further decisions need to be made, this sum falls well short of providing fair compensation to Councils for their assets.

3.2 Opt-in, Opt-out or Compulsory Reform

When the reform was initiated it was presented as voluntary with councils "opting in" to all phases of the reform programme. The December 2020 Cabinet paper retained the process as voluntary but reversed the proposal to require Councils to "opt out" of the programme.

The Cabinet paper also raised the prospect of making the process compulsory. The government will need to reassess this 'opt-out' approach in the future should it become clear that the reforms are at risk of not being achieved. In addition, some Mayors and Chief Executives are overtly suggesting that government make the reforms compulsory. At this point LGNZ's position in their discussions with government is that the reforms must be voluntary, but we understand that all options are subject to negotiation.

We understand that advice on making the reforms compulsory will be provided to Cabinet in May 2021. As noted above, at this point the three waters reform is a voluntary, non-binding

commitment. It currently **does not** require councils to commit to future phases of the reform programme, to transfer their assets and/or liabilities, or establish new water entities. However, that may change.

The MoU is effective from the date of agreement until 30 June 2021, unless terminated by agreement or by replacement with another document relating to the reform programme.

One question for Councillors is do you want to advise the Minister of a provisional decision to "opt out" of the process at this point, given the lack of information provided by government. This may have the effect of strengthening our negotiating position or encouraging government or make the reforms compulsory.

Currently we consider that if the vast majority of Councils stay within the reform process then the reform may not be made compulsory. However, if a large metro (e.g. Auckland or Christchurch) decides to opt-out the government may mandate the reform. This would be awkward for Government as it would go back on previous assurances from the Minister and constitute a significant breach of trust with the local government sector.

3.3 Cost Impact on Council Post Reform

The reforms will have an effect on Council's balance sheet, borrowing capacity, income, expenditure and balanced budget. For many councils these effects may be positive as their waters assets are heavily leveraged. WDC funds its waters assets (except for stormwater which is funded through general rates) through targeted rates and reserves. WDC's financial position is different from many other councils. Now that the LTP has been finalised staff will be able to provide Councillors with some indicative figures at the workshop.

3.4 Local Government and individual Councils not being worse off

Within the Three Waters Reform documentation and in DIA workshops it has been made clear that Councils participating in the reform will not be left in a worse-off position after the reforms. This is yet to be fully understood in terms of ongoing financial benefits and/or 'packages' provided to local government.

3.5 District, Regional, and Multi-regional Service Delivery Options Review

The Northland Councils requested the Four Waters Advisory Group Northland (4WAGN) to undertake an options analysis for service delivery models **(Attachment 2)**. These were to consider and contrast Northland options with the Governments proposed multi-regional model. As an adjunct to this process WDC also investigated, as a separate exercise, a Whangarei District only option (WDC opting-out of the reform process) **(Attachment 3)**. To complete the exercise, both sets of analysis were combined for comparative purposes.

The highest ranked Northland region option was a Multi-Regional Water CCO plus separate Northland Region combined Council. The highest Northland only option (ranked 2nd) was a Regional asset owning water CCO, plus Northland Region combined Council.

The highest ranked Whangarei option was a Whangarei Three Waters Enterprises model. (vertically integrated three waters asset owning CCTO, owner, consultant, contractor). This is similar in many respects to a Northpower type operation.

The combined analysis of all options showed the highest ranked option being Multi-Regional Water CCO, plus separate Northland Region combined Council and the highest Northland only option being regional asset owning water CCO, plus Northland Region combined Council. The Whangarei Three Waters Enterprises model in this scenario was ranked 3rd.

(**Attachment 4** provides a summary of this work).

3.6 What would the opt-out option look like?

If council was to opt-out of the reform process it would need to recognise the need to increase resources to comply with the changes proposed in the new Water Services Bill; the new Drinking Water Standards; the new Operational Rules; the updated National Environmental Standards for Freshwater Management, and the formation of Taumata Arowai. Government expectations around the treatment of water and wastewater as well as the expectations around level of service will dramatically increase the "cost" of water and wastewater services (Watercare have already announced they are doubling their charges over the next 10 years). If WDC chose to opt-out we would need to add considerable resources to our three waters team – in terms of capex, opex and staffing. **Attachment 5** provides further information on a likely scenario however, this is currently hard to predict.

4 Conclusion and Next Steps

As with many reform programmes the details are being worked on as the reform is progressing and the government has been slow to release data to Councils. Consequently, we do not have the data to provide Council with informed advice. Regardless of the lack of information to date, the Northland Councils have engaged with the process and have participated in early discussion with other regions (Auckland and others) to explore the implications of the reform and how it may work in practice.

Our view is that a Northland based provider is not likely to meet government requirements. It is also likely to result on a significant drain on Whangarei ratepayers to support the inferior infrastructure in Kaipara and the Far North.

Joining with Auckland may also have issues. Watercare has significant technical expertise and economies of scale. While Whangarei waters and wastewater facilities are more expensive to run than Auckland's (primarily because of population density and economies of scale), WDC's waters outcomes appear superior. Whangarei has invested strongly in its waters over the years, the most recent example being the new Whau Valley water treatment plant. WDC coped far better than Watercare with the recent droughts (Auckland still has restrictions from 2020) we have good water and wastewater treatment facilities and Whangarei does not need to close beaches because of waster water overflows. In addition, our levels of service compares well, for example, WDC's response to faults is a lot more rapid than Watercare's.

Canvassing options that meet the governments objectives is paramount, and will no doubt temper the potentially 'preferred' Northland service delivery option with one that may be supported by government.

At the workshop we will seek guidance from council on the following:

- Are you comfortable with Whangarei's waters being joined with Auckland as part of this process?
- Do you wish to stay in or seek to 'opt-out' of the reforms?
- What concessions or compensation would you expect from government to support the reforms?

5 Attachments

1. Water Industry Commission for Scotland (WICS Report).
2. Rationale Report - Te Tai Tokerau Water Collaboration – Initial Options Analysis (Final April 2021.
3. Rational Report – Whangarei Water Option Analysis (Draft April 2021).
4. District Regional and Multi-regional Service Delivery Options Review.
5. Whangarei Resourcing Scenario.

Council Workshop

Tuesday, 29th June 2021

Whangarei District Council

Background, Water Reform - Progress to date…

- Water Reform ongoing since 2017
- Significant documents and Cabinet papers available
- Cabinet Paper 14 December 2020
- Water Reform Workshop 30 March – Report now available
- Waiting for Council RFI information and Council specific Packages
- Boundaries and number of entities soon to be available.

Whangarei District Council

Opt-in, Opt-out, or Compulsory Reform?

- RFI – This was “Opt-in”
- Cabinet Paper 14 December 2020 – Changed the process to “Opt-out”.
  - However, noted in the Cabinet paper was that if the objectives of the reforms were at risk, the reform may be made mandated.
  - Local Government response.
  - Risks for the Reform and what that may mean for a mandated reform.

Whangarei District Council

Options Review for a Northland Delivery Entity

- Multi-Regional Water CCO Plus separate Northland combined Authority ranked highest
- Highest ranked Whangarei Only option was a Three Waters Enterprise Entity.
- Combined analysis highest ranking was Multi-Regional Water CCO Plus separate Northland combined Authority (Highest Northland option was Northland asset owning water CCO plus Northland Combined Authority.

Whangarei District Council

Issues to Consider…

- Cost Impact on Council Post Reform
- Local Government and individual councils “not being worse off”
- What would “opt-out” look like?

Whangarei District Council

Government Proposal Pros/Cons

- WDC avoids the large costs arising from reforms
- Helps WDC relationship with government
- Potentially allows other parts of Northland and Auckland to contribute to the costs of waters infrastructure in Whangarei
- Potentially some incentives, as Government has stated that councils will be “no worse off” as a result of the reforms
- Focus on new initiatives provided by the government
- Reduce risk given the new regulators heavy hand
- **Cons**
- Potentially requires Whangarei ratepayers to contribute to the costs of waters infrastructure in other parts of Northland and Auckland.
- Loss of control of WDC infrastructure and services
- Ratepayers face extra costs for waters from reforms
- Reduced spatial planning capability, and limited ‘one stop shop’ infrastructure planning ability
- Potential for reduced Level of service (waste water overflows)
- Balanced budget issues with the removal of waters revenue
- Reduced overall organization FTE and capability
- Stranded overhead
- Risk of LG Reform post waters removal

Whangarei District Council

Go it alone – Pros/Cons

- **Pros**
- Whangarei people retain control through WDC of the water assets
- WDC assets seem to be in good condition
- WDC retains a higher borrowing capacity
- Stronger negotiating position with Government
- Better land management planning
- Maintain a degree of scale
- **Cons**
- WDC fronts all the large cost increases arising from the reforms
- Will harm our relationship with Government
- Risk what WDC will not be able to afford the cost increases that come from the reforms
- Risk that WDC will miss out on the incentives offered by Government
- Risks associated with compliance

Whangarei District Council

Question to Consider…

- Are you comfortable with ‘Whangarei Waters’ being joined with Auckland as part of this process?
- Do you wish to stay in, or seek to “opt Out” of the Reform?
- What Concessions or compensation would you expect from government to support the reforms?
  - Next Steps…

Whangarei District Council

Information Only

Government Reform Objectives.

A **Significantly improving safety and quality of drinking water services**, and the environmental performance of wastewater and stormwater systems.

B **Ensuring all New Zealanders have equitable access** to affordable three waters services.

C **Improving resource coordination and unlocking strategic opportunities** to consider national infrastructure needs at a larger scale.

D **Increasing resilience of three waters service provision** to both short- and long-term risks and events, particularly climate change and natural hazards.

E **Moving three waters services to a more financially sustainable footing**, and addressing the affordability and capability challenges faced by small suppliers and councils.

F **Improving transparency and accountability in cost and delivery of three waters services**, including the ability to benchmark performance of service providers.

Whangarei District Council

Information Only

Reform design features… Provides insight into the future…

Design features that the **proposed** reform programme should examine, as a minimum:

A **Water service delivery entities** that are:

- **of significant scale** (most likely multi-regional) to enable benefits from aggregation to be achieved over the medium- to long-term;
- **asset-owning entities** with balance sheet separation, to support improved access to capital, alternative funding instruments and improved balance sheet strength; and
- **structured as statutory entities** with appropriate and relevant commercial disciplines and competency-based boards.

B **Delivery of drinking water and wastewater services as a priority,** with the ability to extend to stormwater service provision only where effective and efficient to do so.

C **Publicly owned entities,** with a preference for collective council ownership.

D **Mechanisms for enabling iwi /Māori and communities** to provide input in relation to the new entities.

Whangarei District Council

3 Waters

Potential financial impacts

Whangarei District Council

Assumptions

- Very high-level calculations based on draft financial statements from LTP Consultation model with Oruku Landing CEC removed.
- Assumes reforms happen immediately - just so we can show the impacts over 10 years
- Removes all revenue, expenses and debt allocated to 3 water activities
- Future Reserves added to future debt (as no longer available to fund non-waters CapEx)
- No adjustment made for current Reserve balances
- Assumes rates revenue will reduce by the portion of general rates currently allocated to fund stormwater
- No adjustments made for overhead costs (e.g. corporate allocations). Assumes all costs allocated and incurred by 3 waters activities are removed.
- No adjustments have been made to interest calculations
- NZTA revenue based on LTP (reduction in subsidy will lower debt capacity and negatively impact balanced budget)

Whangarei District Council

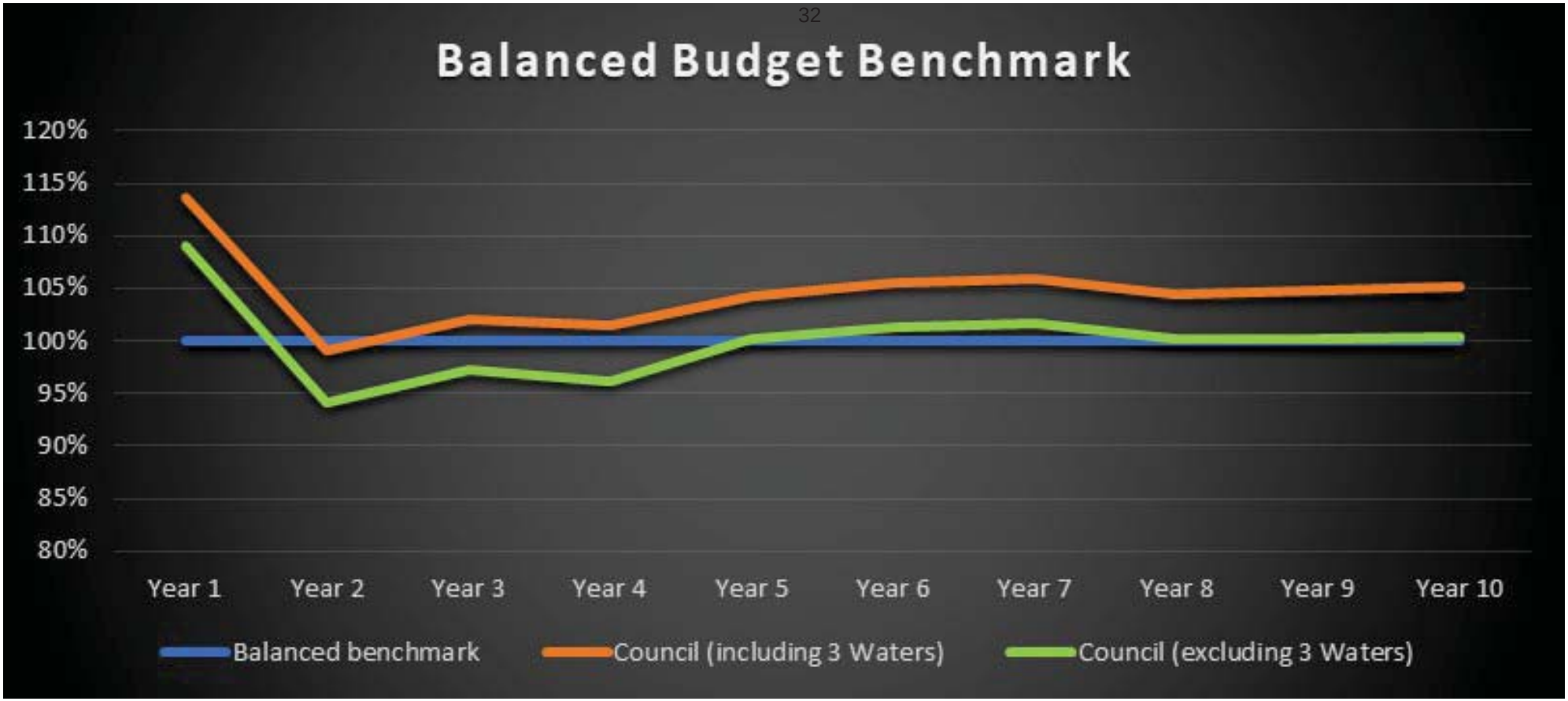
Impacts

- Targeted rates are used to fund **OpEx** (Income Statement) and **CapEx** (balance sheet) so impact on balanced budget and debt capacity will be significant.

- The removal of 3 waters rates will impact our **balanced budget adversely**.
  - Wastewater revenue exceeds spend (we are currently building a credit reserve) and we are funding capital projects directly, rather than with debt

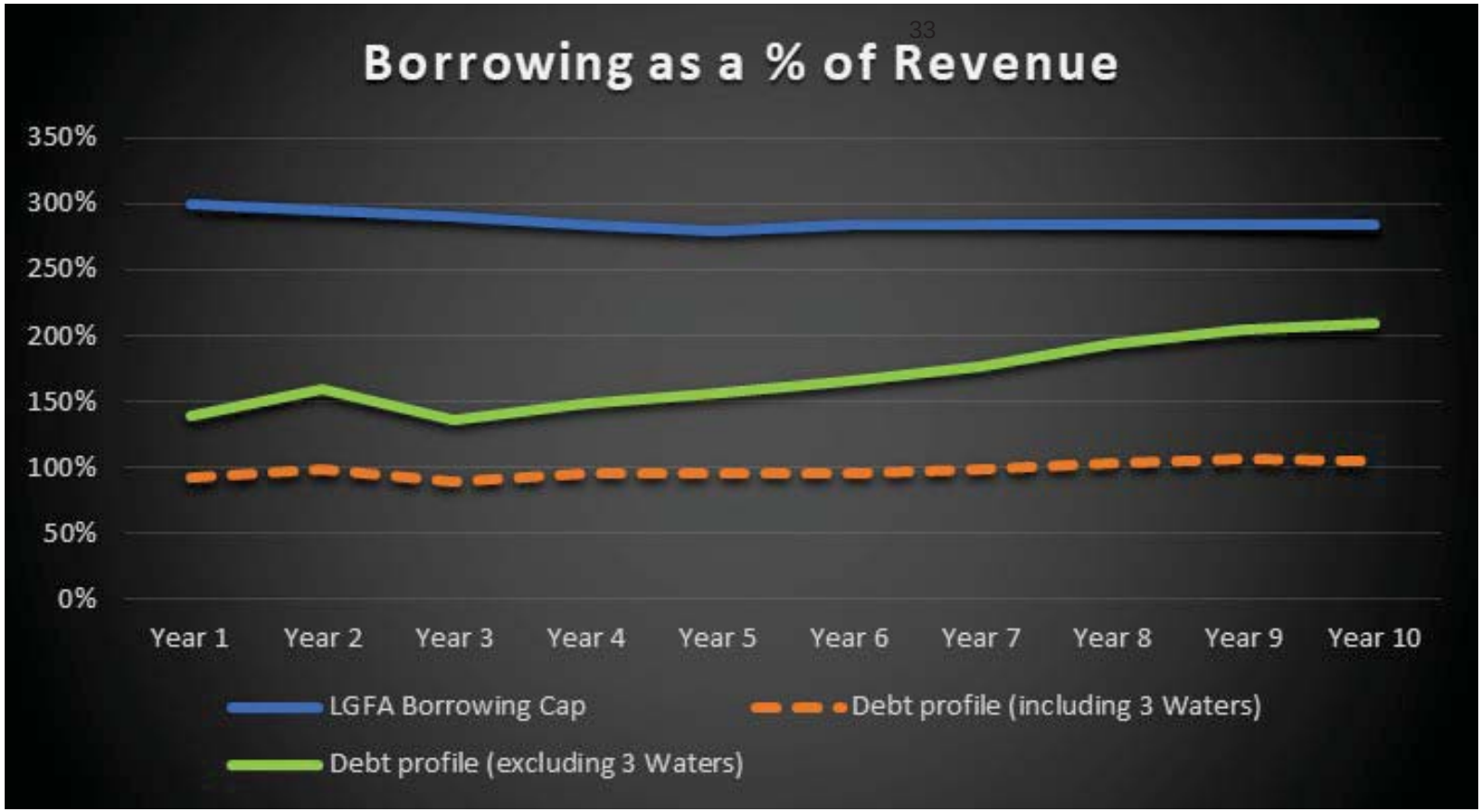
- This reduced revenue will see our **ability to borrow reduce**
  - Debt to Revenue ratio is the limiting factor

Whangarei District Council



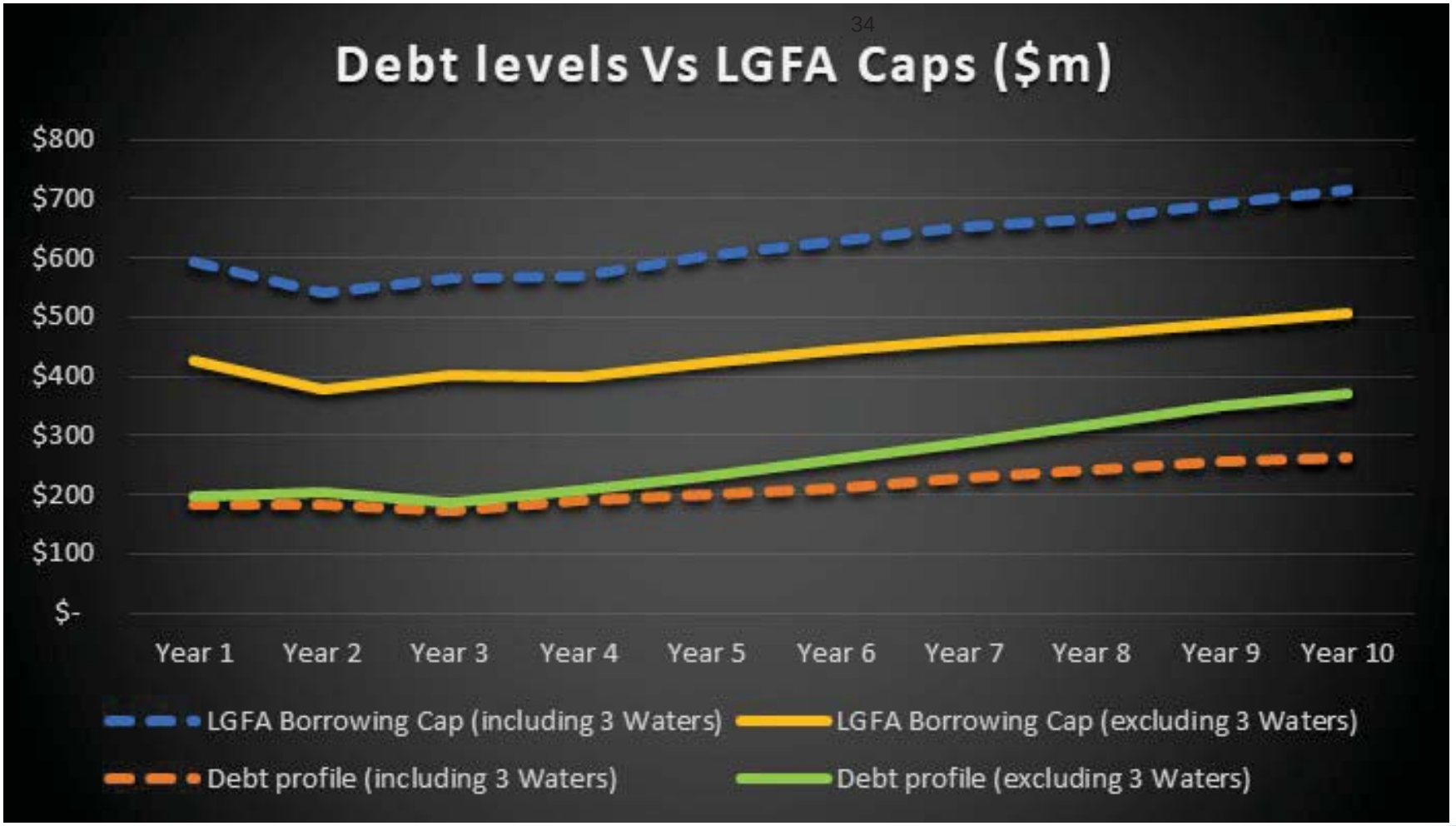
- Current situation vs. what it might look like if 3 waters are removed
- Very rough calculation. Depends on overhead costs.
- Shows at the current rates level we will struggle to achieve a balanced budget

Whangarei District Council

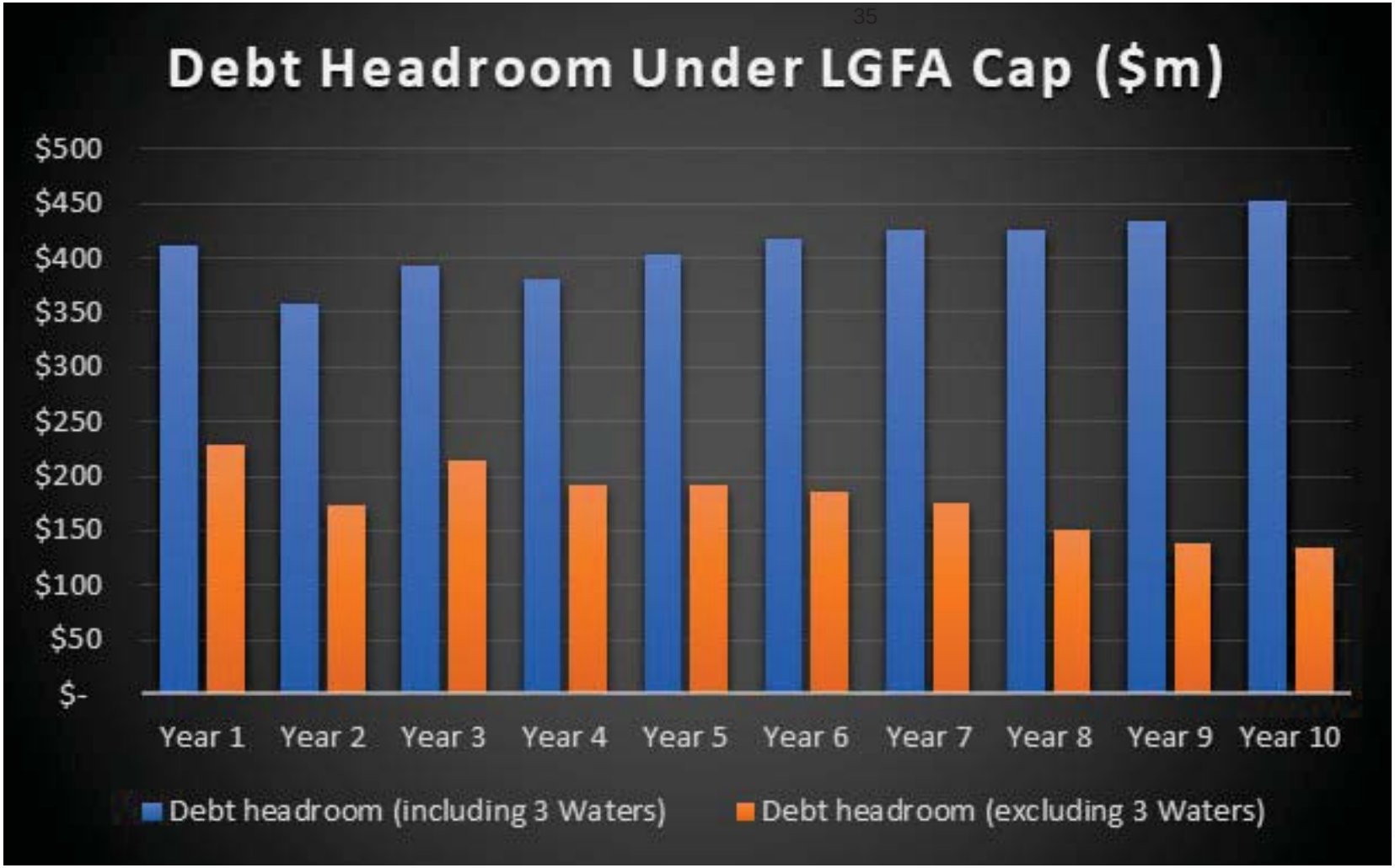


- High level calculations. Remaining activities debt will increase as we won't have the surplus from wastewater to 'borrow' via internal borrowing.
- Assumes we retain current debt levels (i.e. no compensation received on assets transferred out)
- Shows we are still within LGFA covenants.

Whangarei District Council



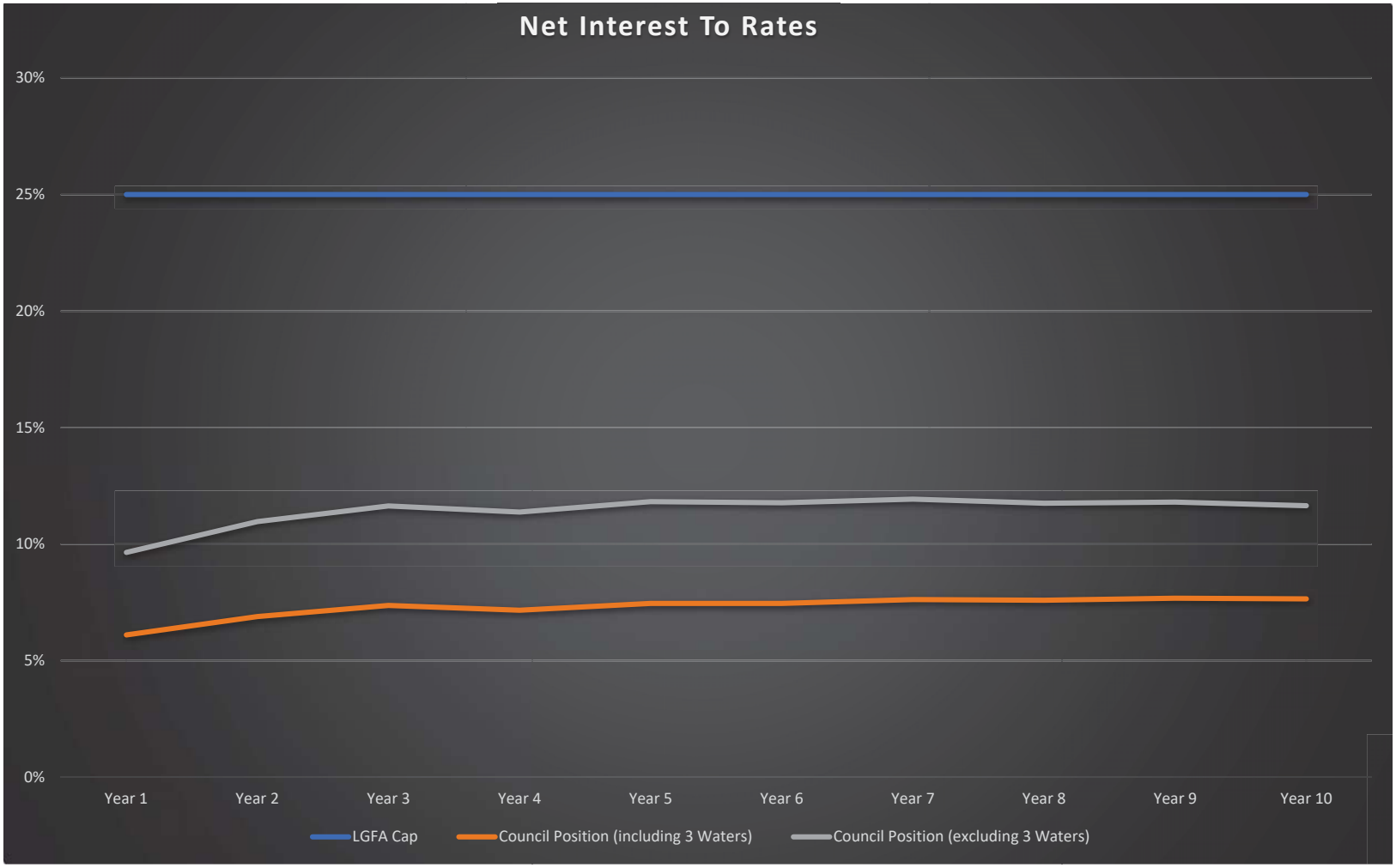
Whangarei District Council



Whangarei District Council

Net Interest to Rates

36



Whangarei District Council

Debt servicing benchmark

- This benchmark measures interest as a percentage of revenue.
- Financial prudence limit is 15%, LGFA limit is 20%
- Still well within this limit in either scenario

Whangarei District Council

Unknowns

- How will this impact our credit rating?
- What about credit reserve balances? Will we have to pay these across?
- Will we be compensated for our assets?
- How will this impact our debt?
- What about development contributions already collected?

Whangarei District Council

Whangarei District Council Meeting Minutes

Date:	**Tuesday, 29 June, 2021**
Time:	**9:00 a.m.**
Location:	**Council Chamber** **Forum North, Rust Avenue** **Whangarei**
In Attendance	**Her Worship the Mayor Sheryl Mai (Chairperson)** **Cr Gavin Benney (Virtually)** **Cr Vince Cocurullo** **Cr Nicholas Connop** **Cr Ken Couper** **Cr Tricia Cutforth** **Cr Shelley Deeming** **Cr Jayne Golightly** **Cr Phil Halse** **Cr Greg Innes** **Cr Greg Martin** **Cr Anna Murphy** **Cr Carol Peters** **Cr Simon Reid**
Scribe	**C Brindle (Senior Democracy Adviser)**

---

1. Karakia/Prayer

Cr Cocurullo opened the meeting with a karakia/prayer.

Crs Cutforth and Murphy joined the meeting at 9.01am following the karakia/prayer.

3. Apologies

There were no apologies.

4. Decision Reports

4.1 Three Waters Reform - Council's Next Steps

That the Whangarei District Council

1. Notes that participation in the Government's three waters reform is voluntary with the ability for Councils to "opt out" of the reform process;
2. Notes that the Memorandum of Understanding with government which provides for WDC to be part of the three waters reform process expires on 30 June 2021;
3. Notes that the Department of Internal Affairs has refused an Official Information Act (OIA) request to provide WDC with specific information which shows that Whangarei ratepayers would be better off under the reform programme;
4. Provisionally exercises its right to "opt-out" of the Governments three waters reform process until new information, that confirms ratepayers would be better off by Council participating in the reforms, is provided.
5. Requests the Mayor and Chief Executive to write to the Chief Executive of the Department of Internal Affairs advising that WDC intends to formally withdraw from the three waters reforms.

On the motion being put Cr Deeming called for a division:

	For	**Against**	**Abstain**
Her Worship the Mayor	X		
Cr Gavin Benney	X		
Cr Vince Cocurullo	X		
Cr Nicholas Connop	X		
Cr Ken Couper	X		
Cr Tricia Cutforth	X		
Cr Shelley Deeming	X		
Cr Jayne Golightly	X		
Cr Phil Halse	X		
Cr Greg Innes	X		
Cr Greg Martin	X		
Cr Anna Murphy	X		
Cr Carol Peters	X		
Cr Simon Reid	X		
Results	**14**	**0**	**0**

The Motion was Carried (14 to 0)
Unanimous

Council Workshop

Tuesday, 29th June 2021

Whangarei District Council

1

Background, Water Reform - Progress to date…

- Water Reform ongoing since 2017
- Significant documents and Cabinet papers available
- Cabinet Paper 14 December 2020
- Water Reform Workshop 30 March – Report now available
- Waiting for Council RFI information and Council specific Packages
- Boundaries and number of entities soon to be available.

Whangarei District Council

2

Opt-in, Opt-out, or Compulsory Reform?

- RFI – This was "Opt-in"
- Cabinet Paper 14 December 2020 – Changed the process to "Opt-out".
  - However, noted in the Cabinet paper was that if the objectives of the reforms were at risk, the reform may be made mandated.
  - Local Government response.
  - Risks for the Reform and what that may mean for a mandated reform.

Whangarei District Council

3

Options Review for a Northland Delivery Entity

- Multi-Regional Water CCO Plus separate Northland combined Authority ranked highest
- Highest ranked Whangarei Only option was a Three Waters Enterprise Entity.
- Combined analysis highest ranking was Multi-Regional Water CCO Plus separate Northland combined Authority (Highest Northland option was Northland asset owning water CCO plus Northland Combined Authority.

Whangarei District Council

4

Issues to Consider…

- Cost Impact on Council Post Reform
- Local Government and individual councils “not being worse off”
- What would “opt-out” look like?

Whangarei District Council

5

Government Proposal Pros/Cons

- WDC avoids the large costs arising from reforms
- Helps WDC relationship with government
- Potentially allows other parts of Northland and Auckland to contribute to the costs of waters infrastructure in Whangarei
- Potentially some incentives, as Government has stated that councils will be “no worse off” as a result of the reforms
- Focus on new initiatives provided by the government
- Reduce risk given the new regulators heavy hand
- **Cons**
- Potentially requires Whangarei ratepayers to contribute to the costs of waters infrastructure in other parts of Northland and Auckland.
- Loss of control of WDC infrastructure and services
- Ratepayers face extra costs for waters from reforms
- Reduced spatial planning capability, and limited ‘one stop shop’ infrastructure planning ability
- Potential for reduced Level of service (wastewater overflows)
- Balanced budget issues with the removal of waters revenue
- Reduced overall organization FTE and capability
- Stranded overhead
- Risk of LG Reform post waters removal

Whangarei District Council

6

Go it alone – Pros/Cons

- **Pros**
- Whangarei people retain control through WDC of the water assets
- WDC assets seem to be in good condition
- WDC retains a higher borrowing capacity
- Stronger negotiating position with Government
- Better land management planning
- Maintain a degree of scale
- **Cons**
- WDC fronts all the large cost increases arising from the reforms
- Will harm our relationship with Government
- Risk what WDC will not be able to afford the cost increases that come from the reforms
- Risk that WDC will miss out on the incentives offered by Government
- Risks associated with compliance

Whangarei District Council

7

Question to Consider…

- Are you comfortable with 'Whangarei Waters' being joined with Auckland as part of this process?
- Do you wish to stay in, or seek to "opt Out" of the Reform?
- What Concessions or compensation would you expect from government to support the reforms?
  - Next Steps…

Whangarei District Council

8

Information Only

Government Reform Objectives.

A **Significantly improving safety and quality of drinking water services**, and the environmental performance of wastewater and stormwater systems.

B **Ensuring all New Zealanders have equitable access** to affordable three waters services.

C **Improving resource coordination and unlocking strategic opportunities** to consider national infrastructure needs at a larger scale.

D **Increasing resilience of three waters service provision** to both short- and long-term risks and events, particularly climate change and natural hazards.

E **Moving three waters services to a more financially sustainable footing**, and addressing the affordability and capability challenges faced by small suppliers and councils.

F **Improving transparency and accountability in cost and delivery of three waters services**, including the ability to benchmark performance of service providers.

Whangarei District Council

9

Information Only

Reform design features… Provides insight into the future…

Design features that the **proposed** reform programme should examine, as a minimum:

A **Water service delivery entities** that are:

- **of significant scale** (most likely multi-regional) to enable benefits from aggregation to be achieved over the medium- to long-term;
- **asset-owning entities** with balance sheet separation, to support improved access to capital, alternative funding instruments and improved balance sheet strength; and
- **structured as statutory entities** with appropriate and relevant commercial disciplines and competency-based boards.

B **Delivery of drinking water and wastewater services as a priority**, with the ability to extend to stormwater service provision only where effective and efficient to do so.

C **Publicly owned entities**, with a preference for collective council ownership.

D **Mechanisms for enabling iwi /Māori and communities** to provide input in relation to the new entities.

Whangarei District Council

10

3 Waters

Potential financial impacts

Whangarei District Council

11

Assumptions

- Very high-level calculations based on draft financial statements from LTP Consultation model with Oruku Landing CEC removed.
- Assumes reforms happen immediately - just so we can show the impacts over 10 years
- Removes all revenue, expenses and debt allocated to 3 water activities
- Future Reserves added to future debt (as no longer available to fund non-waters CapEx)
- No adjustment made for current Reserve balances
- Assumes rates revenue will reduce by the portion of general rates currently allocated to fund stormwater
- No adjustments made for overhead costs (e.g. corporate allocations). Assumes all costs allocated and incurred by 3 waters activities are removed.
- No adjustments have been made to interest calculations
- NZTA revenue based on LTP (reduction in subsidy will lower debt capacity and negatively impact balanced budget)

Whangarei District Council

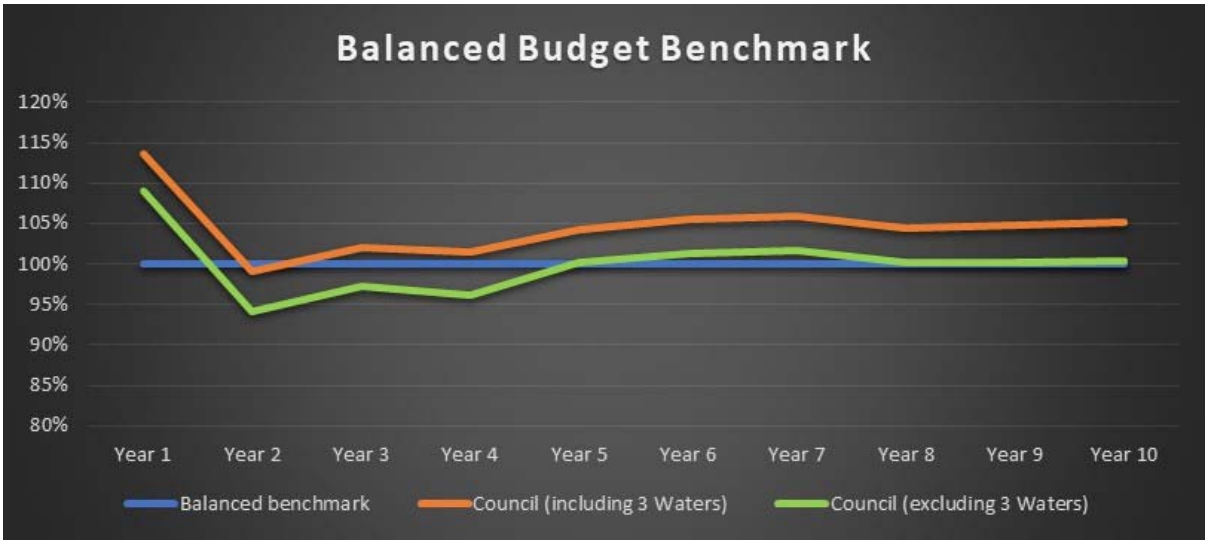
12

Impacts

- Targeted rates are used to fund **OpEx** (Income Statement) and **CapEx** (balance sheet) so impact on balanced budget and debt capacity will be significant.
- The removal of 3 waters rates will impact our **balanced budget adversely**.
  - Wastewater revenue exceeds spend (we are currently building a credit reserve) and we are funding capital projects directly, rather than with debt
- This reduced revenue will see our **ability to borrow reduce**
  - Debt to Revenue ratio is the limiting factor

Whangarei District Council

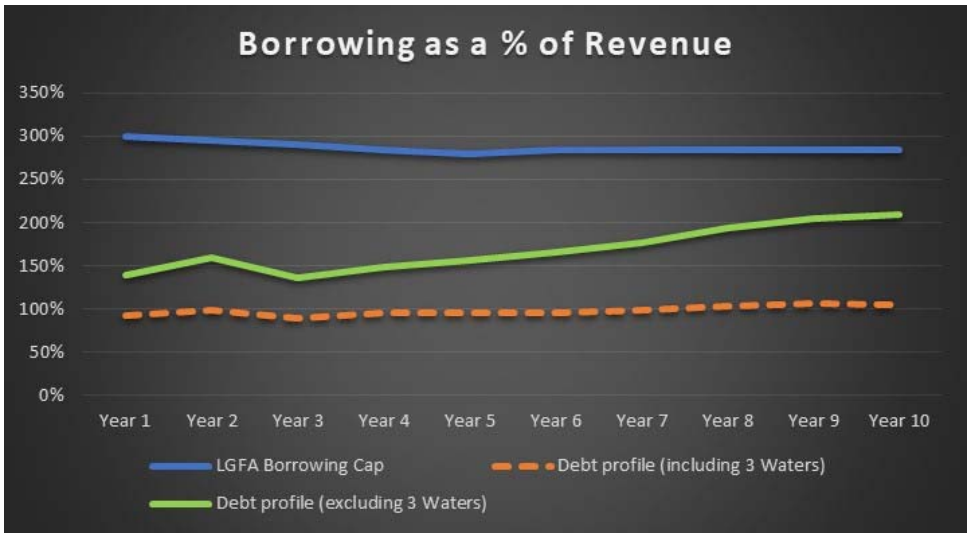
13



- Current situation vs. what it might look like if 3 waters are removed
- Very rough calculation. Depends on overhead costs.
- Shows at the current rates level we will struggle to achieve a balanced budget

Whangarei District Council

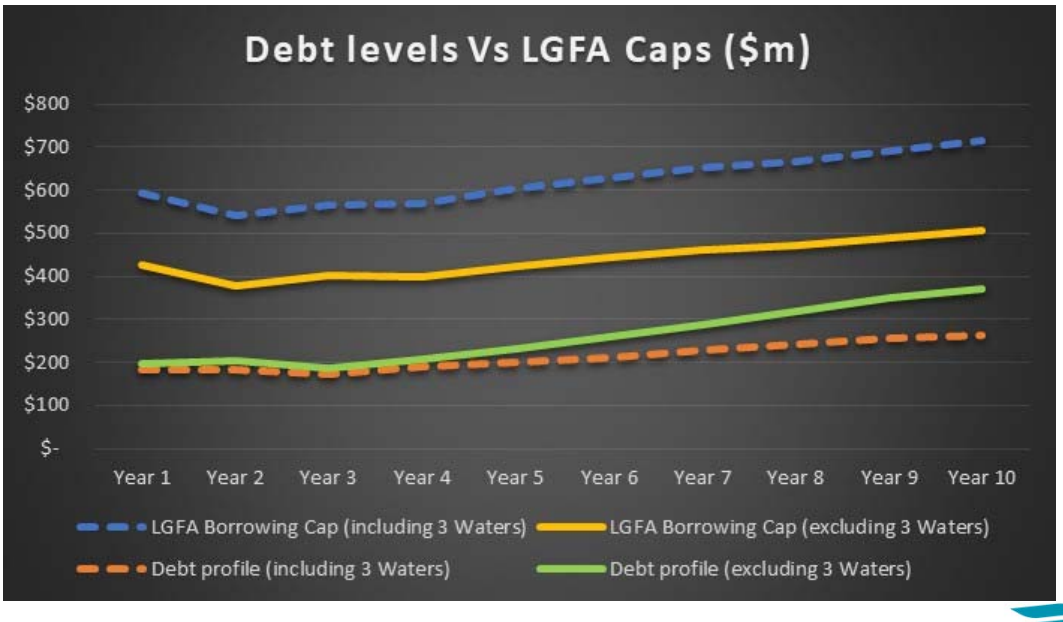
14



- High level calculations. Remaining activities debt will increase as we won't have the surplus from wastewater to 'borrow' via internal borrowing.
- Assumes we retain current debt levels (i.e. no compensation received on assets transferred out)
- Shows we are still within LGFA covenants.

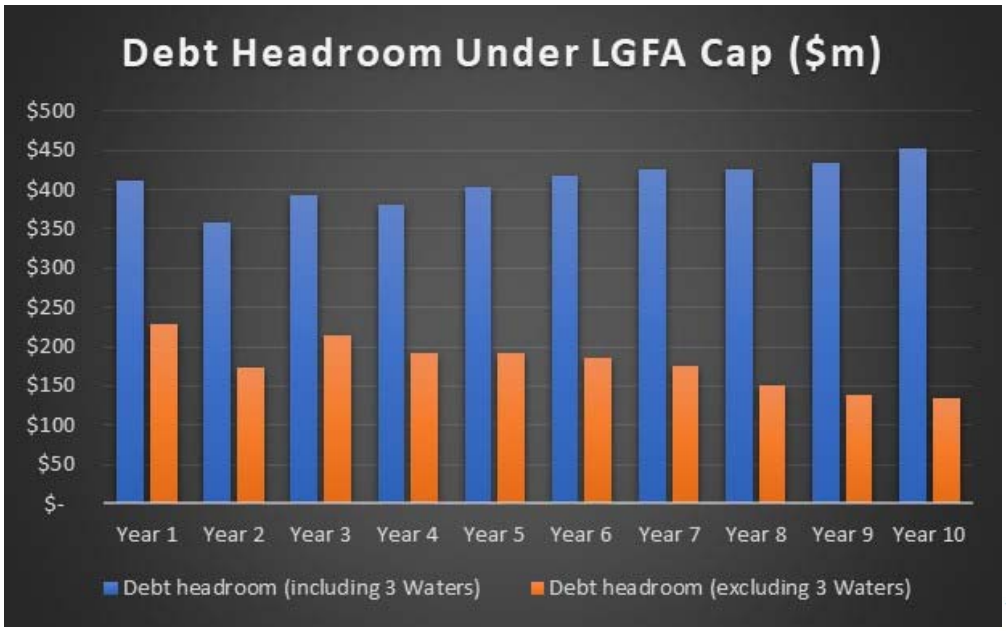
Whangarei District Council

15



Whangarei District Council

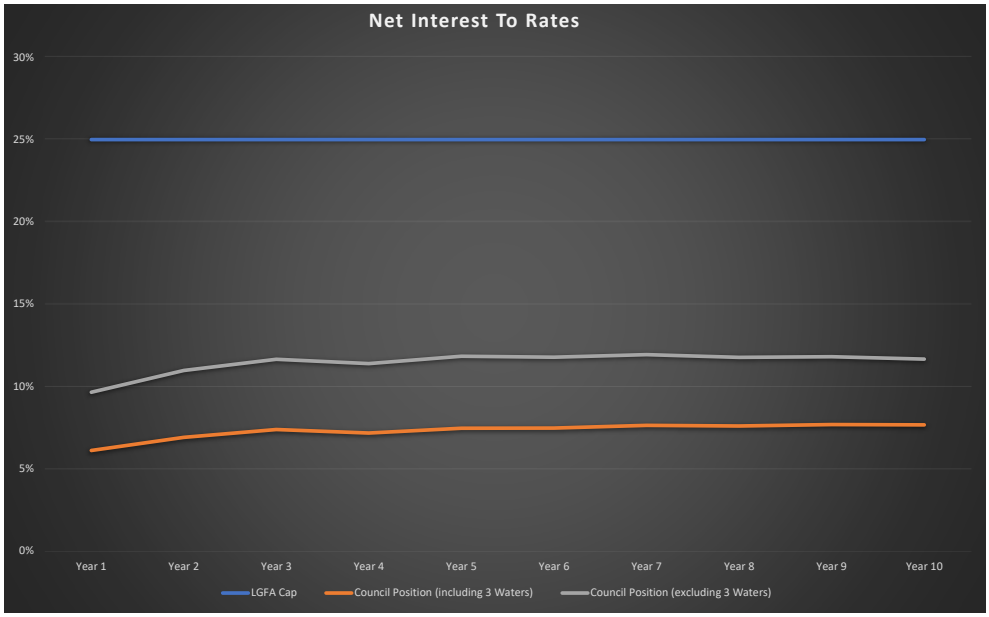
16



Whangarei District Council

17

Net Interest to Rates



Whangarei District Council

18

Debt servicing benchmark

- This benchmark measures interest as a percentage of revenue.
- Financial prudence limit is 15%, LGFA limit is 20%
- Still well within this limit in either scenario

Whangarei District Council

19

Unknowns

- How will this impact our credit rating?
- What about credit reserve balances? Will we have to pay these across?
- Will we be compensated for our assets?
- How will this impact our debt?
- What about development contributions already collected?

Whangarei District Council

20

"Model report" – for Chief Executives to draw from when reporting to/briefing their councils on the next stages of three waters service delivery reform

Version 0.2 5 August 2021

[EXAMPLE] Purpose

This report updates the [Name] Council on

- the Government's 30 June 2021 and 15 July 2021 Three Waters Reform announcements, which change the reform process previously outlined in 2020
- the specific data and modelling Council has received to date
- the implications of the revised Three Waters Reform proposal for Council and alternative service delivery options
- next steps (including uncertainties).

[EXAMPLE] Recommendations

That Council:

1) **notes** the Government's 30 June and 15 July 2021 Three Waters Reform announcements
2) **notes** officer's advice on the accuracy of the information provided to Council in June and July 2021 as a result of the RFI and WICS modelling processes
3) **notes** officer's analysis of the impacts of the Government's proposed three water service delivery model on the [XX] community and its wellbeing, including the impacts on the delivery of water services and water related outcomes, capability and capacity, on [NAME] Council's sustainability (including rating impact, debt impact, and efficiency) and
   a) [BEST PRACTICE - INCLUDE HIGH LEVEL CONCLUSION HERE SO IT CAN EXIST AS A STANDALONE DECISION IN YOUR MINUTES WITHOUT GOING BACK TO THE REPORT]
4) **notes** the analysis of three waters service delivery options available to Council at this time provided in [Report XX/YY]
5) **notes** that a decision to support the Government's preferred three waters service delivery option is not lawful (would be ultra vires) at present due to section 130 of the Local Government Act 2002 (LGA), which prohibits Council from divesting its ownership or interest in a water service except to another local government organisation, and what we currently know (and don't know) about the Government's preferred option
6) **notes** that Council cannot make a formal decision on a regional option for three waters service delivery without doing a Long Term Plan (LTP) amendment and ensuring it meets section 130 of the LGA
7) **notes** that the Government intends to make further decisions about the three waters service delivery model after 30 September 2021

8) **notes** that it would be desirable to gain an understanding of the community's views once Council has further information from the Government on the next steps in the reform process

9) **requests** the CEO to seek guidance on and/or give feedback to the Government on

   a) the following areas of the Government's proposal that Council needs more information on [INSERT AREAS]

   b) the following changes to the Government's proposal/process [Insert areas]

10) **notes** that the CEO will report back further once they have received further information and guidance from Government [,LGNZ and Taituarā] on what the next steps look like and how these should be managed

11) **in noting the above**, **agrees** it has given consideration sections 76, 77, 78, and 79 of the Local Government Act 2002 and in its judgment considers it has complied with the decision making process that those sections require (including, but not limited to, having sufficient information and analysis that is proportionate to the decisions being made).

1. [EXAMPLE] Summary

1.1. Over the past four years the central and local government have been considering the issues and opportunities facing the system for regulating and managing the three waters (drinking water, wastewater, and stormwater) – Three Water Reform. The background is provided in Attachment 1 including information on Taumata Arowai (which became a new Crown entity in March 2021 and will become the dedicated water services regulator later this year).

1.2. The Government has concluded that the case for change[1] to the three waters service delivery system has been made [please see Attachment 2 for further information] and during June and July 2021 it released information and made announcements on:

- the direction and form of Three Waters Reform, including proposed new Water Service Entities (four and their indicative boundaries), their governance arrangements and public ownership
- individual (WICS) Council data based on the information supplied under the RFI process
- a package of investment ($2.5b) for councils to invest in the future for local government, urban development, and the wellbeing of communities, ensuring no council is worse off as a result of the reforms, and funding support for transition
- an eight-week process for councils to understand the implications of the reform announcements, ask questions and propose solutions and for Government to work with councils and mana whenua on key aspects of the reform (including governance, integrated planning and community voice).

1.3. Council has been placed in Entity [X] and our better off funding allocation is [XX]

[1] Transforming the system for delivering three waters services (dia.govt.nz); https://www.dia.govt.nz/diawebsite.nsf/Files/Three-waters-reform-programme/$file/transforming-the-system-for-delivering-three-waters-services-the-case-for-change-and-summary-of-proposals-30-june-2021.pdf

1.4. While the Government and LGNZ consider that national case for change has been made, each council will ultimately need to make a decision based on its local context if the process to join one of the proposed entities remains voluntary.

1.5. This report provides Council will the staff analysis of the information provided and assesses the Government's proposal and currently available service delivery options. In preparing it officers have [note – adjust this section for your own process] used the Local Government New Zealand, Taituarā, and Te Tari Taiwhenua Internal Affairs guidance[2] and our risk framework and policy to assist Council to understand the information that has been provided to date and enable Council to prepare for future decisions and consultation and engagement with communities. Key risks considered are documented in the report and attachments five and seven.

1.6. In summary, **[to be completed by each Council using information in this report and underlying council analysis. An example follows. You can insert any summary tables that assist you to paint the picture at a glance, eg the table at section 6]**

- Our Council specific information looks broadly correct **[insert any issues raised with DIA for correction].**
- Given the peer reviews of the modelling and underlying assumptions (which always carry a degree of uncertainty) no further analysis of this work has been done or is proposed and staff have focussed on the reasonably practicable options and their implications for Council and the community.
- Doing nothing is not an option, as Council must continue to deliver services
- **Option A - Government proposal:** The greater financial capability, efficiency, affordability and community/water benefits (as published by Government) of delivering three waters to the community by the proposed new Water Services Entities are likely to be of significant value if they can be realised.

  Our analysis suggests there should be reduced risk to council (non-compliance with standards and processes, lower costs for delivery, procurement). Council also would not be responsible if a non-council supplier couldn't meet standards.

  There are risks that need to be mitigated including integration with spatial, growth and local planning and transparent prioritisation, households' ability to pay, and Council's financial sustainability [**some councils will be able to state whether the risks fit within their council's risk appetite]**. There are several risks associated with transition to this model, many of which are outside of Council's control and are noted in the transition section of the report.
- **Option B - Delivery of three water services by Council:** The potential benefits of this option include greater Council control and more certainty over local infrastructure integration (planning and delivery) with land use plans and council objectives. Council however faces [significant] risks over the [short/medium/longer term], including potentially high costs, in meeting the new water standards, environmental requirements and achieving compliance. The ability of non-Council water supplies to meet standards and requirements also poses a [small/medium/high…] risk to Council and the community.

[2] https://www.lgnz.co.nz/assets/Three-Waters-Guidance-for-councils-over-the-next-eight-weeks-FINAL.pdf

- The causes of most of these risks are not within Council's control. This makes mitigation difficult, and many potential mitigation options (such as greater investment, larger costs than currently planned, lower levels of service, compliance risk) may not be palatable to Council or the community. [**some councils will be able to state whether the risks fit within their council's risk appetite**].
- **Option C - Delivery of three water services by Council at a higher level of service level and investment** is a realistic but difficult to assess option within the eight week timeframe. The issues and opportunities associated with this option are broadly the same as for Council delivering three waters at the service levels forecast in the LTP 2021-31. There is likely better integration with Council outcomes, objectives and plans, but even if Council can predict the investment required to meet the new water standards, environmental requirements and compliance requirements in the short term, the costs of service provision and levels of service may change significantly over the next 30 years, causing affordability issues for households, lower levels of service and compliance risks for Council.
- **Option D - Regional aggregation of three waters services in a Council Controlled Organisation [asset owning]:** While councils would still need to be satisfied that the changing regulatory environment was adequately provided for, including ensuring there was sufficient funding to meet legal and regulatory obligations due to scale, this option (better) addresses the risk that the size of investment required to meet new standards and community expectations is greater than forecast by individual councils
  - it enables an organisation to focus on the group's three water challenges and prioritise investment decisions across the region, which should lead to better environmental and community outcomes
  - it provides for greater strategic, management and operational capacity and capability, workforce development and planning
  - it enables efficiencies (in planning, programming, procurement and delivery)

  and should as a result reduce household costs and increase affordability. There are however integration risks with spatial, growth and local planning and uncertainties around the future costs to households.
- **[TABLE SUMMARY IF AVAILABLE / PREFERRED CAN BE INSERTED]**

1.7. Under all options except the Government proposal, Council bears the risk of meeting the new water standards, environmental requirements and achieving compliance. There are also implications and challenges for non-Council supplies to meet water quality requirements, with the risk that these supplies might default to Council in the future.

1.8. Other Government reforms (Resource Management Act, Future of Local Government) pose opportunities and challenges for each option.

1.9. Managing transition risks are likely to pose a greater challenge for Council (and others in its grouping) than the risks associated with the Government proposal. If the Government's proposal were to proceed, effective management of the transition by Council, Government and partners will be critical.

1.10. The law currently prohibits Council's deciding to opt-in to the current proposal (given section 130 of the Local Government Act 2002 and what we know about this option at present). Current decision-making requirements, including the need to take account of community views and strategic nature of the assets involved, would also preclude Council deciding to opt-in at this time without consultation.

1.11. Similar requirements apply if the council wishes to consider alternative arrangements that involve asset transfers, divestment, change in ownership and or the setting up of a Council Controlled Organisation (CCO) to deliver water services in the future.

1.12. There are a number of issues, concerns and uncertainties for the Government and councils to work through before a robust Council decision (and decision-making process) can be produced, including whether legislative change will enable or require the Water Services Entity or CCO approach to be adopted. Therefore, there is no expectation that councils will make a decision to opt-in (or out) or commence community engagement or consultation over the eight-week period.

1.13. Councils have been specifically asked to provide solutions to three outstanding issues during the next eight weeks:

- ensuring all communities have both a voice in the system and influence over local decisions
- effective representation on the new water service entities' oversight boards, including preventing future privatisation
- ensuring integration between growth planning and water services planning.

1.14. Staff therefore request Elected Members consider the issues that arise from the Government's proposal and any potential solutions so these can be raised with Government and LGNZ before the end of September 2021.

1.15. Government decisions on entity boundaries, governance and transition and implementation arrangements will occur after the eight week-process ends (30 September 2021).

1.16. On the assumption that the reform goes ahead, it is anticipated that councils will continue to deliver water services until at least early 2024 and council involvement in transition will be required throughout.

NB Author advice - Don't attach the legal advice or refer to it (e.g. our legal advice said …; quotes etc) as you will risk waiving legal privilege for the sector on the reform – not just your council.

2. Background and context [to edit down / or add information from attachments 1, 2 and 3 based on previous levels of reporting / briefing to council]

2.1. Following the serious campylobacter outbreak in 2016 and the Government's Inquiry into Havelock North Drinking Water, central and local government have been considering the issues and opportunities facing the system for regulating and managing the three waters (drinking water, wastewater, and stormwater).

2.2. The focus has been on how to ensure safe drinking water, improve the environmental performance and transparency of wastewater and stormwater network and deal with funding and affordability challenges, particularly for communities with small rating bases or high-growth areas that have reached their prudential borrowing limits.

2.3. The Government's stated direction of travel has been for publicly-owned multi-regional models for (with a preference for local authority ownership). The Department of Internal Affairs (DIA), in partnership with the Three Waters Steering Committee (which includes elected members and staff from local government commissioned specialist economic, financial, regulatory and technical expertise to support the Three Waters Reform Programme and inform policy advice to ministers.

2.4. The initial stage (Tranche 1 - MOU, Funding Agreement, Delivery Plan and RFI process) was an opt in, non-binding approach. It did not require councils to commit to future phases of the reform programme, to transfer their assets and/or liabilities, or establish new water entities. The 2020 indicative reform programme and then anticipated next steps can be found in Attachment 1.

2.5. Council completed the RFI process over Christmas and New Year 2020/21 and the Government has used this information, evidence, and modelling to make preliminary decisions on the next stages of reform and has concluded that the case for change has been made [Attachment 2].

3. Government's June and July 2021 announcements and information releases [to edit / place in an attachment / use attachment information provided based on previous levels of reporting to council]

3.1. In June 2021 a suite of information was released by Government that covered estimated potential investment requirements for New Zealand, scope for efficiency gains from transformation of the three waters service and the potential economic (efficiency) impacts of various aggregation scenarios.[3]

[3] This information, including peer reviews and the Minister's briefing can be accessed at: https://www.dia.govt.nz/Three-Waters-Reform-Programme and release-of-second-stage-evidence-base-released-june-2021.

3.2. In summary the modelling indicated a likely range for future investment requirements at a national level in the order of $120 billion to $185 billion, an average household cost for most councils on a standalone basis to be between $1910 and $8690 by 2051. It also estimated these average household costs could be reduced to between $800 and $1640 per household and efficiencies in the range of 45% over 15-30 years if the reform process went ahead. An additional 5,800 to 9,300 jobs and an increase in GDP of between $14b to $23b in (Nett Present Value, NPV terms over 30 years were also forecast.

3.3. As a result of this modelling, the Government has decided to:

- **establish four statutory**, **publicly-owned water services entities** that **own and operate three waters infrastructure on behalf of local authorities**
- **establish independent, competency-based boards to govern**
- set a clear national policy direction for the three waters sector, including integration with any new spatial / resource management planning processes
- establish **an economic regulation regime**
- develop an industry transformation strategy.

The proposed safeguards against privatisation can be found on page 26 of the DIA's summary of the case for change.

3.4. Both DIA and LGNZ have produced two page national overviews, available on the DIA website[4] and LGNZ websites[5] respectively. Attachment 2 contains more detail on the national context and Attachment 3 provides the DIA/LGNZ overviews. **[You don't need to include both but for ease of reference they are both there if you wish to include either of them]**

3.5. We have been placed in Water Services Entity X **[can describe boundaries or use one of the following maps enlarged / reformatted as required]**, although the precise boundaries are still up for discussion.

[4] 2872-DIA-A3-A New Water with-without reform Map 20210526 v2.7

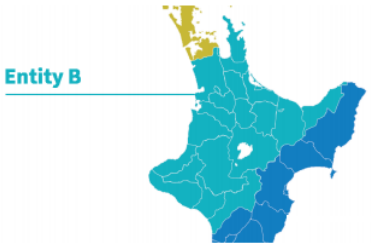
[5] Three-Waters-101-Infographic.pdf (lgnz.co.nz)

Entity A

Auckland
Far North
Kaipara
Whangarei

	Entity A
Connected population (2020)	1.7m
Average household cost (2051, real)[1]	
With reform	$800
Without reform	$2,170

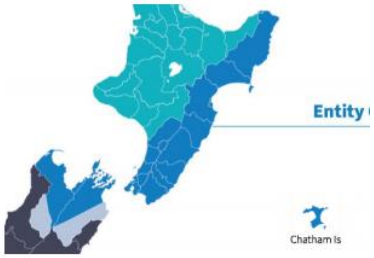
Entity B



Hamilton
Hauraki
Kawerau
Matamata-Piako
New Plymouth
Opotiki
Otorohanga
Rangitikei
Rotorua Lakes
Ruapehu
South Taranaki
South Waikato
Stratford
Taupo
Tauranga
Thames-Coromandel
Waikato
Waipa
Waitomo
Western Bay of Plenty
Whakatane
Whanganui

	Entity B
Connected population (2020)	0.8m
Average household cost (2051, real)[1]	
With reform	$1,220
Without reform	$4,300

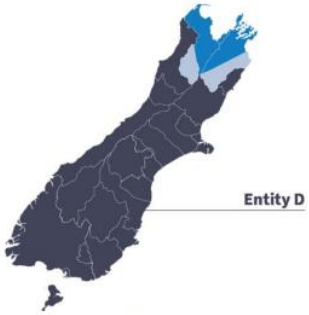
Entity C



Carterton
Central Hawke's Bay
Chatham Islands
Gisborne
Hastings
Horowhenua
Kapiti Coast
Lower Hutt
Manawatu
Marlborough
Masterton
Napier
Nelson
Palmerston North
Porirua
South Wairarapa
Tararua
Tasman
Upper Hutt
Wairoa
Wellington

	Entity C
Connected population (2020)	1.0m
Average household cost (2051, real)[1]	
With reform	$1,260
Without reform	$3,730

Entity D



Ashburton
Buller
Central Otago
Christchurch
Clutha
Dunedin
Gore
Grey
Hurunui
Invercargill
Kaikoura
Mackenzie
Queenstown Lakes
Selwyn
Southland
Timaru
Waimakariri
Waimate
Waitaki
Westland

	Entity D
Connected population (2020)	0.9m
Average household cost (2051, real)[1]	
With reform	$1,640
Without reform	$4,970

3.6. On 15 July, in partnership with LGNZ under a Heads of Agreement[6], the Government announced a package of $2.5 billion to support councils to transition to the new water entities and to invest in community wellbeing. This funding is made up of a '**better off' element** ($500 million will be available from 1 July 2022 with the investment funded $1 billion from the Crown and $1 billion from the new Water Services Entities) and **'no council worse off' element** (available from July 2024 and funded by the Water Services Entities)**.** The "**better off"** funding can be used to support the delivery of local wellbeing outcomes associated with climate change and resilience, housing and local placemaking, and there is an expectation that councils will engage with iwi/Māori in determining how to use their funding allocation.

3.7. **Council's funding allocation is [XX]**. The detail of the funding (including expectations around the use of reserves) and the full list of allocations found in Attachment 4. Conditions associated with the package of funding have yet to be worked through.

3.8. In addition to the funding announcements, the Government has committed to further discussions with local government and iwi/Māori over the next eight weeks on:

- the boundaries of the Water Service Entities
- how local authorities can continue to have influence on service outcomes and other issues of importance to their communities (eg chlorine-free water)
- ensuring there is appropriate integration between the needs, planning and priorities of local authorities and those of the Water Service Entities
- how to strengthen the accountability of the Water Service Entities to the communities that they serve, for example through a water ombudsman.

3.9. As a result, the original timetable for implementing the reform (outlined in Attachment 1) and for councils to consult on a decision to opt-in (or not), no longer applies. Further advice on the difficulties and risks of making a decision to opt-in or not is included at section X of this report.

3.10. Next steps are expected to be announced after 31 September 2021, which would include the timeframes and responsibilities for any community or public consultation.

3.11. It is also important to note that the Government has not ruled out legislating for an "all-in" approach to reform to realise the national interest benefits of the reform.

3.12. In the interim the DIA continues to engage with council staff on transition matters on a no regrets should the reform proceed. These discussions do not pre-empt any decisions about whether to progress the reforms or whether any individual council will transition.

3.13. On the assumption that the reform goes ahead, it is anticipated that councils will continue to deliver water services until at least early 2024 and council involvement in transition will be required throughout.

4. Council specific information and analysis

4.1. While the Government and LGNZ consider that national case for change has been made, each council will ultimately need to make a decision based on its local context.

---

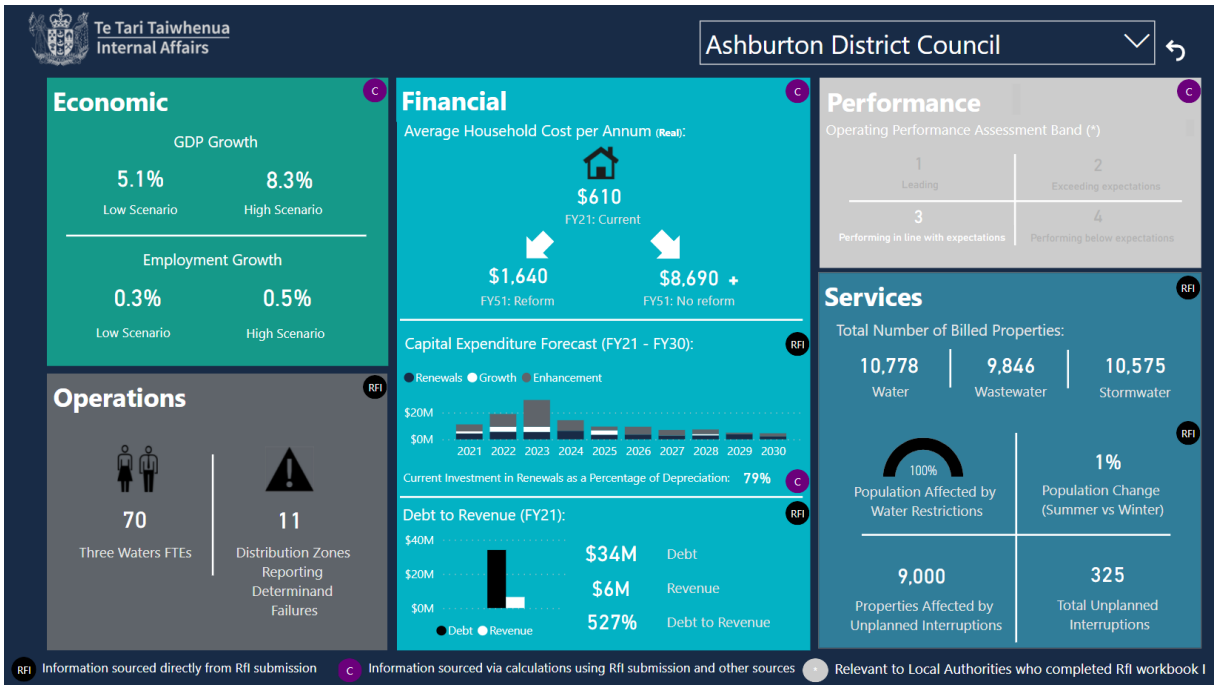
[6] https://www.dia.govt.nz/diawebsite.nsf/Files/Three-waters-reform-programme/$file/heads-of-agreement-partnering-commitment-to-support-three-waters-service-delivery-reform.pdf

4.2. Councils do not have a national interest test for their decision making. Councils are required to act in the interests of their communities and the community's wellbeing (now and into the future), provide opportunities for Māori to contribute to their decision-making processes, ensure prudent stewardship and the efficient and effective use of its resources in the interests of the district or region (including planning effectively for the future management of its assets) and take a sustainable development approach[7].

[Can insert a table version of the below if you wish. Suggest appendix can be used for more comprehensive analysis if the Council has it]

4.3. Council currently delivers three waters as [INSERT AS APPROPRIATE - a standalone entity – contracted out service/ mix of inhouse and contracted out etc /part of a shared service/through a CCO (non-asset owning) etc].

4.4. Our dashboard looks like this:



[INSERT OWN DASHBOARD]

4.5. It, and the dashboards of other councils, can be accessed on this site[8].

4.6. The key aspects Council should note are detailed below.

4.7. Average cost of per household -

- the DIA (based on several assumptions) states it is $X,XXX; our council based on the 2021/22 Plan is $X,XXX
- projected out to 2031 (again based on assumptions) is $X,XXX (DIA – inflation stripped out) and our council (based on year 10 of the LTP 2021-31) is $X,XXX (inflation stripped out)

[7] See for example sections 5 and 14 of the LGA.

[8] https://app.powerbi.com/view?r=eyJrIjoiOGE1OTJlYWUtZDZkNy00YWZjLTgzN2EtOTY1MzQxNGM5NzJmIiwidCI6ImY2NTljYTVjLWZjNDctNGU5Ni1iMjRkLTE0Yzk1ZGYxM2FjYiJ9

- DIA's reform (Entity X) projects $x,xxx by 2051

4.8. Debt –

- **[in addition to own numbers cf modelling, could include a graph with three waters debt transferred/gone.]**
- **[Also insert here any issues re lower debt because of the use of rates/depreciation to fund asset renewals / upgrades, low debt because Council hasn't invested in necessary upgrades / new plant etc using debt/at all]**
- **[Insert here any issues with delivering necessary upgrades / new plant etc because at / near debt ceiling and /or interest and depreciation costs affecting rates affordability etc.]**

4.9. Capital Expenditure Forecast –

- The DIA are forecasting $x
- Our own information demonstrates that there is significant [moderate] investment required over the next 10 years of our Long Term Plan and out across 30 years in our infrastructure strategy, underpinned by assumptions that regulatory standards will tighten and that there will be more monitoring and enforcement in the future.
- **[can insert own LTP / Infrastructure strategy information if useful, including any limitations known – e.g. debt ceiling, rate affordability]**
- In addition, Council has the following upgrades / additional plant and treatment capital works and investment planned beyond the 10 years of the LTP 2021/31:
    - XX at $YY in [Year]
    - XX
    - XX
    - XX

  Only works **a,b, c** have a fully costed business case against known standards. The remainder [**and the works required to meet future standards and resource consent renewals beyond the next 10/15/20/30 years**] are only [rough] estimates [based on XX e.g. historic investment] or largely unknown and will/will not be able to be quantified with any degree of accuracy before October 2021.

- Council investment in stormwater

NB for many councils you might only be able to say that there will be further costs associated with investment in stormwater in the future. However, at this stage Council does not know what these standards may be or the investment required so the Council's own information on the costs beyond year 5 [or 10] are unreliable.

4.10. Our asset condition, performance (and confidence) levels for

- water are [low, medium, high]
- wastewater are [low, medium, high]
- stormwater are [low, medium, high]

Our maintenance budgets are [adequate for today, the next 3 years, next 10 years, next 30 years – or suitable alternative for your situation].

4.11. [**Insert statement about carbon emissions or put this in your analysis of the status quo** E.g Wastewater dominates/is a significant contributor to Council's carbon emissions. Our emissions reduction plan and funding for it is / is unlikely to be sufficient to address our short, medium and long term responsibilities including NZ Emissions Trading requirements.]

4.12. [Insert climate change impacts on three waters service delivery – e.g. from your LTP assumptions or studies]

4.13. [Inset any challenges in developing resilience to respond to floods, slips, infiltration and coastal inundation if not covered above]

4.14. [**FOR COUNCILS WITH PRIVATE/COMMUNITY/RURAL WATER SUPPLIERS -** There is also the potential for Council to have to work with and potentially take over the following water supplies if they are unable to meet quality standards and regulatory requirements:

- Mm [risk – low, medium, high – and why and any mitigation in place]
- Mm [risk – low, medium, high – and why and any mitigation in place]
- Mm [risk – low, medium, high – and why and any mitigation in place]

4.15. There are a few other specific items that I would like to draw Council's attention to. They are:

- [INSERT HERE ANY CONCERNS / OPPORTUNITIES / ISSUES COUNCIL IS FACING E.G. matching infrastructure to growth (to enable housing etc), previous conclusions on three waters service delivery – e.g. studies carried out - Hawkes Bay , Council's Audit opinion – matters of emphasis/qualifications/changes made to address affordability/debt ceiling issues, Joint ventures / water storage / CCOs and loans, other matters affecting social, cultural and environmental wellbeing]

4.16. Council has not budgeted to not comply with the law (and any applicable standards, rules or regulations or enforcement undertakings).

4.17. Against the above information, in general the Dashboard and underlying information for the next 10 [30] years

- [looks broadly accurate when compared with council's own information and LTP 2021-31/contains some inaccuracies/is fundamentally flawed and Council [staff] have conveyed this to DIA and corrections have been made/we are awaiting corrections].

4.18. While prepared at the national level, it has been peer reviewed by Farrierswier and Beca to ensure that both the modelling and underlying assumptions are reasonable in the New Zealand context. It therefore provides a reasonable indication of the "order of magnitude"[9] of the gains that can be delivered though the new system and the level of future investment Council is likely to need to make over the next 30 years.

[9] Page iv, 2021, Farrierswier, Three Waters Reform, Review of methodology and assumptions underpinning economic analysis of aggregation available at https://www.dia.govt.nz/diawebsite.nsf/Files/Three-waters-reform-programme/$file/farrierswier-three-waters-reform-programme-review-of-wics-methodology-and-assumptions-underpinning-economic-analysis-of-aggregation-released-june-2021.pdf

4.19. At this stage it is not possible to fully test the projections as the standards for Aoteraoa/New Zealand out to 2051 are not known, although it is reasonable to assume that there will be greater community and mana whenua expectations around environmental performance and quality, tougher standards to meet for water quality (drinking and receiving environment) and that monitoring, compliance and enforcement will be greater than it is now. This affects both operational and capital expenditure (costs will go up), including the number of staff (or contractors) that council will need to ensure Council outcomes for water and community and legal requirements are met.

4.20. There is always a level of uncertainty and therefore risk around assumptions and forecasts, whether prepared by us for our LTPs or by others such as Government to facilitate policy decisions, such as the current Three Waters Reform process. [I/we/staff] consider that it would not be a good use of Council's limited resources to spend time and money on a detailed review of the assumptions and modelling.

4.21. Council staff have used the above dashboard and additional information, and Council plans and studies (as described above) to define the status quo option in section 5 below.

4.22. To assess whether the proposed better off and no worse funding to Council [$XX] is sufficient Council needs further information on the conditions that will be associated with that funding. For the purposes of the following analysis it is assumed that this funding would provide Council with an opportunity to address a range of issues and opportunities to improve community wellbeing in partnership with mana whenua and the communities Council serves. [Taituarā suggest not indicating what/the detail at this stage particularly if there has not been considerable discussion with mana whenua around priorities for this money.]

5. Options available to Council for three waters service delivery

5.1. Section 5 provides an overview of the options available to Council and is followed by an analysis of the Council's reasonably practicable options.

5.2. This analysis will provide some of the required information to enable Council to make a decision and consult on opting in or out of the reform process at the end of the eight week period (but not all as there is further information to be developed and decisions to be made), although whether this is ultimately required will be dependent on where the Government gets to with the reform process and the decisions it makes after 30 September 2021.

5.3. Staff have used [delete if have not used] the Local Government New Zealand, Taituarā, and Te Tari Taiwhenua Internal Affairs guidance[10] and our risk framework and policy [plans and previous studies] to understand the potential impact of reform and other practicable options (both today and in the future) in terms of service, finance and funding, economic development and growth, workforce, delivery and capability and social, cultural and environmental wellbeing.

5.4. Option A - Government Proposal

[10] https://www.lgnz.co.nz/assets/Three-Waters-Guidance-for-councils-over-the-next-eight-weeks-FINAL.pdf

- Under this option, we are in entity X, a publicly owned water services entity that owns and operates three waters infrastructure on behalf of councils, mana whenua and communities.
- The ownership and governance model is a bespoke model, with councils listed in legislation as owners, without shareholdings or financial interests, but an advocacy role on behalf of their communities. Iwi/Māori rights and interests are also recognised and representatives of local government and mana whenua will sit on the Regional Representative Group, issue a Statement of Strategic and Performance Expectations and receive a Statement of Intent from the Water Services Entity. Entities must also consult on their strategic direction, investment plans and prices / charges.
- The law currently prohibits Council deciding to opt-in to the current proposal (given section 130 of the LGA, which prevents councils from divesting their ownership or interest in a water service except to another local government organisation such as a Council Controlled Organisation) and what we know about this option at present.

[The following needs to be tailored to reflect your actual status quo situation and reasonably practicable options]

5.5. Option B - Council as a standalone deliverer of three waters [for some the Status quo]

[NB for Councils in an aggregated model or delivering though a CCO you could assess this option as not practicable either because you are legally obliged to deliver through the CCO e.g. Auckland or the significant threats inherent in unwinding complex governance, management and delivery arrangements – costs, time, difficulties in maintaining current levels of service]

- Council [currently] delivers three waters services itself / through a contracted model / through a mixed model of in-house and contracted services.
- While the RFI information, dashboard and supporting information provided to Council suggests that this might not be a sustainable future model for the country, we have used the information in section 4 to analyse whether this is a viable option for Council and our communities.

5.6. Option C - Council continues to deliver three waters but at a higher level of service and investment [modified status quo]

- A modified version of Council continuing to deliver services to reflect the anticipated regulatory environment for three waters delivery.
- This option requires making assumptions about
  - the future regulatory requirement (potentially using the assumptions underpinning the WICS modelling and the Government's proposal and draft/emerging standards and compliance regimes e.g. those coming from Taumata Arowai)
  - the ability of non-Council water supplies to meet standards and requirements and the risks to Council

  and would ideally include the production of business cases for investment and enhanced activity and asset management planning to be robust.

- Council staff have assessed our ability to do this work in the current operating environment (delivering business as usual, stimulus projects, other Government reform workloads, consultant availability etc) and concluded that only a very high level of analysis of this option could be done in the available timeframe. This is included in section 6 below. [Change if this work has been done – place analysis in attachment 5]
- Please note that any changes to levels of service or material changes to the cost of service would require consultation and an LTP amendment (or consultation on those changes as part of the next LTP 2024-34 and potentially later ones).

5.7. Option D – Asset owning CCO - [adapt as necessary e.g. Wellington Water to asset owning]

- The geographic region that has been assessed as part of the group delivering three water services under this option is [INSERT REGION / SUB REGION / Multi REGION]
- While it is possible that a group could be set up as a shared service, at scale this is likely to be suboptimal to the CCO option.[11]
- This option has therefore been developed as council-controlled organisations (CCOs) as provided for in the LGA with governance, management and operational oversight.
- This option enables assets to be transferred.
- Although both a management CCO and an asset owning CCO have benefits, the detailed analysis in the Hawkes Bay report demonstrates that a regional asset owning CCO is a more effective service delivery model than the management CCO and best met the investment objectives and principles set by the participants in that review.
- This option has therefore been developed assuming that assets are owned by a CCO.
- There are existing examples of CCOs WaterCare (water and wastewater services) and Wellington Water (who don't own but do manage all three waters on behalf of their owners) and studies such as [the Hawkes Bay study ..] that have been considered in developing and analysing this option.
- Please note that both the Auckland Council and the owners of Wellington Water are affected by the Government's proposal and are assessing their options, e.g. for Wellington Water to become an asset owning company.

[INSERT OTHER OPTIONS OR VARIATIONS YOU HAVE EXAMINED, INCLUDING VARIATIONS ON THE ABOVE]

5.8. Do-nothing

- While the do-nothing option is conceptually always an option, the reality is that Council needs to continue to deliver its water, wastewater and stormwater responsibilities. Doing nothing is therefore not a practicable option and is not assessed further.

[11] HB-3-Waters-Delivery-Detailed-Analysis-29.07.20-Full-Report.pdf (hb3waters.nz)

6. Options analysis

[Insert high level summary / table of options analysis if possible – following is just an example NB Guidance focuses on service, finance and funding, economic development and growth, workforce, delivery and capability and social, cultural and environmental wellbeing, but you could have your own objectives too if there are other criteria that are known to be important; or just use your risk framework]

Option	Water objectives and service levels met	Financial capacity and funding	Legal / compliance risk (assuming higher stds in future)	Workforce Capability and Capacity	Achievement of Wellbeings and integration with Council wellbeing outcomes	Key Threats (Risk) mitgiations e.g. Affordability	Key Opportunities (Risk) mitigations e.g.	Other e.g. Te Tiriti Mana whenua; R and D
A - Govt proposal								
B - Council delivery								
C -Modified for new stds								
D - CCO (Asset own)								
Other								

6.1 Risks (opportunities and threats) considered for the various options included [a prompt for your analysis / inclusion – edit as you see appropriate]:

- Financial sustainability
- Underestimating the investment Required
- Compliance failure
- Cost of Works
- Workforce, skills, Technical Capability
- Economies of Scale
- Council Plan Implementation and Integration
- Council Risk (and capacity for it)
- Household Ability to Pay
- Long Term Outcomes and wider wellbeing outcomes
- Gaps in Service Delivery and Funding Responsibilities
- R&D Funding Opportunities
- Increased Incident Response Time
- Additional Water Capacity (water source)
- (Reduction in the) Local Contractor Capacity
- Partnerships (ineffective)
- Compliance Monitoring
- Industry support
- Impact on business
- Value of Council Services
- Community perception; Loss of interest in Council – effect on candidacy
- Regional investment(lack of additional in the district due to current asst condition)
- More efficient water use
- Reduced ability to Promote Sustainable Resource Use
- Failure to Recognise Cultural Knowledge in Design
- Business Priorities Differ to Council Goals
- Loss of Community Engagement
- Lack of service integration
- Lack of Understanding of Growth Constraints
- Unclear responsibility for environmental impacts
- Gaps in infrastructure data
- Procurement outcomes
- Litigation
- Reduced levels of service / optional service level increases

6.2 Option A - Government Proposal

6.2.1 In summary, the greater financial capability, efficiency, affordability and community/water benefits (published by Government) of delivering three waters to the community are likely to be of significant value if they can be realised.

6.2.2 The key opportunities our own analysis identifies include reducing the Council's current risk profile (when considered against the status quo) including compliance risk and the risk of not meeting standards [etc].

6.2.3 Our analysis suggests that (a) key risk theme(s) is/are:

- [XX]

6.2.4 Risks that need to be mitigated include integration with spatial, growth and local planning and transparent prioritisation, households' ability to pay, and Council's financial sustainability [some councils will be able to state whether the risks fit within their council's risk appetite].

6.2.5 The full analysis can be found in Attachment 5.

6.2.6 Transition risks are dealt with in section 7 below and attachment 6.

6.3 Option B - Council as a standalone deliverer of three waters

6.3.1 In summary, the potential benefits of this option include greater Council control and more certainty over local infrastructure integration (planning and delivery) with land use plans and council objectives.

6.3.2 However, Council faces [significant] risks over the [short/medium/longer term], including potentially high costs, in meeting the new water standards, environmental requirements and achieving compliance. In addition, contractor availability is limited, the construction pipeline is already substantial and inflationary pressures are growing, meaning costs are rising.

6.3.3 The ability of non-Council water supplies to meet standards and requirements also poses a [small/medium/high…] risk to Council and the community.

6.3.4 These present affordability challenges for households in the future, exacerbating our current affordability challenges [rates/charges, population/rating base]

6.3.5 Council is also experiencing workforce challenges to meet the current requirements of three waters service delivery, Government reforms and an enlarged investment programme created by stimulus funding. [Expand as required e.g. technical skill gaps, including any risk mitigation in place such as shared services, training / cadet / graduate programmes]

6.3.6 This option becomes less sustainable if those around us move to some form of aggregated model (which will adversely affect our ability to retain and attract workers, access technical, financial or construction support, and procure cost effective contracts to deliver services and capital works).

6.3.7 The causes of most of these risks are not within Council's control. This makes mitigation difficult, and many potential mitigation options (such as greater investment, larger costs than currently planned, lower levels of service, compliance risk) may not be palatable to Council or the community. [some councils will be able to state whether the risks fit within their council's risk appetite].

6.3.8 Given the Government has rejected this as a sustainable solution for three waters service delivery there should not be an expectation that the Government would be willing to financially support councils to meet the new regulations beyond existing Tranche 1 stimulus funding.

6.3.9 There may also be broader implications for our relationship with Government, iwi/Māori and key stakeholders.

6.3.10 Given the analysis to date, Council continuing to deliver the three waters as a standalone entity is [not / is unlikely to be…] sustainable in the medium to long term.

6.3.11 The full analysis can be found in Attachment 5.

6.4 Option C - Council continues to deliver three waters but at a higher level of service and investment [modified status quo]

6.4.1 The full options analysis can be found in Attachment X – or if not done you could use the following:

6.4.2 The issues and opportunities associated with this option are broadly the same as for Council delivering three waters at the service levels forecast in the LTP 2021-31.

6.4.3 There is likely better integration with Council outcomes, objectives and plans, but even if Council can predict the investment required to meet the new water standards, environmental requirements and compliance requirements in the short term, the costs of service provision and levels of service may change significantly over the next 30 years.

6.4.4 As in the case of the status quo:

- should one or more non-Council water supplies default to Council this would exacerbate Council's risk profile and financial position
- if Council's neighbours voluntarily joined a larger water services grouping or entity, we would likely experience negative impacts on our workforce capability and capacity, on our pipeline of construction and ability to deliver cost effectively and on our ability to get professional services, advice and support.

6.4.5 Again, there should not be an expectation that the Government would be willing to financially support councils to meet the new regulations beyond existing Tranche 1 stimulus funding.

6.4.6 This presents affordability challenges for households in the future and there may also be broader implications for our relationship with Government, iwi/Māori and key stakeholders.

6.5 Option D – CCO asset owning

6.5.1 Under this option the entity and councils would still need to be satisfied that the changing regulatory environment was adequately provided for, including ensuring there was sufficient funding to meet legal and regulatory obligations.

6.5.2 However, due to scale, this option (better) addresses the risk that the size of investment required to meet new standards and community expectations is greater than forecast by individual councils;

- it enables an organisation to focus on the groups three water challenges and prioritise investment decisions across the region, which should lead to better environmental and community outcomes
- it provides for greater strategic, management and operational capacity and capability, workforce development and planning
- it enables efficiencies (in planning, programming, procurement and delivery)

and should as a result reduce household costs and increase affordability.

6.5.3 As with the above options, should one or more non-Council water supplies default to the CCO then this would need to be funded from the group or consumers, however the risk is [may be] reduced.

6.5.4 There are some integration risks with spatial, growth and local planning and ensuring transparent prioritisation, the achievement of Council objectives and ensuring there is sufficient funding and that costs are affordable.

6.5.5 There is Council oversight and input. A statement of intent would be prepared by the CCO (and it would be best practice for the councils to prepare a letter of expectation to guide this) and half yearly and annual reports would be prepared. Councils would need to monitor the performance of the CCO. Consideration would need to be given to governance arrangements, including the involvement of iwi/Māori in both decision making and governance, and how council, community and mana whenua aspirations and needs will be met.

6.5.6 This option is still constrained in its ability to raise debt as the connection to council balance sheets remains under the available funding models.

6.5.7 There would also need to be agreement from all councils and each would need to undertake public consultation, which would take time and creates uncertainty about the outcome.

6.5.8 If a new CCO is to be set up this will require council(s) to use the Special Consultative Procedure (section 83 of the LGA) and arrangements (and a policy) for the appointment of directors or trustees will need to be made (as the councils appoint the "board"), as well as transition arrangements (including workforce transition), prioritisation of investment and integration with planning at the regional and local level.

6.5.9 If the CCO already exists, consultation would still be required to transfer control or ownership of council's three waters strategic assets (unless it is explicitly allowed for in an adopted LTP or empowering legislation).

6.5.10 Councils would need to adequately resource the establishment or transition process (if they are changing to an asset owning arrangement).

6.5.11 The Government has stated that it is "not clear if sector-led reform under existing legislation would deliver the kind of transformation required to address the root causes of the challenges the sector is facing" so there should not be an expectation that the Government would be willing to financially support councils to transition to this model or change the law to enable different funding setting.

7 Transition

7.1 Managing transition risks to the Government's proposed model are likely to pose a greater challenge for Council and others in its grouping than the risks associated with the Government proposal. If the Government's proposal were to proceed, effective management of the transition by Council, Government and partners will be critical.

[Add in any other key points from your analysis e.g. risk appetite]

NOTE Risks to consider could include

- Staff/Contractor Retention
- Transfer of Contracted Services
- Maintaining Good Quality Assets
- Stranded Overheads
- Loss of Customer Experience
- Resistance to Change

- Speed of Change - an increase in mistakes
- Lack of Business Confidence
- Transition Team – would help but will require resourcing. Staff workloads
- Limited Transfer of Water Debt – reserve funds collected for water related services affecting Council's financial position.
- Development / Financial Contribution Refunds - may affect Council's charges linked to debt (including the possibility of refunds).
- Current System Unable to Cope
- Scope of Agency Service - continuing / picking up for e.g. stormwater [and / or wastewater]
- Different Local Approaches - to regional neighbours may reduce the economies of scale making regional water solutions more expensive.
- Unreasonable Economic Influence - from existing industry players
- Asset Valuation - returning a much different value than expected affecting Council's financial position
- Deferred Decision Making - development projects to stall.
- Community Uncertainty - owners continue to call Council delays in resolving faults.
- Poor Transition Management - cause delays and confusion over responsibility exposing Council to liabilities and affecting continuity of service delivery.
- Existing Contract Liabilities - Council may be liable for compensation if contractors take legal action.
- Liability for Environmental Damage - Lack of clarity for monitoring environmental impacts may expose Council to liabilities
- Loss of Asset Management Systems & Data - unclear responsibilities - loss of data or failure of systems affecting continuity of service delivery.
- Impact on Bylaws -.

7.2 That said, transition away from the status quo to any other option, carries inherent risks, with potential mitigations to reduce both impact and likelihood and therefore residual risk and sticking with the status quo may not be sustainable in the short, medium or long term.

7.3 A high-level overview of what we know of the transition process [and risks] is contained in Attachment 6 [insert your specific risk analysis of this process – and remove HASTINGS EG].

8 Council decision making and consultation

8.1 Part 6 of the LGA, sections 76 to 90, provide the requirements for decision making and consultation, including the principles of consultation and information that needs to be provided including the reasons for the proposal and the reasonably practicable options.

8.2 In particular, section 76 requires that in making a significant decision, which a decision on the future management and or ownership of three waters assets will be, councils must comply with the decision-making provisions. This is a 'higher bar' than the "promote compliance with" that applies for ordinary decisions.

8.3 Section 77 states that councils must seek to identify all reasonably practicable options and then assess the advantages and disadvantages of each option.

8.4 Section 78 requires that in the course of making a decision a Council must consider community views but section 78(3) explicitly says that consideration of community views does not require consultation, which is reinforced by case law.

8.5 Section 79 gives Council discretion to decide how the above Part 6 requirements are met including the extent of analysis done etc. Therefore, while a decision could be challenged, a judicial review is unlikely to be successful unless the decision made by council was manifestly unreasonable, the process was flawed or the decision was beyond its powers (as given in law, ie the council did not act within the law).

8.6 However, despite section 79 of the LGA, a decision to transfer the ownership or control of a strategic asset from the council (or to it) must explicitly be provided for in the council's Long Term Plan (and have been consulted on specifically in its consultation document).

8.7 Council's existing LTP and the consultation information and process used to develop it will not suffice to meet this test, as Council did not itself have adequate information on the options and the implications earlier this year when it consulted on the LTP. An LTP amendment and commensurate consultation process on the ownership and governance arrangements and asset transfers proposed would be necessary.

8.8 There are also provisions in the LGA that relate to unlawful decisions to sell or dispose of assets, which can be investigated by the Auditor-General.[12]

8.9 A decision to opt-out would also be affected by the consultation and decision-making requirements set out in this report, including the need to follow a robust process that could survive a judicial review, as well as make a final decision that was not manifestly unreasonable in the circumstances.

8.10 Given the Government's

- 8 week period of engagement with mana whenua and councils
- commitment to explore issues such as council and community influence of service outcomes, integration with other reform proposals, spatial and local planning
- request for councils to give feedback on the proposal, identify issues and solutions
- and uncertainty around next steps, including whether the reform may become mandatory or legislative change will remove legal barriers to opting in

it would be premature to make a decision to opt out of the reform process and may expose the Council to litigation risk.

[12] See sections 43 to 47 of the LGA.

8.11 A Government Bill to progress the reforms could address the issues raised above, for example removing the section 130 requirements has explicitly been raised.

8.12 At this stage no decision is required on future delivery arrangements. Based on the analysis in this report, Council should wait until it has further information before consulting on and/or making a decision on the Government's proposal.

8.13 It is recommended that the Council therefore notes the options canvassed in this report, the [high-level] analysis of them and the information and decisions that are yet to be made.

8.14 If reform is not made mandatory, to ensure sufficient information is available to meet the moral and legal requirements of Council decision-making staff will further develop the analysis of options (based on further information from the Government, advice on next steps, and regional discussions) prior to Council decision making and consultation on future water services delivery. Whether this is ultimately required will be dependent on where the Government gets to with the reform process and the decisions it makes after 30 September 2021.

9 Information that the Council requires or potential solutions to outstanding issues that it would like to convey to Government and LGNZ

9.1 There are still several issues that need to be resolved, including:

- the final boundaries
- protections from privatisation
- consultation with mana whenua and communities
- how will community voice be heard and what influence will local authorities have (and what can the community realistically expect the council to influence particularly if it is not on the regional Representation Group)
- representation from and on behalf of mana whenua
- integration with other local government reform processes
- integration with spatial and local planning processes and growth
- prioritisation of investment
- workforce and capability – we don't have enough of the right people now to deliver three waters and we need to retain our people through the transition
- what will a Government Bill cover and whether the reform will be mandatory
- conditions associated with the Government's package of funding for local government
- transition arrangements, including our own workforce challenges (without transition challenges on top) and due diligence for asset transfers etc.

9.2 Council is invited to discuss whether there are specific information needs, issues or solutions that the Council would like staff to convey to the DIA or LGNZ.

10 Conclusion

10.1 While there is uncertainty about the future steps in the Government's reform proposal, and current legislative impediments to it, the current eight-week period gives Council the opportunity to understand the information it has received (and will continue to receive) from the RFI and modelling processes.

10.2 It also provides an opportunity for Council to understand its potential options, including the financial, workforce and sustainability impacts for Council and the wider economic, social and cultural implications of each option, using the guidance that has been issued. It also provides and opportunity to engage in discussions with other councils in its entity grouping, share information and ask questions and propose solutions to issues it sees to Government and LGNZ.

10.3 All of this information will be useful to inform future decision making by both council and Government and consultation and engagement with mana whenua and communities.

11 Decision making compliance statements

To be completed on basis - no decisions recommended. Use your standard format

Significance

The future of water services delivery is a significant issue. This report however does not commit to the council to a decision relating to that reform. Instead it provides initial analysis of the reform proposals for Council's information and highlights the uncertainties around information and next steps. As such the significance of this report is [use your significance and engagement policy eg low}

Risks / Legal and Financial implications

Significant risks, legal responsibility and financial implications have been identified in analysing the reform proposals and completing an analysis of options for this report. However, there is not decision required, other than to note those issues and to request further information from Government if Council wishes to, to reduce the risks and implications to Council and its communities

Te Tiriti/Treaty of Waitangi and involvement of Māori in decision making considerations

The issues covered in this paper are important for Māori. The Crown is currently leading the engagement with iwi/Māori, mana whenua. Council has done XX with YY.

Climate Change / environmental impact

Climate considerations (both mitigation and adaptation), resilience and environmental impacts are drivers of the reform process. While there are no specific impacts arising from this report the decisions that occur post September 2021 will have an impact on climate and environmental issues. Some of these impacts have been canvassed in this report as appropriate to the options analysis that can be done with currently available information.

Engagement and Consultation

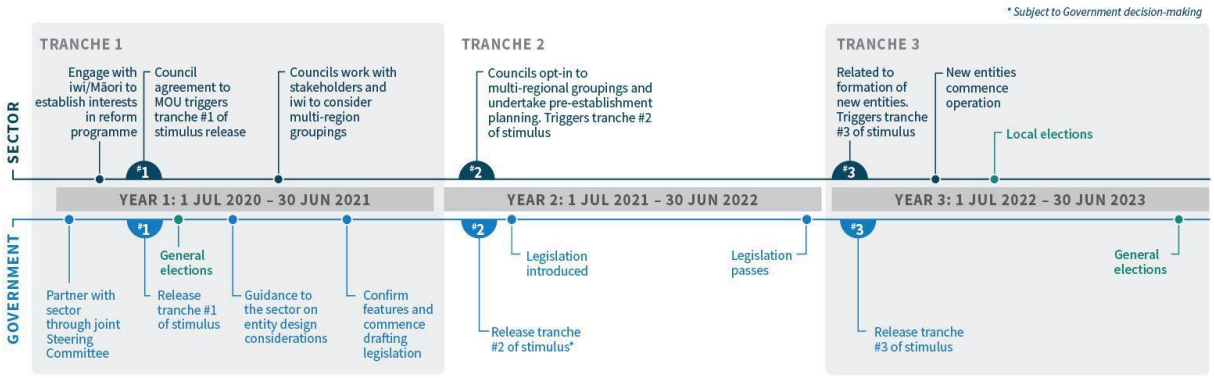
Council is not required to consult at this time as provided for in section 8 of this report. Further advice regarding any future consultation requirements will be provided after September 2021. In the interim Council has [talk to what engagement and information has been provided on websites, public briefings etc.]

Attachment 1 – 2020 Background (including Taumata Arowai information and Indicative Reform Programme)

In July 2020, the Government launched the Three Waters Reform Programme to reform local government three waters service delivery arrangements, with the following objectives:

- improve the safety, quality, and environmental performance of water services
- ensure all New Zealanders have access to affordable three waters services
- move the supply of three waters services to a more financially sustainable footing, and address the affordability and capability challenges that currently exist in the sector
- improve transparency about, and accountability for, the delivery and costs of three waters services
- improve the coordination of resources and unlock opportunities to consider New Zealand's water infrastructure needs at a larger scale and alongside wider infrastructure and development needs
- increase the resilience of three waters service provision to both short and long-term risks and events, particularly climate change and natural hazards
- provide mechanisms for enabling iwi/Māori rights and interests.

The 2020 indicative timetable for the full reform programme is provided below. It was always subject to change as the reforms progressed, future Government budget decisions and Councils were advised that any further tranches of funding would be at the discretion of the Government and may depend on progress against reform objectives.



Also in July 2020 the Government announced an initial funding package of $761 million to provide a post COVID-19 stimulus to maintain and improve water three waters infrastructure, support a three-year programme of reform of local government water service delivery arrangements (reform programme), and support the establishment of Taumata Arowai, the new Waters Services Regulator.

Following initial reports (that used publicly available council information) from the Water Industry Commission for Scotland (WICS), between October 2020 and February 2021, (all) 67 councils participated in the Government's Request for Information (RfI) on council's three waters assets, including future investment requirements. In return they received what was known as Tranche 1 stimulus funding (under a MoU and funding agreements with Government) for operating or capital expenditure that supported the reform objectives, economic recovery through job creation and maintaining, increasing and/or accelerating investment in core water infrastructure delivery, renewals and maintenance. [OPTIONAL - Council received XX under this arrangement and is currently completing the agreed delivery plan. Previous Council reports [xx] detail the reasons for Council participation and resolutions [or insert resolutions].

In line with Government policy, Taumata Arowai became a new Crown entity in March 2021 and will become the dedicated water services regulator when the Water Services Bill passes, expected to be in the second half of 2021 (the Select Committee is dure to report back on 11 August 2021). They will oversee and administer, and enforce a new, expanded and strengthened drinking-water regulatory system, to ensure all New Zealand communities have access to safe drinking water. They will also provide oversight of the regulation, management, and environmental performance of wastewater and storm-water networks, including promoting public understanding of that performance.

An overview of local authority obligations under the Bill is provided below. The Bill provides for a range of compliance and enforcement tools including compliance orders, enforceable undertakings, infringement offences, and criminal proceedings, which can be taken against council officers (but not elected officials).

Taumata Arowai will have the authority to prepare standards and rules that water suppliers (such as councils) must comply with. Their initial working drafts are available online[13] and are currently being updated. Consultation will occur later this year. Guidance to support the operational compliance rules is also being developed and will be available when the rules are consulted on.

It is anticipated that monitoring, compliance and enforcement of standards will increase substantially on the status quo with the passing of the Water Services Bill and as Taumata Arowai begins to operate. It is also likely that the drinking water standards and their coverage (including non-Council water suppliers) and environmental standards will become more rigorous over time. This creates risks for council in meeting future standards and mana whenua and community aspirations (such as greater investment required than currently planned, risk of enforcement action).

[13] www.taumataarowai.govt.nz/for-water-suppliers/

Water Services Bill obligations of local authorities

Table 2 from https://www.dia.govt.nz/diawebsite.nsf/Files/Three-waters-reform-programme/$file/transforming-the-system-for-delivering-three-waters-services-the-case-for-change-and-summary-of-proposals-30-june-2021.pdf

Local authorities as suppliers of water services	General obligations of local authorities

• Duty to provide safe drinking water and meet drinking water standards, and clear obligations to act when water is not safe or fails to meet standards
• Key provisions include:
  ○ Suppliers need to register with Taumata Arowai
  ○ Local authority suppliers will need a drinking water safety plan and a source water risk management plan
  ○ Water suppliers must give effect to Te Mana o te Wai
• Taumata Arowai will have significant compliance and enforcement powers, including powers to direct suppliers and enter into enforceable undertakings with suppliers
• Officers, employees and agents of suppliers will have a duty to exercise professional due diligence
• Complying with these new requirements is expected to require significant capital and operating expenditure by local authorities (including paying levies to Taumata Arowai for operation of the regulatory system)
	• Local authorities will have a duty to ensure communities have access to drinking water if existing suppliers face significant problems in complying with drinking water standards including:
	  ○ Requirements to work with suppliers and consumers to identify solutions
	  ○ Intervention responsibilities if a supplier is unable to meet standards, including potentially taking over management and operations of private or community supplies
	• In rural communities, this could represent a significant risk (contingent liability) for local authorities
	• Local authorities will be required to make assessments of drinking water, wastewater and sanitary services to ensure communities have access to safe drinking water
	• Local authorities will need to assess drinking water services available to communities at least once every three years, including private and community supplies (excluding domestic self-supplies)

Attachment 2 – the Government's conclusion that the case for change has been made

1. The modelling has indicated a likely range for future investment requirements at a national level in the order of $120 billion to $185 billion, an average household cost for most councils on a standalone basis to be between $1910 and $8690 by 2051.
2. It also estimated these average household costs could be reduced to between $800 and $1640 per household and efficiencies in the range of 45% over 15-30 years if the reform process went ahead.
3. The efficiencies noted are underpinned by evidence across a range of countries based on joined up networks (the conclusion is that 600,000 to 800,000 connections achieve scale and efficiency), greater borrowing capability and improved access to markets, procurement efficiencies, smarter asst management and strategic planning for investment, a more predictable pipeline and strengthened benchmarked performance, governance and workforce capabilities.
4. The briefing to the Minister notes that this "investment is what WICS has estimated is necessary for New Zealand to meet current United Kingdom levels of compliance with EU standards over the next 30 years, which in its assessment (and confirmed by Beca) are broadly comparable with equivalent New Zealand standards.".
5. However, this is caveated as a conservative estimate that does not take into account iwi goals and aspirations, higher environmental standards or performance standards that are anticipated in future legislation, uncertainties in asset lives, seismic and resilience risk, supply chain issues, and the current workload to manage and deliver improvements as well as address renewal backlogs.
6. For councils with non-council drinking water suppliers in their areas there is additional risk if they are unable to consistently provide safe drinking water to their consumers, including the potential for council to have to take on the water supply. Council operating on expired consents or with consent renewals in the next 15 years also face uncertainty over the standards they will need to meet in the future and therefore the level of investment that needs to occur.
7. Councils could also add to the above list of uncertainties and challenges their business as usual workload, the workload associated with delivering on stimulus packages and associated with responding to other government reform initiatives such as reform of the Resource Management Act, and general workforce retention and attraction issues, which are exacerbated by public sector competition for talent and skills.
8. The modelling indicated that between one and four water services entities would provide the most efficiencies and reduce costs to individual households.
9. When this is added to
    a. known variations across the nation in water suppliers' compliance with drinking standards, including permanent and temporary boil water notices
    b. evidence of poor health and environmental outcomes, including expired resource consents for wastewater treatment plants (and the need for 110 of these plants to go through the resource consenting process in the next 10 years)
    c. stormwater overflows and other challenges
    d. climate change

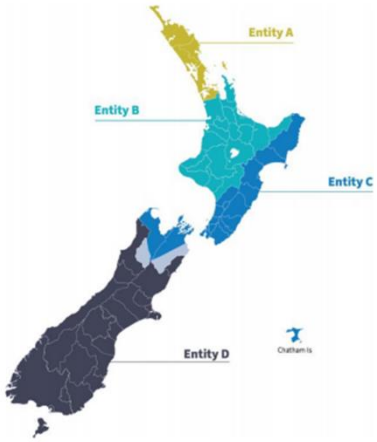
e. Te Tiriti obligations and the need to uphold Te Mana o te Wai

f. the size and scale of current service delivery units and workforce issues

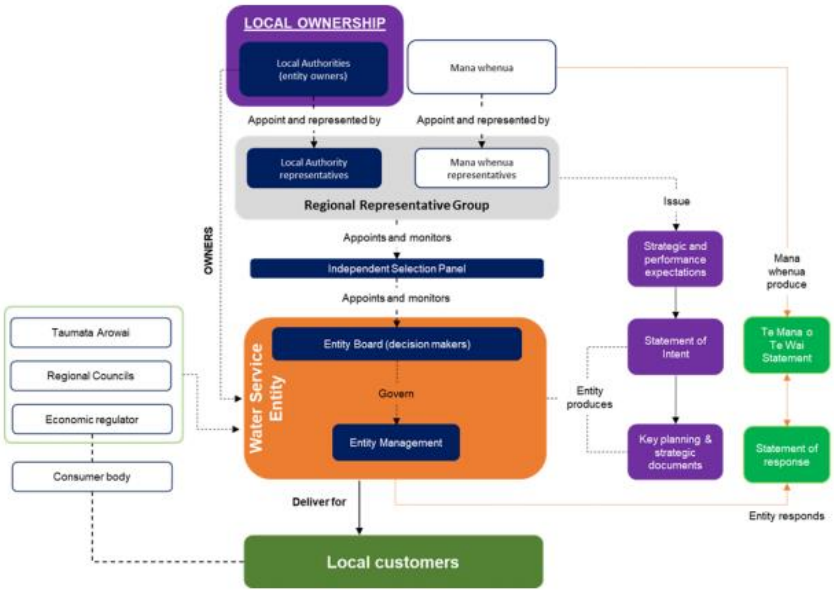
g. the obligations and responsibilities that councils (and other water suppliers) will face when the Water Services Bill and associated regulations are enacted

h. the Government has concluded that the status quo is not sustainable and that the case for change has been made.

10. The four entities and their proposed boundaries (which may yet change) and the proposed structure for the system are as follows:

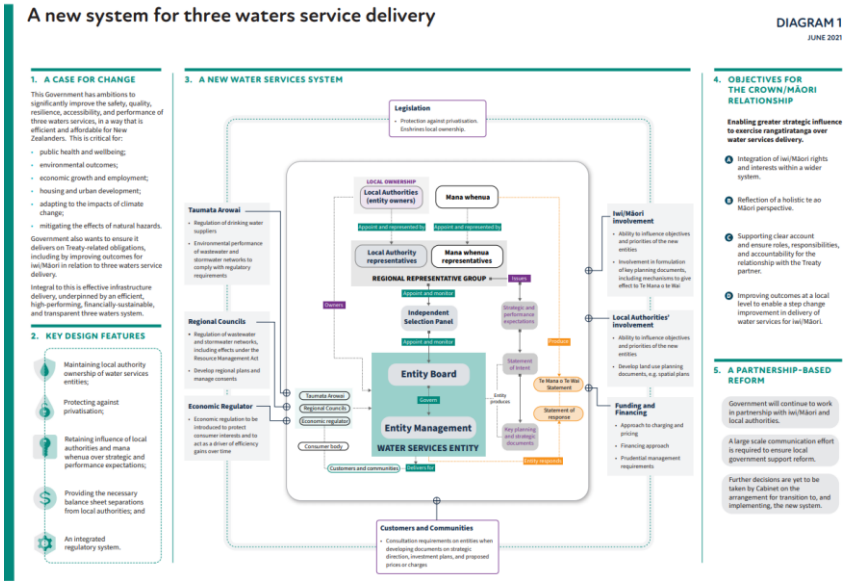


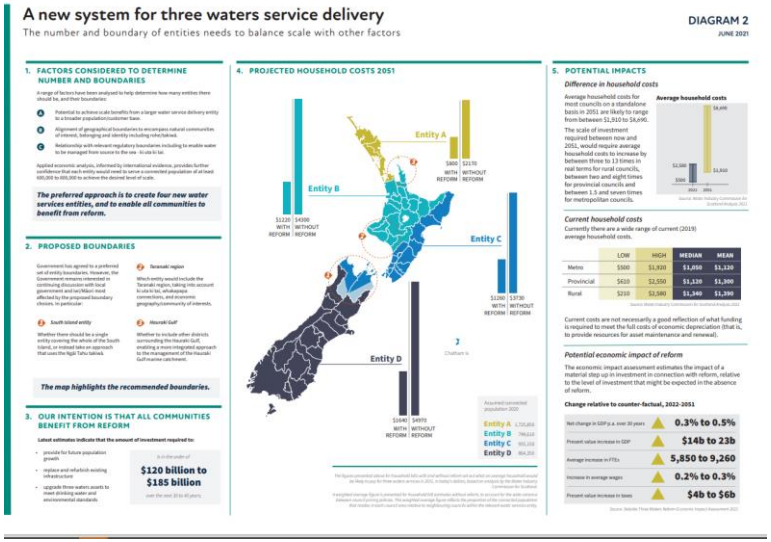
	Entity A	Entity B	Entity C	Entity D
Connected population (2020)	1.7m	0.8m	1.0m	0.9m



Attachment 3 – DIA two-page summary

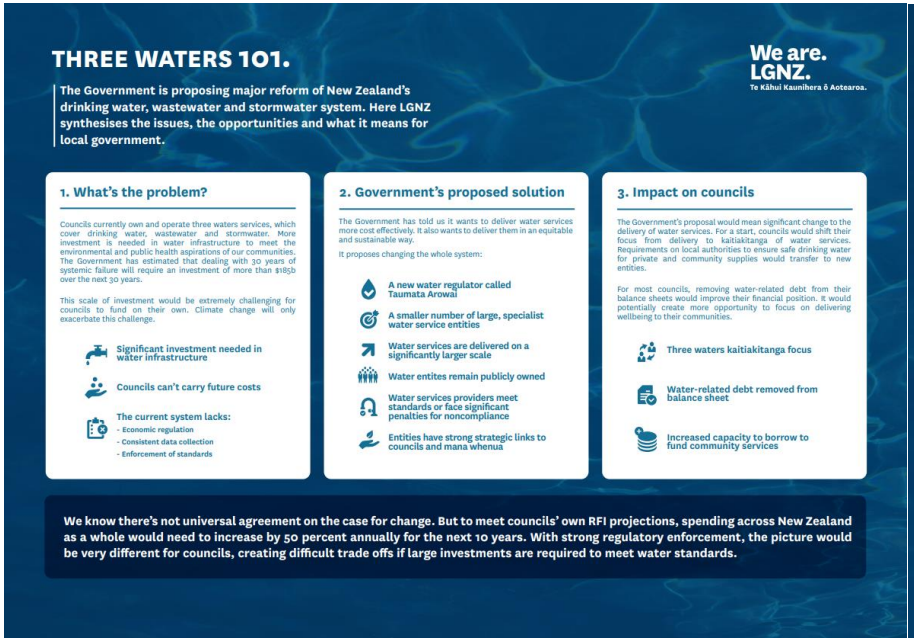
For you to format/resize if you use it





LGNZ two-page summary

For you to format/resize if you use it



Attachment 4 - funding to invest in the future of local government and community wellbeing

1. On 15 July, in partnership with LGNZ under a Heads of Agreement[14], the Government announced a package of $2.5 billion to support councils to transition to the new water entities and to invest in community wellbeing.
2. The '**better off' element**: an investment of **$2 billion** into the future for local government and community wellbeing.
    - The investment is funded $1 billion from the Crown and $1 billion from the new Water Services Entities. $500 million will be available from 1 July 2022. The funding has been allocated to territorial authorities (which includes unitary authorities)[15] on the basis of a nationally formula that takes into account population, relative deprivation and land area.
    - The funding can be used to support the delivery of local wellbeing outcomes associated with climate change and resilience, housing and local placemaking, and there is an expectation that councils will engage with iwi/Māori in determining how to use their funding allocation.
3. The **'no council worse off' element**: an allocation of up to around $500 million to ensure that no local authority is in a materially worse position financially to continue to provide services to its community as a direct result of the reform.
    - This element is intended to ensure the financial sustainability of councils and address reasonable costs and financial impacts associated with the transfer of assets, liabilities and revenues to new water services entities.
    - Up to $250 million is available to meet the unavoidable costs of stranded overheads and the remainder for other adverse impacts on financial sustainability of territorial authorities (including future borrowing capacity).
    - Of this $250 up to $50 million is allocated to Auckland, Christchurch and Wellington Water councils, the remainder is available to other councils.[16] This funding is not available until July 2024 and is funded by the Water Services Entities.
4. Council's funding allocation is [XX].

[14] https://www.dia.govt.nz/diawebsite.nsf/Files/Three-waters-reform-programme/$file/heads-of-agreement-partnering-commitment-to-support-three-waters-service-delivery-reform.pdf

[15] Please note that any allocation to Greater Wellington Regional Council (the only regional council affected by the proposed changes) is not clear at this stage.

[16] Due to their size and in the case of Wellington Water and Auckland's WaterCare having already transferred water service responsibilities (to varying degrees)

5. The package is in addition to the $296 million announced in Budget 2021 to assist with the costs of transitioning to the new three waters arrangements. The Government will "meet the reasonable costs associated with the transfer of assets, liabilities and revenue to new water services entities, including staff involvement in working with the establishment entities and transition unit, and provision for reasonable legal, accounting and audit costs."[17]
6. The Government is also encouraging councils to use accumulated cash reserves associated with water infrastructure for this purpose. There are likely to be practical limitations on a council's ability to do this set by councils' own financial strategy and policies (including conditions on the use of the reserves ie targeted reserve funds must be used for the purpose they were collected for in the first instance e.g. if collected for capital works).
7. There are also political and / or community acceptance challenges with this approach - if the assets are transferred under a voluntary or mandatory process the reserve balances are expected to be used to invest those funds in the communities that paid for them, consistent with the conditions under which they were raised rather than pooling as a general fund. Councils and communities are unlikely to embrace using these funds instead to enable the transition.
8. The proposed national allocations are as follows:

[Some Councils might find it useful if these were put these amounts in groupings – e.g. entity groups/Zones etc]

[17] 15 July 2021 FAQ https://www.dia.govt.nz/diawebsite.nsf/Files/Three-waters-reform-programme/$file/three-waters-reform-programme-support-package-information-and-frequently-asked-questions.pdf

Council	Allocation
Auckland	$ 508,567,550
Ashburton	$ 16,759,091
Buller	$ 14,009,497
Carterton	$ 6,797,415
Central Hawke's Bay	$ 11,339,488
Central Otago	$ 12,835,059
Chatham Islands	$ 8,821,612
Christchurch	$ 122,422,394
Clutha	$ 13,091,148
Dunedin	$ 46,171,585
Far North	$ 35,175,304
Gisborne	$ 28,829,538
Gore	$ 9,153,141
Grey	$ 11,939,228
Hamilton	$ 58,605,366
Hastings	$ 34,885,508
Hauraki	$ 15,124,992
Horowhenua	$ 19,945,132
Hurunui	$ 10,682,254
Invercargill	$ 23,112,322
Kaikoura	$ 6,210,668
Kaipara	$ 16,141,395
Kapiti Coast	$ 21,051,824
Kawerau	$ 17,270,505
Lower Hutt	$ 38,718,543
Mackenzie	$ 6,195,404
Manawatu	$ 15,054,610
Marlborough	$ 23,038,482
Masterton	$ 15,528,465
Matamata-Piako	$ 17,271,819
Napier	$ 25,823,785
Nelson	$ 20,715,034
New Plymouth	$ 31,586,541
Opotiki	$ 18,715,493
Otorohanga	$ 10,647,671
Palmerston North	$ 32,630,589
Porirua	$ 25,048,405
Queenstown Lakes	$ 16,125,708
Rangitikei	$ 13,317,834
Rotorua Lakes	$ 32,193,519
Ruapehu	$ 16,463,190
Selwyn	$ 22,353,728
South Taranaki	$ 18,196,605
South Waikato	$ 18,564,602
South Wairarapa	$ 7,501,228
Southland	$ 19,212,526
Stratford	$ 10,269,524
Tararua	$ 15,185,454
Tasman	$ 22,542,967
Taupo	$ 19,736,070
Tauranga	$ 48,405,014
Thames-Coromandel	$ 16,196,086
Timaru	$ 19,899,379
Upper Hutt	$ 18,054,621
Waikato	$ 31,531,126
Waimakariri	$ 22,178,799
Waimate	$ 9,680,575
Waipa	$ 20,975,278
Wairoa	$ 18,624,910
Waitaki	$ 14,837,062
Waitomo	$ 14,181,798
Wellington	$ 66,820,722
Western Bay of Plenty	$ 21,377,135
Westland	$ 11,150,183
Whakatane	$ 22,657,555
Whanganui	$ 23,921,616
Whangarei	$ 37,928,327
Total	$ 2,000,000,000

Attachment 5 – Options analysis

[Place here the fuller options analysis for each of the options you have assessed.] **ACKNOWLEDGEMENTS AND THANKS TO HASTINGS DISTRICT COUNCIL FOR THE FRAMEWORK AND FORMAT – Council to use/replace based on own work – Hastings has kindly circulated their information so not all is reproduced here as each council will do their own work]**

Option A - Government Proposal

Key Threat Risks: [EG ONLY]

	Description	Inherent	Possible Mitigation	Target
	Compromised Growth Plan Implementation		Regulation to give effect to Council land use planning.	
	Household Ability to Pay		Economic regulation	
	Gaps in Service Delivery and Funding Responsibilities		Agencies required to participate in development of regional spatial plans.	
	Increased Cost of Works		Key supplier partnerships.	
	Increased Incident Response Time		CDEM Coordinated Incident Management System	
	Vague Growth Objectives/Lack of strategic Direction		Spatial plan	
	Lack of Programme Coordination		Robust programme planning	
	Limited Technical Capability		Professional development pathway	

Key Opportunity Risks:

	Description	
A2	**Reduced Council Risk**	
A4	**Better Long Term Outcomes**	High
A6	**R&D Funding Opportunities**	High
A19	**More Efficient Water Use**	Med

§

Ref	Type	Risk Description	Inherent Impact	Inherent Likelihood	Inherent Risk	Possible Mitigations	Target Impact	Target Likelihood	Target Risk
	Threat	**Compromised Growth Plan Implementation** Due to loss of control over Major strategic assetcommunities may not be able to give effect to growth plans (eg Long Term Plan integration) or adapt timing of developments delaying economic growth opportunities.				Regulation to give effectto Council land use planning.			
	Opportunity	**Council Risk Reduced** Because Council is no longer responsible for water service deliver there may be risk capacity available to enable other activities to be performed.							
	Threat	**Household Ability to Pay** Independent agencies (i.e. Water, Power, Council) passing on costs of higher compliance obligations (e.g. increase in water service standards or environment adaptation related costs such as carboncounting) based on lack of understanding of other cost overheads may result in total household costs that are beyond the householders ability to pay (including Council rates) adversely affecting community social and economic wellbeing.				Economic regulation includes a level of inflationar y control.			
	Opportunity	**Better Long Term Outcomes** Due to the scale and mandate of water agencies theyhave the potential to delivery better long term outcomes (aka step change Asset Management Planning as seen in electricity sector).							

	Threat	**Gaps in Service Delivery and FundingResponsibilities** Due to multiple agencies involved in delivery of interrelated services there may be gaps between theresponsibility of the various agencies (particularly storm water) resulting in lack of funding or ownership of the customer experience (customer ends up being passed around in circles).	Major (25% - 50% service level impact)	Likely	High (24)	Agencies required to participate in development of regional spatial plans.	Major	Possible	Medium (16)

Option B - Council as a standalone deliverer of three waters

Ref	Type	Risk Description	Inherent Impact	Inherent Likelihood	Inherent Risk	Possible Mitigations	Target Impact	Target Likelihood	Target Risk
	Threat	**Financial Sustainability** Increased cost operation (to meet best practice) or need to refund Government funds may require unacceptable rates increases affecting Council's financial sustainabilityand/or reducing the funding available for other Council services.				Reduce spending in otherareas.			
	Threat	**Lack of Technical Skills** Due to the relatively small scale of the Council service it may not be possible to attract or retain people with the required competency resulting in failure to achieve the required service standards.				Council provides a professional development pathway			
	Threat	**Unable to Leverage Economies of Scale** Not being part of the regional water agency may mean Council is unable to access the same level of funding orexpertise resulting in substandard services.				Strategic partnerships			
	Threat	**Lack of Water Sector Support** Few Council's delivering water services - Council may become isolated and unable to access adequate support (technical, financial or construction) causing failure to deliver the required services.							

	Threat	**Excessive Development Contributions** The higher cost of service delivery may cause Development /Financial Contributions to become very highrestricting regional growth							
	Threat	**Inability to Attract Business** Commercial operators may consider the water supply as less secure and decide not to locate industry here adversely affecting economic growth.							
	Threat	**Compliance Failure** Because of the significant increase in water standards Council may not be able to meet the new requirements resulting in liability/prosecution and/or loss of Governance control (Commissioner being installed).				1.			

Attachment 6 - Transition

1. Consideration is being given to establishing a national transition unit and local establishment entities mirroring the boundaries of the (proposed) Water Services Entities and supporting, through a reprioritisation of stimulus funding if required, council staff costs related to reform and transition, enabling staff to participate in transition priority working groups, gathering and sharing data.
2. Current considerations, in addition to funding for backfilling and / preparing for change, are:
    - support for three waters workers – including:
        - if a staff members role is primarily three waters related, an automatic transfer to the new Water Services Entity in a similar role on the same salary at the same location with the same conditions
        - advice, including Employee Assistance Programmes, legal and union representation
    - the need to increase staffing levels to implement the transition, continue business as usual and deliver current and increased infrastructure investment
    - staff and contractor retention in a time of uncertainty (and competition for resources)
    - the speed of change and the risk of mistakes and service interruptions
    - stranded overheads and the no worse off element of the funding package
    - asset transfers and valuations
    - existing contracts and contractors and any residual liabilities
    - development and financial contributions
3. What isn't clear (but will be worked through) is:
    - where the bulk of managerial and support staff (eg communications, financial, asset management) will be located, although the presumption is that they will be (at least notionally in post COVID flexible working world) located in the regional headquarters of the Water Services Entities
    - what the principles and any threshold would be for a staff member that does some three waters related work (say 50% of their time) and whether it would be their choice to move to the Water Services Entity and the implications for their employment situation
    - if all three water services are included and will transfer at the same time

DRAFT TRANSITION RISK/PESTLE ASSESSMENT –

ACKNOWLEDGEMENTS AND THANKS TO HASTINGS DISTRICT COUNCIL (AND THE HAWKES BAY COUNCILS) FOR THE FRAMEWORK AND FORMAT – Council to use/replace based on own work

Our Goals is: our / XX regional communities continue to receive water services without disruption during the transition, the risks (threats and opportunities) for moving Council services, assets and data to …

The following benefits of reform are taken from information published by the Department of Internal Affairs:

- Greater financial capability
- More efficient providers
- Cost sharing across communities
- Improved outcomes for communities – affordable way to meet costs of water services now and into the future.

The following risks have been identified: INSERT RISKS AND RATINGS for YOUR COUNCIL/GROUP – THIS BASE MAY HELP

Threat Risks:

No	Description	Inherent	Possible Mitigation	Target
	Staff/Contractor Retention		Attractive employment contracts	
	Stranded Overheads		Alternative funding or restructure overheads	
	Loss of Customer Voice		Advocating for community outcomes	
	Resistance to Change		Education programme	
	Speed of Change		Change management programme.	
	Lack of Business Confidence		Public relations campaign	

Opportunity Risks:

	Description	Inherent
	Maintaining Good Quality Assets	
	Transition Team	

NB Hastings also had Easy Transfer of Contracted Services which may be applicable to you

Risk [Appetite] Assessment:

The risk in transition is much greater than the risk profile for operation once entities are established and operating. Many of the causes for the transition risks are outside Council's control, so minimal mitigation is possible.

[State risk appetite assessment against Council's risk appetite or develop one e.g. within/well outside etc]

Insert conclusions e.g.

- Work proactively with the Government in the development of the framework
- Work collaboratively with other group members, Taituarā, LGNZ, iwi/Māori and partners
- Ensure forward planning caters for any possible delays in transition, and
- Adapt quickly and efficiently to handle new obligations that might arise.

Risk analysis and Risk Register if desired. Extract from Hastings eg below to help you. Risks noted are in body of report and in Hastings doc if you wish to use them

Ref	Type	Risk Description	Inherent Impact	Inherent Likelihood	Inherent Risk	Possible Mitigations	Target Impact	Target Likelihood	Target Risk
	Threat	**Staff/Contractor Retention** Due to greater employment opportunities presented by water agencies there may be a loss of key Council or contractor staff, or an inability to recruit new technical staff reducing Council's ability to plan or deliver infrastructure projects.				Attractive employment contracts. Keeping staff informed.			
		Transfer of Contracted Services							
	Opportunity	**Maintaining Good Quality Assets** By maintaining infrastructure investment it may be Possible to reduce the transition impacts on the community.							
	Threat	**Stranded Overheads** Because the overheads will not change significantly after divestment thecost of other services may be impacted by the redistribution of overhead costs				Alternative funding or restructure support overheads			
	Threat	**Loss of Customer Experience** Because of the scope of change community voice may be lost affecting customer experience and relevance of services delivered.				Advocating for community outcomes			

NEW ZEALAND LOCAL GOVERNMENT FUNDING AGENCY
TE PŪTEA KĀWANATANGA Ā-ROHE

11 August 2021

Craig Stobo
Chair
NZ Local Government Funding Agency

Dear Craig
LGFA assessment of the proposed Water Entities

On behalf of the LGFA Shareholders' Council as representatives of all LGFA Shareholders (who are also LGFA's major Guarantors), we request that an assessment of the implications of LGFA lending to the proposed Waters Entities is completed.

We are not seeking any comment on the merits of Government's policy in relation to Three Waters reform, but do want to understand the potential effects (both positive and negative) on LGFA Shareholders and Guarantors. We note one of the Secondary Objectives in the 2021/22 Statement of Intent is to "Assist the local government sector with significant matters such as COVID -19 response and the proposed Three Waters Reform Programme."

This will help us to provide a recommendation to Shareholders should any changes are required in due course that require a shareholder resolution e.g. amendments to foundation documents or the Shareholder's Agreement.

We see three potential scenarios unfolding from an LGFA perspective:

- LGFA not lending to new 3 Water entities, with around $4 billion of current LGFA loans being repaid, with (presumably) the new entities entering domestic capital markets to borrow in their own name. While the current council-held 3 Water loans may be replaced by other council borrowing, this may cause some disruption to LGFA.
- Councils assigning their existing loans related to water assets to the new Water Entities
- LGFA having a substantive role in either assisting the new Water entities with arranging financing or lending directly to them (subject to any legislative amendments required)

There may be other scenarios apart from those identified above, and we would welcome your analysis of any potential impacts of those as well.

While we expect the first scenario would have negative impacts on lending volumes, we understand it would have minimal impact on LGFA from a credit perspective. However, we are concerned about the impacts of the other two scenarios as they could require fundamental changes to the current arrangements for Shareholders and more importantly, Guarantors.

In particular, based on the current proposed entity structures and operating model, we would like you to consider the implications from a credit perspective of:

- The quality of future water revenues as security if they rank lower than council's rates revenue
- The ability of the Water Entities to enforce collection of unpaid water levies
- The extent of any Crown guarantees or other financial support
- The level of accountability to Councils (from a guarantor perspective) inherent in the proposed governance and ownership structure
- The controls required to ensure fiscal prudence from an inter-generational perspective e.g. Debt to Revenue covenants or similar
- The impacts on the overall credit quality of the LGFA loan book if the Water Entities borrowing (through all sources) results in a Debt to Revenue ratio higher than LGFA's current limits
- Whether there should be a lending cap on each of the Water Entities
- The expected credit rating of the proposed entities

This list is not exhaustive, and we welcome your consideration of any other relevant issues.

We would also like you to consider whether the Water Entitities should also be LGFA guarantors and if so, what modifications would be required to the current arrangements and associated documentation.

Once this work is completed, we will use it to inform Shareholders about any perceived benefits and/or deficiencies with the proposed arrangments from a credit perspective. Should any be identified that you consider cannot be addressed with the cooperation of government officials, we would welcome an assessment of the remaining underlying risks and any potential mitigants.

We are conscious that there is still considerable uncertainty about the exact arrangements for the new Water Entities and this may limit your ability to provide detailed analysis of the impacts to LGFA. However, as a minimum we would appreciate an indication of any areas where there are unresolved issues causing concern.

Finally, we seek your assessment of what steps would be required to obtain approvals from our Shareholders should LGFA wish to lend to the new Water Entities if/when they eventuate.

Yours sincerely

Alan Adcock
Chair, LGFA Shareholders' Council

cc. Mark Butcher, Chief Executive LGFA

LGFA
New Zealand Local Government Funding Agency
Te Pūtea Kāwanatanga ā-rohe

Alan Adcock
LGFA Shareholders Council

9 September 2021

Dear Alan,

Re Proposed Three Waters Entities

Introduction

As requested, we outline below our response to your letter of 11 August which requests our assessment of the implications of LGFA lending to the proposed Three Waters Entities. As you note our Statement of Intent requires us to "assist the local government sector with significant matters such as COVID-19 and the proposed Three Waters Reform Programme". We do not comment on the merits or otherwise of the Government's policies, rather we have used the lens of the interests of our shareholders and guarantors to come to the following assessments.

LGFA Expertise

LGFA is a great example of local and central government cooperation. From its incorporation in December 2011 the Central Government has seen its $5m minority shareholder contribution enable the business to grow to a balance sheet as of 30 June 2021 of $14.5b with 72 out of 78 Councils now voluntary members. LGFA's treasury expertise and product innovation has ensured it has continued to meet its purpose of benefiting communities through delivering efficient financing for local government.

It is because of our expertise and success to date that we welcome LGFA's inclusion in Central Government discussions with our member Councils.

Proposed Three Waters Structure Programme

While we understand that the Three Waters Reform Programme is still work in progress, we have keyed our understanding of the Programme off the presentation by the Department of Internal Affairs ("DIA") on 22 July at our Shareholders/Borrower Day in Wellington and the BNZ hosted webinar with DIA and S&P Global Ratings ("S&P"). The key structural points were, (and our commercial observations on the proposal are):

- While the programme is Three Waters, it is not clear yet how and when stormwater assets and associated accountabilities can be transferred.
- Four regional water entities are proposed within boundaries that have been outlined but not finalised;
- Councils will no longer own or control their water assets. A "bespoke" ownership model is proposed. This is unusual in NZ. Ownership will not consist of shareholdings but is proposed to be defined solely by legislation i.e. this is not a traditional corporate model. Ipso facto it can also be amended or overturned by subsequent legislation.
- Legislation will prescribe the entities' purpose as delivering water services and infrastructure; and enabling housing and urban development.
- Residual equity risk in the event of an adverse event suffered by an entity is to be implemented by "a

(central government) intervention framework with a risk-based approach". This has yet to be defined.

- Councils will retain the primary role in urban and land use planning. Water entities will be required to identify and make provision for infrastructure to support Council growth and development. It is unclear how each water entity can meet multiple stakeholder Council requirements without prioritising their scarce resources. The mechanism for this has not been detailed.
- Councils will only have an indirect and diluted role in governance of the entities. Councils will represent half of their Regional Representative Group, with the balance represented by Mana Whenua. It is unclear how voting rights will be distributed amongst Councils in each Regional Representative Group. Each Representative Group appoints an Independent Selection Panel which then appoints and monitors the entities' directors.
- Directors will have to manage diverse accountabilities and trade-offs. These include monitoring by their Independent Selection Panels; the issuance of a traditional Statement of Intent in response to a Statement of Strategy and Performance issued by each Regional Representative Group; consultation (with yet to be defined groups) on strategy, investment plans, pricing and charges; interaction with a consumer forum via a (yet to be determined) mechanism which allows for participation in entity decision-making; any Government Policy Statement; economic regulation (yet to be defined;) and (yet to be defined) charging and pricing frameworks to protect consumers.
- Former Council-owned assets are to be voluntarily transferred to the four water entities.
- Upon transfer of the assets, the water entities will pay to the Council the amount of debt linked to the water assets being transferred.
- The Government has agreed to provide a $2.5 billion package to support local government transition through the reforms. This is designed to ensure no council will be left financially worse off. However most of this support package comes from the water entities themselves which means their starting debt position is not zero and will reduce their total borrowing capacity.
- Councils are likely to have to transfer any water reserves that are in credit along with any Three Water development charges collected but not spent, to the new water entities.
- Water entities will borrow in their own names.
- The water entities are prohibited from paying dividends. This improves the working capital profile of the entities. But, as debt is allowed for and interest is able to be paid, the cost of capital for the new water entities effectively becomes the cost of their debt i.e. interest. Interest costs through time assumed on the more highly leveraged water entities are critical for the setting of water charges.
- We have assumed that all four water entities will implement water charges. Water charges are critical cashflows for working capital including servicing the entities' borrowing programmes. However there is no information yet on these charges, collection enforcement and whether they can differ by entity.
- We understand that the entities have obtained a shadow credit rating of "AA+" from S&P Global Ratings. We have not sighted this documentation but the rating rationale is critical for understanding debt, interest and liquidity covenants.

Various Scenarios and their Impact on LGFA

At your request we have considered the two scenarios of LGFA lending to, and not lending to, the proposed water entities. Our assessments of the possible impact on LGFA and other issues to consider are outlined in the following section. As discussed earlier these assessments are preliminary while negotiations between Councils and Central Government are still work in progress.

1. LGFA does not lend to the water entities

As at 30 June 2021 LGFA estimates the size of the water assets owned by local authorities to be around 25% of their total assets. Estimated debt associated with these assets as at June 2021 is $8.1 billion of which $5.6 billion are loans from LGFA. Note that there is no actual data available as at June 2021 because annual reports have not been published. The estimated debt is therefore based on the DIA dashboards which we have not verified.

At this stage we are not fully aware of how transition is expected to take place in July 2024. We assume that under the proposed programme Councils would transfer assets to the water entities and be repaid their associated loans. Councils could repay their loans (including loans from LGFA) in 2024 and could unwind their associated derivative positions. LGFA will need to be consulted early and work closely with the sector on this critical transition. LGFA will have to unwind our own derivative hedges associated with these loans and use the loan repayment proceeds to either repurchase LGFA bonds or add to our Liquid Assets Portfolio (and reduce future borrowing requirements). Due to the large amount of debt and hedges involved, a carefully managed transition would be important to minimise transaction costs.

Based on our most recent Statement of Intent forecasts the financial impact on LGFA would be

- Our balance sheet would reduce from $17.5 billion to $12.5 billion.
- We cannot accurately estimate the impact on Net Operating Profit due to other factors (general level of interest rates, cost of LGFA borrowing, loan margins, revenue from other products). However, we would expect it to decline by between $1.5 million and $3 million per annum to around $10 million per annum due to this lower level of assets.

In terms of credit quality

- Based on our modelling, we do not expect any Council borrower to breach its covenants given the assumption that the transfer of water assets, debt and revenue will generally be positive for councils from a static credit assessment. In general, water assets are more highly geared relative to revenue compared to other council assets. In addition, the government's transition package is designed to support councils who would be left worse off. But it will be important for each council to complete their own analysis and present their case to DIA for appropriate compensation.
- We expect lending to Auckland Council to remain within their covenant limit.
- We do not expect LGFA's AAA credit rating to be affected.

We are conscious that the sector is subject to the Review into the Future for Local Government, which is due to report back in April 2023, with a draft report in September 2022. This may change functions and accountability of local authorities including their borrowing profile.

Nevertheless, absent changes from the Review, we are confident that the sector's borrowing needs will continue to grow off this lower base level of debt. The water reforms potentially create headroom for councils to complete capital expenditure that currently does not fit within their financial headroom. In addition, LGFA will continue to innovate with its products and services to meet the sectors' borrowing needs.
The water entities would be new entrants in NZ's capital markets providing alternative debt instruments for investors. The degree of the "crowding out" impact on LGFA's access to capital markets and credit spreads to underlying benchmarks (and therefore the cost of borrowing on behalf of Councils for their remaining debt) will depend upon the success of the borrowing programmes chosen by the water entities. Nonetheless we would expect our issuance spreads to possibly widen in the first instance.
LGFA considers its rates security for lending to Councils to be very strong. LGFA's AAA domestic credit rating and its track record of successful issuance and lending over ten years to date, give us confidence that we will continue to support Councils.
In summary, at this stage of the Programme design, we do not have concerns for shareholders or guarantors, but expect a possible increase in borrowing costs for Councils.

2. LGFA lends to the water entities

LGFA could perform a principal role as a lender to the water entities or carry out a facilitator/arranger role of debt issued by the water entities on either an individual or consolidated basis. The choice would need to be supported by the owners of the water entities and LGFA shareholders.
It is proposed that the Three Waters Programme will legislate Council ownership of the water entities through a structure that has financial separation between councils and the water entities. Subject to legal advice and shareholder approval, LGFA could therefore lend to the water entities under the existing or any amended legislation. As is the case with Council borrowing from LGFA currently, we would expect to compete for business from these water entities. Given our AAA credit rating and track record LGFA should be able to provide a lower cost of borrowing, market access and long-dated debt maturities desired by these water entities than existing capital market alternatives.
Issues that would need to be resolved if we were to lend to water entities would include:

- The nature and size of the security of LGFA's loans such as a charge over water delivery or a crown indemnity.
- LGFA's required guarantee structure and its implications for the water entities and LGFA.
- Resolution of the residual equity equivalent. Transparency of the circumstances under which the Government would intervene to support the water entities is important.
- A final credit rating outcome for the new water entities that is no worse than the credit ratings of councils
- An assessment of their banking covenants, and security arrangements on any other financing
- An outline of their borrowing profile linked to the entities' capex programme rollout

The impact on LGFA will include:

- a larger balance sheet over time
- a larger and potentially different funding task
- a larger net operating profit
- a reduced concentration of credit risk on Auckland and Christchurch Councils
- a greater ability to issue Sustainable and Social Bonds because the water assets will be more explicitly identified and separated out.

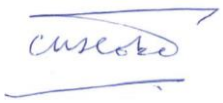
LGFA guarantors would need to be assured that LGFA lending to the water entities leaves them in no worse position than currently.

Shareholders would need to be assured that the risk profile of the business remains within the risk appetite of Councils and that returns on and return of their capital is enhanced.

Finally, Council borrowers would need to be assured that LGFA's participation improves (or in the very least not worsen) their borrowing spread costs relative to LGFA not participating.

I hope these thoughts are of interest and we look forward to further discussion.

Regards



Craig Stobo
Chair
On behalf of the Board of Directors
New Zealand Local Government Funding Agency

Advice on Water Reform Opt-Out

Report to Whangārei District Council

AUGUST 2021

Table of contents

Executive summary **5**
1 Introduction **10**
2 Government's Reform Scenario produces implausible household bill estimates **10**
2.1 Required investment estimate is overstated 10
2.1.1 WICS approach to estimating required investment is unsound 11
2.1.2 Required investment level is based on inappropriate Scottish comparators 13
2.1.3 WICS' required investment estimate is much higher than WDC's investment plans 16
2.2 Efficiency estimates for Reform Scenario are implausible 17
2.2.1 Capex efficiency estimates are implausible 17
2.2.2 Opex efficiency estimates are implausible 21
2.3 WICS analytical approach has other methodological flaws 24
3 WDC's Opt-Out household bills are likely to be much lower than government estimates **26**
3.1 WICS overlooks WDC's current high relative performance 26
3.2 Improved regulatory regimes will incentivise improved performance by WDC 27
3.2.1 Water quality regulation will likely lead to improved performance by WDC 27
3.2.2 Possible improvements from economic regulation regime have been overlooked 28
3.2.3 WDC management and operational competence likely to improve with competition between entities for staff 30
3.3 WDC can increase access to finance to lower short-term costs 30
4 WDC residents face risks and costs from Reform Scenario **32**
4.1 Local accountability for significant public asset and public service will be lost 32
4.2 Local variability in service and quality levels will be lost 32
4.3 Loss of economies of scope increases average cost of remaining council services by $1.9 million per annum 32
5 Recommended next steps **33**

Tables

Table 2.1: WICS modelling approaches for required investment 12
Table 2.2: Urban population statistics of New Zealand and Scotland 16
Table 3.1: Average bill per household under different financing options for WDC in Opt-Out Scenario 30
Table 3.2: Average bill per household under different financing options for Reform Scenario 31

Figures

Figure 0.1: Government's predicted outcomes in Reform Scenario and Opt-Out Scenario 6
Figure 0.2: Net investment scenarios for Whangārei under WICS models and WDC's own plan 7
Figure 0.3: Asset value per connected citizen for selected water utilities 8
Figure 2.1: New Zealand's asset gap according to WICS 14
Figure 2.2: Asset value per connected citizen for selected water utilities 15
Figure 2.3: Total Net Investment scenarios 17
Figure 2.4: Major cities within the proposed Entity A and the distances between them 19
Figure 2.5: Population density (persons per square kilometre) in Scotland 19
Figure 2.6: WDC three waters operating expenditure breakdown 22
Figure 2.7: Operating expenditure cost per connected property 23
Figure 2.8: Impact of time-profile adjustment on new investment path under the reform scenario 25

Definitions

WDC	Whangārei District Council
WICS	Water Industry Commission for Scotland
RFI	Request for Information
DIA	Department of Internal Affairs
LGNZ	Local Government New Zealand
IPART	Independent Pricing and Regulatory Tribunal

Executive summary

The government is proposing to reform the drinking, waste and storm water (three waters) sector. The reform will involve amalgamating the water services of the 67 local authorities into four new regional statutory corporations, with centralised management and a new governance structure. The structure will have indirect Board appointment rights for local authorities to be shared with mana whenua representatives.

The government proposes to amalgamate Whangārei District Council (WDC) into a new statutory corporation called "Entity A" together with the water services of Far North District Council, Kaipara District Council and Watercare Services Limited (owned by Auckland Council) (the Reform Scenario).

The government has given WDC two choices, join the Reform Scenario or Opt-Out. WDC, along with other local authorities, has been asked by the government to consider the evidence and whether the government's proposal to reform the water sector will deliver benefits to its residents. The government also committed to providing Whangārei with $38 million in funding under the "better off" package, an additional $5 million for stranded overhead costs under the "no worse off" package, and further compensation for any loss in WDC's debt headroom. These amounts are to be part-funded from the balance sheet of the new entity.

Key question: will the Reform Scenario deliver the claimed benefits?

The key question for this report is whether the benefits for WDC that are claimed by the government are robust, and whether the Whangārei community is likely to be better off with the Reform Scenario.

The Reform Scenario uses analysis provided by Water Industry Commission for Scotland (WICS), the Scottish government's regulator of its monopoly water provider Scottish Water. The WICS analysis and modelling underpins the case for reform. The government has relied on WICS for the claims that significant capital investment is needed in the New Zealand water sector, and that amalgamation into four separate entities with accompanying institutional changes is the only way to achieve the cost-efficiencies to make the reform affordable.

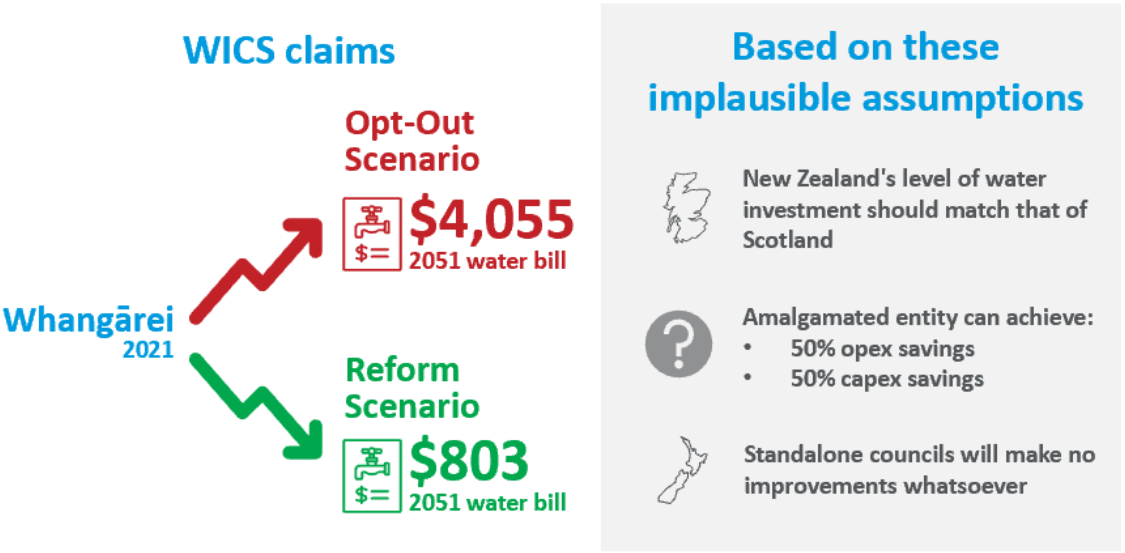
The government is promising that household bills will be four times lower in Reform Scenario than in Opt-Out

The government is promising that the Reform Scenario will deliver household bills that are more than four times lower than the bills that would exist in the Opt-Out Scenario. The government claims that the Reform Scenario will deliver Whangārei residents:

- Household bills that average $803 by 2051
- Improvements in service delivery and affordability
- Improvement in the ability to raise finance

In contrast, the government's WICS analysis claims that if WDC provides water services as an opt-out provider, household bills will rise to $4,055 by 2051.

Figure 0.1: Government's predicted outcomes in Reform Scenario and Opt-Out Scenario



Reform Scenario is based on faulty assumptions and flawed analysis

The Reform Scenario is based on faulty assumptions and flawed analysis. The government has not shown with sufficient certainty to WDC that the claimed benefits of the Reform Scenario will materialise.

The benefits of the Reform Scenario rest on three key claims:

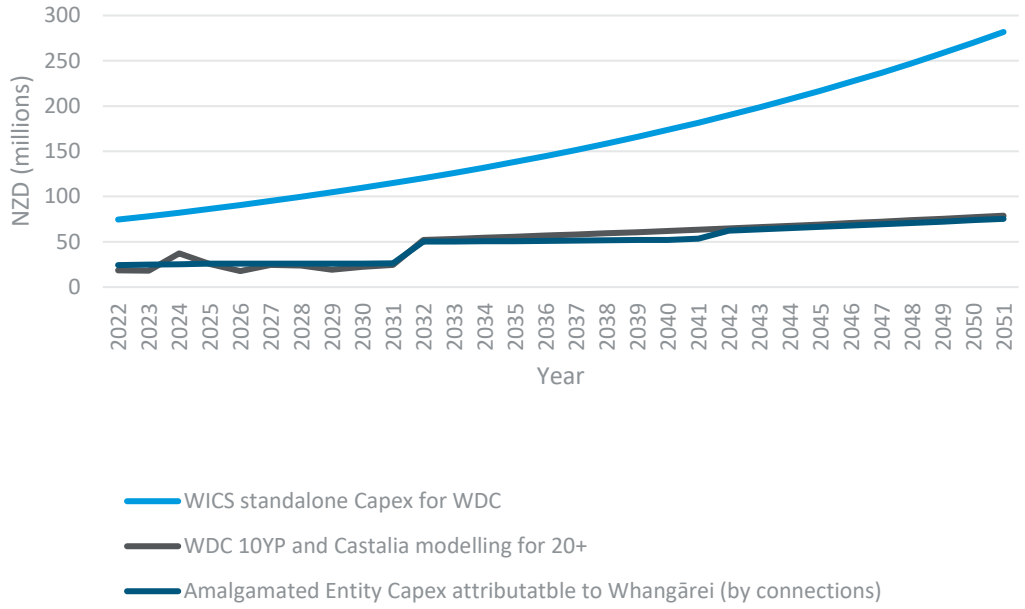
- That WDC (and New Zealand as a whole) needs to invest to match Scottish levels of water sector capital stock per resident
- The amalgamated entity will be able to halve its opex and capex relative to existing opt-out entities
- WDC as an opt-out entity will not improve over the next 30 years.

Required investment for WDC and for New Zealand as a whole is overstated

The Reform Scenario rests on WICS' modelling and manual adjustments that assume New Zealand will need significantly higher levels of capital investment over the next 30 years than is currently estimated in local authorities' own 10-year plans. The required capital investment, compared to WDC's own planned investment is illustrated below.

Figure 0.2 shows how WICS models a significant difference in net investment for WDC in the Opt-Out Scenario compared to WDC's own planned capital investment.[1] However, when the capital investment attributable to WDC in Entity A is calculated using WICS' model, the profile of planned investment is almost identical to WDC's own investment plans.[2]

Figure 0.2: Net investment scenarios for Whangārei under WICS models and WDC's own plan

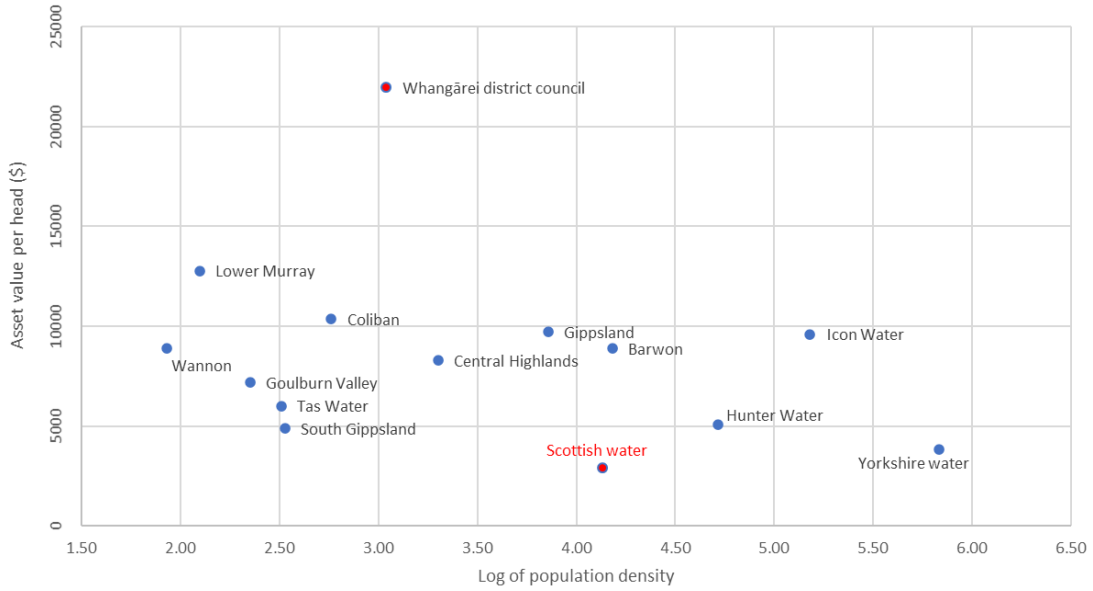


However, in modelling the Opt-Out Scenario, WICS claims that WDC needs large capital investment increases from 2021 because WICS selectively and mechanistically applies a model based on Scotland, that WICS suggests shows that New Zealand requires water asset capital stock of up to $70,000 per capita. However, there is no strong evidence that Scottish asset levels are relevant to New Zealand in general, or to Whangārei in particular. When we compare asset levels per capita to a wider range of water entities in Australia, which has closer similarities to New Zealand's urban geography than Scotland, the choice of the Scottish model is less clear.

[1] Total investment for WDC unconstrained scenario is derived from their Long-Term plans until 2031. After 2031, the investment requirements for years moving forward are projected as an average of total investment from 2022-2031 adjusted for inflation. It has been noted in the RFI that a further investment of $226 million, $78 million, and $55 million will be required for wastewater, water, and stormwater projects respectively. These figures have also been added to the projected investment requirements for 2031-2050.

[2] Amalgamated entity investment attributable to Whangārei has been calculated by attributing the net investment from the WICS models for Entity A proportionate to the total number of connections for Whangārei.

Figure 0.3: Asset value per connected citizen for selected water utilities



Note: Castalia could not reconcile WICS' estimated asset value per connected citizen for Scottish Water and Yorkshire Water based on those entities' annual reports. It is possible that WICS may be using undepreciated replacement values for the assets of those entities. For our analysis, we used asset values from the relevant entities' annual reports. As a result, the asset value per connected citizen in this figure for Scottish Water and Yorkshire Water do not match the WICS figures illustrated in Figure 2.1. We included all vertically integrated Australian water utilities where recent replacement values were available.

Efficiency assumptions are implausible

WICS' modelling makes implausible assumptions about the efficiency in the Reform Scenario. The government assumes that the Reform Scenario will deliver 50 percent capital expenditure (capex) savings and 53 percent operating expenditure (opex) savings.

The capex saving is not grounded in any actual evidence, but rather on WICS' observations. The implausibility of capex savings has also been addressed in previous analysis by Castalia for Local Government New Zealand and the Joint Steering Committee. Economies of scale in capex are not available in New Zealand water services, except for minor potential cost savings in procurement.

The opex saving is also derived from Ofwat and Scottish observations. However, for WDC the opex efficiency is implausible because WDC already has comparable opex to Watercare. Furthermore, the government and LGNZ representatives have assured councils that no jobs will be lost in the water sector. Given the profile of WDC's opex (mostly power, labour and outsourced services), it seems unlikely that significant further savings are possible.

WDC is likely to improve water service delivery if it opts out, yet WICS assumes no such improvements

In any case, WDC is likely to improve its services over the next 30 years, yet WICS' modelling assumes that WDC will make no efficiency gains under the Opt-Out scenario. As a result, the Opt-Out scenario, as modelled by WICS, likely overstates WDC's costs.

WDC will be subjected to water quality regulation, and obtain guidance and expertise from Taumata Arowai. Corporatisation and improved performance of other water service providers will lead to changes at WDC that drive better performance as WDC seeks to match the benchmarks set.

Economic regulation is likely to apply across the sector, not just to four amalgamated entities. The government's assumption that it cannot regulate all council-owned water services is inconsistent with the Commerce Commission's regulation of electricity distribution businesses and inconsistent with the experience in multiple overseas jurisdictions where economic regulators are capable of regulating many entities. Economic regulation is also likely to enable benchmarking and comparisons.

WDC should examine how it can provide a constructive counter-proposal to the government

Water services are critical to wellbeing, so it is very important that options are considered that are locally appropriate. Water services should be safe, resilient, reliable, and customer responsive, at least cost. Some reform of the sector is necessary in some parts of New Zealand. However, the analysis needs to done to determine where water services fall short of this objective, and for what reasons.

Other than opting out, the Reform Scenario is the only option that has been presented to WDC and other local authorities.

This report has shown that the Reform Scenario is founded on unsound evidence and faulty analysis. The promised benefits of reform are unlikely to materialise. There are risks to the Whangārei community from losing control of water services, and accountability of those tasked with governance to local customers.

We recommend that WDC carry out a proper net benefit analysis, potentially with other local authorities that have a similar viewpoint. This is likely to be many councils, since the WICS analysis has consistent faults that apply to all local authorities. Such an analysis should include the full range of options together with transparent data and sound and contestable analysis so these options can be properly evaluated. There is plenty of analysis, evidence and now a rich data set in the RFI responses for WDC and like-minded local authorities to be able to identify alternative and better reform options. WDC could prepare a constructive counterproposal that achieves desirable objectives, while avoiding the risks and costs of the Reform Scenario.

1 Introduction

The New Zealand government is proposing to reform the drinking, waste and storm water (three waters) sector. It proposes to amalgamate the three waters services of the 67 local authorities into four regional public corporations.

The government is proposing to amalgamate WDC's water services into a new statutory corporation called "Entity A" together with the water services of Far North District Council, Kaipara District Council and Watercare Services Limited, owned by Auckland Council (the Reform Scenario). The government has presented the only alternative to the Reform Scenario as being a situation where WDC remains as a standalone water service provider under council control (the Opt-Out Scenario).

This report analyses the evidence underpinning both the Reform Scenario and the Opt-Out Scenario as follows:

- The Reform Scenario is analysed, and its underlying assumptions tested to determine whether the stated level of household bills is robust (section 2). Specifically the analysis reviews:
  - The estimates of the required level of assets for the Reform Scenario (section 2.1)
  - The estimated efficiencies apparently available in the Reform Scenario (section 2.2)
  - Other aspects of the methodology that raise questions (section 2.3).
- The Opt-Out Scenario is analysed and its underlying assumptions tested to determine whether the stated level of household bills is robust (section 3)
- Finally, the risks and costs to the WDC community with the Reform Scenario are examined (section 4).

2 Government's Reform Scenario produces implausible household bill estimates

The Reform Proposal predicts household bills for 2051. The WICS analysis rests on two key assumptions: First, that the capital stock invested in New Zealand water services needs to increase by a very large amount. Second, that the Reform Scenario will deliver large efficiency gains compared to the Opt-Out Scenario. In our view, WICS' assumed scale of required increase in capital stock, and of the achievable efficiency gains under the reforms, are both implausible.

2.1 Required investment estimate is overstated

The government's case for reform rests on a claim that New Zealand water services require a significant capital investment over the next 30 years. The government relies on WICS advice and analysis to set the level of investment for the Reform Scenario from 2021 to 2051.

WICS' modelling is entirely based on a top-down, New Zealand-wide assumption that a massive nationwide investment programme is necessary for all council water services. This is

despite WDC and all other local authorities submitting detailed bottom-up information about planned capital investment.

Capital investment is needed in some parts of New Zealand now and in the next 30 years to meet the demands of growth and due to historical deferred and underinvestment. There have been high-profile asset failures. However, it is not clear that the investment is needed in all places, at the scale WICS claim.

WICS are selective in estimating the nationwide required investment amount. WICS also use inappropriate Scottish comparators to support its claim that New Zealand needs to invest at equivalent levels. WICS' estimate of required investment is significantly higher than the levels of investment that asset-owner WDC has estimated will be required.

WICS used projected investment requirements across three investment types that include replacement or renewal investment, enhancement investment, and growth investment projections. These projections are based on assumptions relating to asset lives, replacement costs, inflation, population density, and projected connections growth.

2.1.1 WICS approach to estimating required investment is unsound

In order to estimate the required investment, WICS uses English and Scottish comparators. WICS allocated New Zealand-wide investment requirements for councils based on statistical relationships and observed experiences in England and Scotland. The total investment required is made up of two key components that include 'enhancement and growth' and 'asset replacement and refurbishment'.

WICS modelled the required investment using three approaches. WICS then cross-checked the modelled investment against information gathered from councils' RFI responses. The modelled investment from the three approaches, plus investment specified in councils' RFI responses are summarised in Table 2.1.

WICS took three steps with each of its three modelling approaches:

- Step 1 is to apply econometric models to predict New Zealand's investment needs
- Step 2 is to manually adjust the Step 1 estimate for differences in growth
- Step 3 is to apply a cap of $70,000 to reflect an assumption about the ability to pay for the investment.

Table 2.1: WICS modelling approaches for required investment

	Approach	Enhancement and Growth Investment ($ billions)			Asset replacement and refurbishment ($ billions)	Total Investment [3] ($, billions)
		Step 1: Unadjusted model output (NZ $, billions)	Step 2: Manual adjustment for "differences in growth"	Step 3: Apply cap of $70,000 per connected citizen		
1	Great Britain comparative Models	49 – 69	63-83	57-77	63-77	120-154
2	Scotland only comparative models (WICS preferred)	73- 99	87 -113	77-100	70-86	148-185
3	Asset value comparisons with UK [4]	52-57	81-85	77-81	70-79	148-160
	Information included in councils' RFI	53	*N/A*	*N/A*	61-69	115-122

Source: WICS Final Report

WICS makes no adjustment for the overlapping nature of growth and replacement investment

We note that, in practice, when enhancement and growth investment takes place, the new upgraded assets often replace at least some ageing assets, thus reducing the need for replacement expenditure. WICS' approach appears to have made no adjustment for this, since the total investment is calculated as the simple sum of 'enhancement and growth' and 'asset replacement and refurbishment', and the estimates for the two categories are derived separately, with no consideration of interaction between the two. This means that WICS' total investment estimate will be overstated.

WICS' preferred model appears highly selective

WICS' models in approaches '1' (Great Britain comparative) and '3' (comparing asset values) produce a level of enhancement and growth investment in Step 1 that is broadly consistent with councils' RFI responses.

Yet despite the consistency with councils' own estimates of investment, WICS' preferred model is approach '2'. Approach '2' reports significantly higher required levels of investment.

[3] Total investment is calculated adding enhancement and growth estimates taken from estimates after applying a cap of NZ$70,000 per connected citizen and the asset replacement and refurbishment expenditures. The range represents the modelled low and high values of investment requirements.

[4] This approach is briefly explained by WICS to use projected investment that is required to match the levels of asset values per connected citizen in the UK and Scotland for 2020 after adjusting for depreciation and connection differences.

WICS Step 2 and Step 3 adjustments to its models are unsound

WICS' 'enhancement and growth investment' models in approaches '1' and '2' are apparently driven by population density.[5] That is to say, the models should automatically predict the required level of investment, given population density in New Zealand. However, WICS has manually increased the required level of investment to "adjust for differences in growth".

WICS then make a further manual adjustment and impose an investment constraint cap of $70,000 per connected citizen due to affordability concerns, because mechanistically applying the Scotland comparator (Step 1) and manual adjustments (Step 2) leads to even higher and even more implausible levels of investment.

WICS ignored local authorities' own estimates of required investment

All local authorities in New Zealand agreed to provide the government with comprehensive information about water services during the Request for Information (RFI) phase in mid-2020. The RFI responses included a full picture of all local authorities' planned water sector investment.

Local authorities, as asset owners with accountability to local communities, have a sound understanding of the investment needs required in three waters' services. WICS could have used this detailed and rich data source to estimate the required investment levels. WICS could have made adjustments to the RFI data to account for any conservatism, or to account for differences in the sophistication of management in estimating investment needs. However, WICS preferred top-down modelling using overseas comparators.

2.1.2 Required investment level is based on inappropriate Scottish comparators

WICS estimate of New Zealand's water investment needs is based on an assumption that it must match investment levels in Scotland. This is justified on the grounds that NZ has a relatively lower level of urbanisation.[6] However, WICS does not use urbanisation figures in its analysis. Instead, it uses population density, which is a different concept.

WICS concludes that Scotland is the most appropriate guide for the required level of investment because of New Zealand's low population density compared to other areas in the United Kingdom.

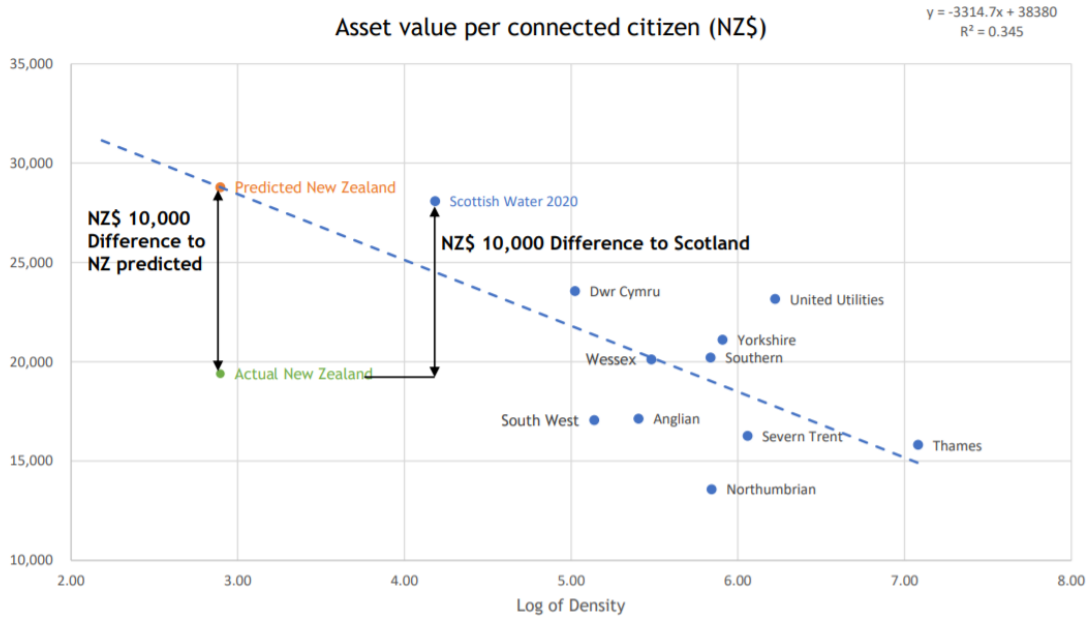
WICS predicts New Zealand's water investment needs based on correlation with population density

WICS identifies a correlation between English and Scottish drinking water and wastewater asset value levels and population density. This is illustrated in Figure 2.1, which we reproduced from WICS report. Based on the correlation between asset value levels and population density, WICS suggests that NZ investment needs to rise significantly. According to this correlation, New Zealand's top-down, national-level required investment is $10,000 lower than it should be.

[5] WICS supporting material 1 – required investment (slide 33), https://www.dia.govt.nz/diawebsite.nsf/Files/Three-waters-reform-programme/$file/wics-supporting-material-1-required-investment.pdf

[6] WICS supporting material 1 – required investment (slide 19), https://www.dia.govt.nz/diawebsite.nsf/Files/Three-waters-reform-programme/$file/wics-supporting-material-1-required-investment.pdf

Figure 2.1: New Zealand's asset gap according to WICS



Source: WICS final report

Population density is not a good predictor of required asset value levels

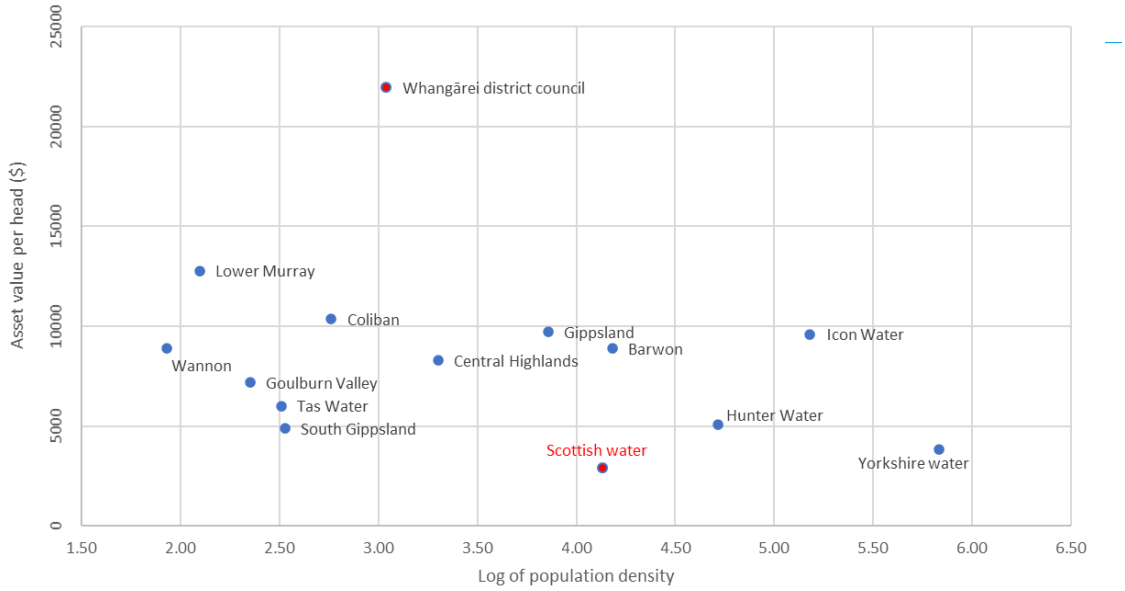
However, WICS does not show how the weak correlation in Scotland and England might predict water investment needed in New Zealand. No causal link is drawn. We were also unable to reconcile WICS' Asset value per connected citizen figures for Scottish Water and Yorkshire. They are much higher than what is implied by the asset values listed in those entities' annual accounts. It is possible that WICS may be using undepreciated replacement values for the assets of those entities, which should not be compared to the optimised depreciated replacement values submitted by WDC.

We analysed other regulated water utilities, including in Australia, to determine whether there was a clear relationship between asset level per connected citizen and population density. Australia has some similarities with New Zealand in that its population is highly urbanised, but overall population density is quite low, because towns are far from each other. Australia's towns developed at a similar time to New Zealand's and therefore follow the same typical geography (detached houses on suburban sections). Figure 2.2 shows a plot of asset value per connected citizen for water utilities in Australia, Scottish Water, Yorkshire Water and WDC.

For our analysis, we used asset values from the relevant entities' annual reports. As a result, the asset value per connected citizen in this figure for Scottish Water and Yorkshire Water do not match the WICS figures in Figure 2.1.

There is a very weak relationship between population density and asset value per connected citizen as identified by WICS. Figure 2.2 shows that by adding or removing comparator water providers, the correlation line could change markedly.

Figure 2.2: Asset value per connected citizen for selected water utilities



Note: Castalia could not reconcile WICS' estimated asset value per connected citizen for Scottish Water and Yorkshire Water based on those entities' annual reports. It is possible that WICS may be using undepreciated replacement values for the assets of those entities. For our analysis, we used asset values from the relevant entities' annual reports. As a result, the asset value per connected citizen in this figure for Scottish Water and Yorkshire Water do not match the WICS figures illustrated in Figure 2.1. We included all vertically integrated Australian water utilities where recent replacement values were available.

There are significant differences between Scotland and New Zealand geographies

Scotland is not a relevant comparator for New Zealand water services because of fundamental differences between the two countries' geography. In water services, geography is important for the cost and quality of service. Denser urban areas tend to have lower average costs of service. Water services with more dispersed customers have to distribute drinking water, and pump wastewater over longer distances with more pipes, dispersed treatment infrastructure and higher costs. Aside from some high-level discussion of available water sources, and similar populations, WICS has not investigated why Scotland's geography is a good predictor of New Zealand's water investment needs.

The total land area and the geographical distribution of the populations are very different. WICS incorrectly assumes that lower population density in New Zealand implies lower levels of urbanisation. Table 2.2 illustrates how New Zealand's population is more urbanised than Scotland's, but despite this, New Zealand still has a lower population density. A larger majority of New Zealand's population live in urban areas and the urban population is more likely to grow in New Zealand as compared to Scotland.

Table 2.2: Urban population statistics of New Zealand and Scotland

	Population Density(people per sq. km of land are)	Urban population (% of population)	Population in the largest city (% of urban population)	Urban population growth (annual %)
New Zealand	18.6	86.7	36.4 (Auckland)	2.2
Scotland	65	83.04[7]	11.6 (Glasgow)	-0.06[8]

Source: World Bank Indicator Database, 2020

2.1.3 WICS' required investment estimate is much higher than WDC's investment plans

WDC's investment plans in its 10-year plan and longer-term investment planning are significantly lower than the WICS estimates for the Opt-Out Scenario. WDC's RFI response reveals that its planned investment is orders of magnitude below the level that WICS' model predicts. This is despite the WDC having a similar level of asset value per connected property as Auckland's Watercare, the largest water provider and, according to WICS, the most sophisticated. The net assets per connected property was $23,732 for Auckland and $22,831 for WDC in 2020.[9] Moreover, WDC compares even more favourably than Scottish Water in terms of asset values per connected citizen, as illustrated in Figure 2.2

Figure 2.3 illustrates the significant difference between WICS' modelled net investment needs for WDC, and WDC's own planned capital investment.[10] We also calculated the capital investment attributable to WDC in Entity A using WICS' model and find that it is remarkably similar to WDC's own investment plans.[11]

[7] https://www.gov.scot/publications/rural-scotland-key-facts-2018/pages/2/

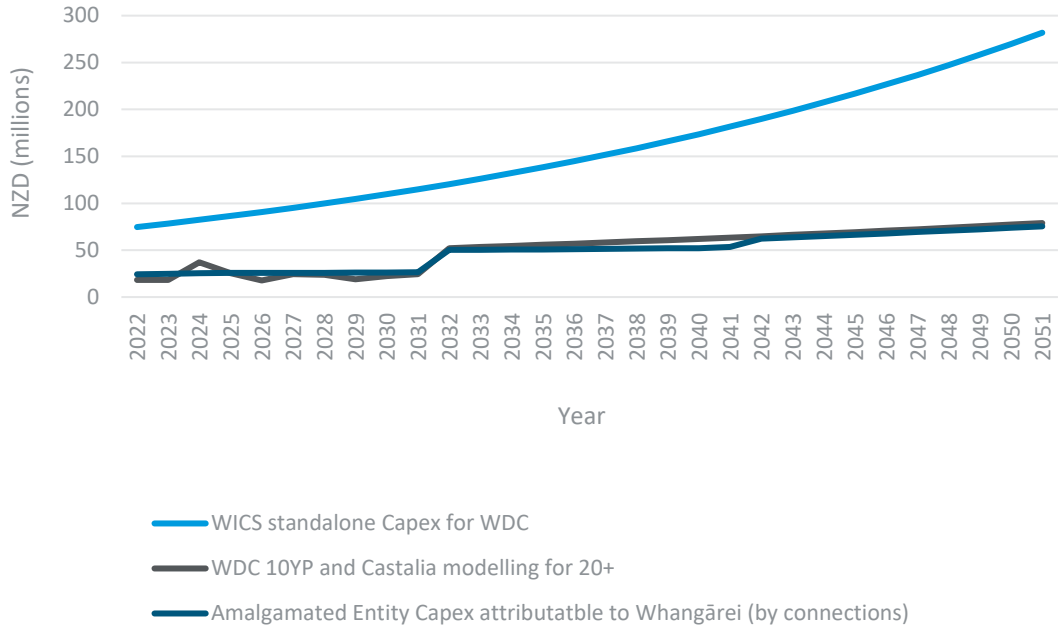
[8] Urban population as a percent of total population has decreased by 0.06 percent between 2018 and 2019. https://www.nrscotland.gov.uk/statistics-and-data/statistics/statistics-by-theme/population/population-estimates/2011-based-special-area-population-estimates/population-estimates-by-urban-rural-classification

[9] Calculated from WDC and Auckland Council's RFI responses.

[10] Total investment for WDC unconstrained scenario is derived from their Long-Term plans until 2031. After 2031, the investment requirements for years moving forward are projected as an average of total investment from 2022-2031 adjusted for inflation. It has been noted in the RFI that a further investment of $226 million, $78 million, and $55 million will be required for wastewater, water, and stormwater projects respectively. These figures have also been added to the projected investment requirements for 2031-2050.

[11] Amalgamated entity investment attributable to Whangārei has been calculated by attributing the net investment from the WICS models for Entity A proportionate to the total number of connections for Whangārei.

Figure 2.3: Total Net Investment scenarios



2.2 Efficiency estimates for Reform Scenario are implausible

WICS uses efficiency assumptions in its analysis of the amalgamated entity (Entity A). The efficiency assumptions drive significant cost savings for the Reform Scenario. WICS assumes that:

- Capital expenditure (capex) efficiency will reach 50 percent
- Operating expenditure (opex) efficiency will reach 53.3 percent

It also assumes a total factor productivity efficiency improvement of 0.4 percent per annum for the Reform Scenario but not for WDC as an opt-out entity. These efficiency estimates are highly implausible.

2.2.1 Capex efficiency estimates are implausible

WICS claims that the Reform Scenario will result in 50 percent lower capital costs. WICS claims that Entity A will progressively improve its capex efficiency so that by 2041 it is saving 50 percent per annum. That is, by 2041, for each $0.50 invested, Entity A will get $1.00 of capex value. This is an implausible assumption for the following reasons:

- The assumption is not sourced to any credible authority or from any observed experience that is relevant to New Zealand
- WICS has not shown how Scottish Water capex has any bearing on New Zealand water services and geography

- Only very minor economies of scale are available in New Zealand water services
- The assumption has been criticised by government-appointed peer reviewers
- The assumption does not consider diseconomies of scale.

The Entity A model results are highly sensitive to this assumption, so if it is wrong, the benefits of the Reform Scenario change drastically.

WICS capex efficiency is based on a single source of information

WICS capital expenditure assumption is based solely on a belief that it "seems reasonable to expect a reformed three waters industry in New Zealand to match the efficiency improvement of the industry in Scotland and by the water and sewerage companies in England and Wales." The only quantitative analysis WICS says it has undertaken to support this belief is an observation that Scotland improved capital expenditure efficiency from 2002-2021. This quantitative analysis has not been substantiated in any documents released to WDC. There are many reasons why Scottish Water may have improved reported capital expenditure efficiency. These reasons are likely to be specific to Scottish Water. Decision-makers need an explanation of those reasons to understand whether the same improvements can be achieved in New Zealand entities. WICS provides no such explanation.

The citation used in the Entity A model[12] is also misleading. WICS incorrectly cites the source for the capital efficiency improvement as "based on observed experience from GB". However, the actual source of WICS' capital efficiency assumption is not Great Britain at all. Rather WICS cites[13] the single observation of claimed efficiency improvements by Scottish Water from 2002-2021.

WICS claims that the capex efficiency will come from:

- Economies of scale
- Clarity of policy priority
- Robust water quality and environmental regulation
- Economic regulation
- Excellence in management.

WICS does not disclose the relative contribution of these factors to the total 50 percent efficiency gain. In section 3 below, we discuss how water service providers in the Opt-Out Scenario are likely to improve as a result of the improved water quality regulatory regime, how management may improve, and how it is possible that economic regulation could apply to other water services (not just the amalgamated entities).

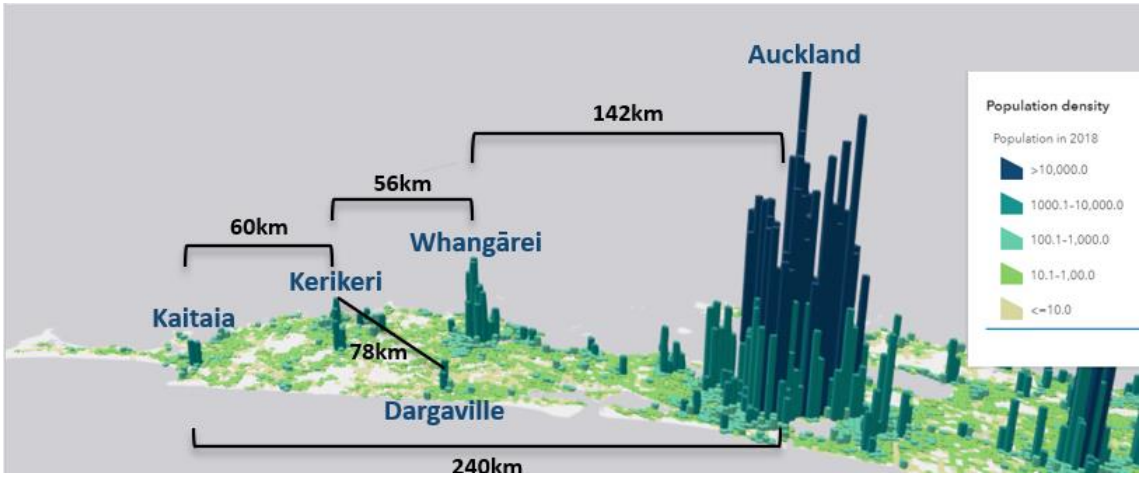
Scotland is an inappropriate model for Entity A—Auckland, Whangārei, Kaipara and Far North

The population within the Entity A boundaries almost all live in urban areas. There are significant distances between each urban area. Figure 2.4 illustrates the population densities and distances between Entity A towns.

[12] And in the models for Entity B, Entity C and Entity D.

[13] WICS slidedeck "Entity A: the use and analysis of the RFI information and other benchmarks", available at: https://www.dia.govt.nz/Three-Waters-Reform-Individual-council-models-and-slidepacks

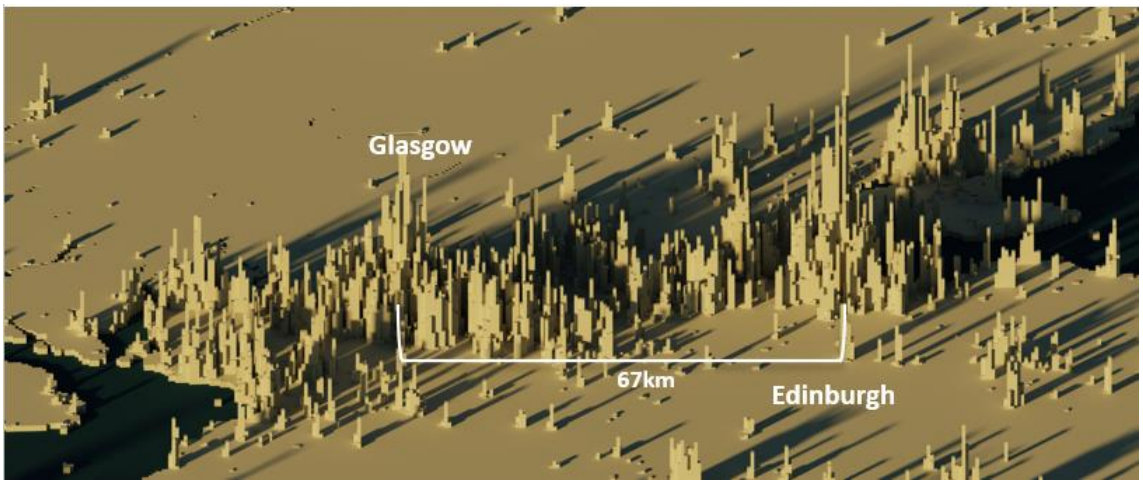
Figure 2.4: Major cities within the proposed Entity A and the distances between them



Source: NZ Population in 3D, Stats NZ

This is different from Scotland, where most of the population lives in the narrow band that is between and around Glasgow and Edinburgh (Figure 2.5). There is potential for agglomeration efficiencies and for networks to achieve some scale benefits based on proximity alone.

Figure 2.5: Population density (persons per square kilometre) in Scotland



Data Source: https://www.worldpop.org/ (3D map generated by Castalia)

In contrast, almost 99 percent of the total population of proposed Entity A live in urban areas with significant distances between them. This means that the "asset optimisation" (that is, the ability to consolidate water networks between towns) is likely to be much lower than as claimed by WICS due to significant distances between New Zealand towns.

Economies of scale are not available in water services from amalgamations at the level WICS claims

Castalia has previously advised DIA, LGNZ and the Joint Steering Committee that the economies of scale claimed in WICS' 2020 slidedecks from administrative amalgamations were

implausible. In New Zealand, only minor economies of scale are achievable through institutional reform, and these will be mostly in management and procurement (not infrastructure capex).[14] Castalia showed that economies of scale are unlikely to be available in New Zealand on the basis of the evidence presented by WICS, Frontier Economics and in the economic literature relied on by the government. The findings in Castalia's 2020 Economies of Scale report have not been rebutted.

WICS claims that the 50 percent capex efficiency gain emerges when water entities achieve a population of 800,000 or more. It also claims that entities serving a minimum population of 59,000 increase capex efficiency as they approach the 800,000 population number. This claim has no basis in the economic literature.

In fact, the literature that looks at the specific question of whether economies of scale are available from administrative amalgamations find that there are none except in highly specific circumstances, not present in New Zealand. Economies of scale estimate is based on non-credible evidence

When preparing the 2020 Economies of Scale report, Castalia reviewed the WICS 2020 slidedecks. Access to the underlying models and assumptions was refused. In the 2020 Economies of Scale report, we were advised[15] that the economies of scale assumption was based on England, Wales and Scotland observations. However, we now know that the supporting evidence for the 53 percent capex efficiency is a single Scottish observation from 2002-2021.[16]

WICS economies of scale claims are rejected by peer reviewers FarrierSwier

FarrierSwier peer-reviewed WICS' approach and had access to the underlying models. It found that "WICS analysis cannot be used to definitively conclude that amalgamation in and of itself will lead to material efficiency gains in New Zealand".[17] Its review did not assess whether the outputs from the WICS analysis are reasonable or free from error.[18]

FarrierSwier also state "significant care should be taken when relying on the capital efficiency gaps estimated by WICS. This is particularly important, given the significant step up in investment forecast for the 30-year period and the role that the capex efficiency assumption plays when estimating benefits from amalgamation and associated reform." Like Castalia, FarrierSwier express concern with the sensitivity analysis approach.

Diseconomies of scale not considered

Diseconomies of scale can emerge from administrative amalgamations in water services. This was not considered in WICS' modelling.

WICS has overlooked a relevant case from Australia. In 1992, Melbourne and Metropolitan Board of Works merged with several smaller urban water authorities to form Melbourne

[14] Castalia (2020), Analysing Economies of Scale in New Zealand Water Services: Report to Local Government New Zealand

[15] Conference call between Castalia and WICS (Alan Sutherland) on 20 August 2020

[16] WICS (2021), Slidedeck "Entity A: the use and analysis of the RFI information and other benchmarks", available at: https://www.dia.govt.nz/Three-Waters-Reform-Individual-council-models-and-slidepacks

[17] FarrierSwier (2021), Three Waters Reform: Review of the methodology and assumptions underpinning economic analysis of aggregation, page 29

[18] FarrierSwier (2021), Three Waters Reform: Review of the methodology and assumptions underpinning economic analysis of aggregation, pp. iv-v

Water. However, in 1995, the entity was disaggregated, and Melbourne Water reformed to become a wholesale water company only. City West Water, South East Water and Yarra Valley Water became separate retail water companies.[19] Several studies confirm that the three disaggregated retail water entities achieved significant cost efficiencies and service level improvements compared to Australian and international water companies since the disaggregation of Melbourne Water.[20] A benchmarking analysis using data from 2002-2003 concluded that the three separate retailers performed "at or near the determined efficiency frontier".[21] It also made major improvements in customer services in comparison to major urban water authorities in Australia. Melbourne's disaggregated water entities even performed better than UK water companies, according to Ofwat.[22]

2.2.2 Opex efficiency estimates are implausible

Efficiency estimates derived from econometric studies in the UK are used in the Reform Scenario to drive a claimed 53.3 percent saving in opex.

WICS use econometric models to claim that opex efficiencies of 50 percent are possible

WICS has used an Ofwat 2004 econometric model to estimate that, after reform, larger New Zealand water entities can achieve up to a 53.3 percent efficiency improvement to operating expenditure (opex).

To estimate the opex efficiencies, WICS combined 2003-2004 data from the UK with recent data from New Zealand councils to estimate a performance baseline to measure New Zealand water entities against. To ensure compatibility of the estimates with New Zealand's operating environment, the gaps in efficiency between New Zealand entities and the benchmark were adjusted with 'special factors' related to regulatory, geographic and environmental factors that were considered unique to New Zealand.

Based on observed efficiency gains from UK water reforms, WICS assumes that New Zealand water reforms may achieve the same operating efficiency results – roughly a 50 percent improvement.

It is important to note that these estimates are an assumed benchmark that provides a guide to what might be possible based on experiences in the UK water sector but, as peer reviewer FarrierSwier notes, care needs to be taken as it is not possible to conclude that those efficiencies can be realised.[23]

From observations of UK data, larger water entities – those serving populations greater than 800,000, realised larger efficiency improvements than smaller entities. As such, WICS assumes

[19] https://www.melbournewater.com.au/water-data-and-education/water-facts-and-history/history-and-heritage/timeline-our-history

[20] Water Ways: Inquiry into Reform of the Metropolitan Retail Water Sector (2007). https://www.dtf.vic.gov.au/sites/default/files/2018-02/reform-of-the-metropolitan-retail-water-sector-inquiry.pdf

[21] Coelli and Walding (2006), "Performance measurement in the Australian water supply industry: A preliminary analysis." Performance measurement and regulation of network utilities, 29-61.

[22] Annual Report 2007-08 (Ofwat) https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/250280/0589.pdf

[23] FarrierSwier (2021), Three Waters Reform: Review of the methodology and assumptions underpinning economic analysis of aggregation, page 60

that given the small size of individual councils in New Zealand, the councils will not be able to fully realise the predicted efficiency improvements if they do not amalgamate.

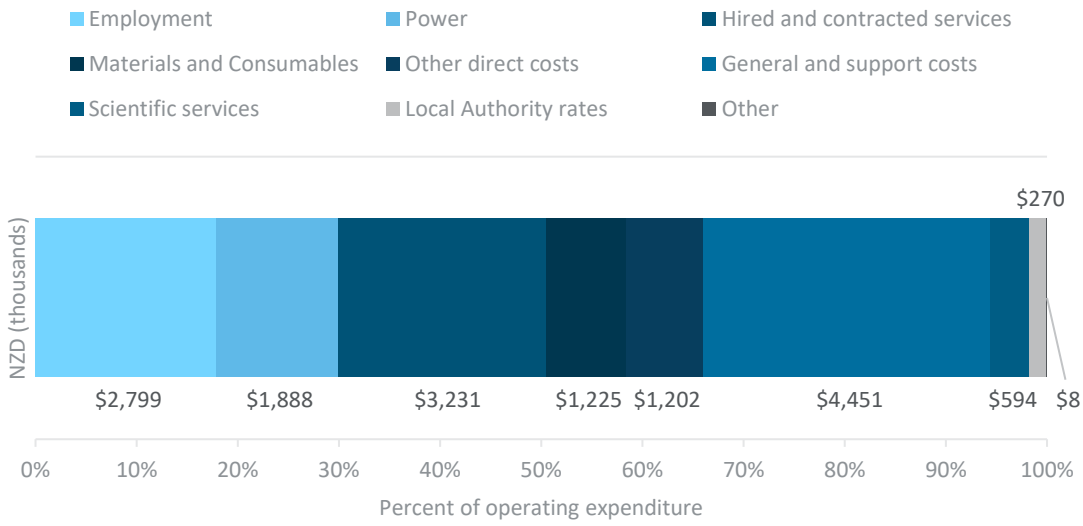
WDC does not appear to have significant opportunity for opex savings

A 50 percent reduction in WDC's opex costs appears implausible given the nature of those costs. Approximately 58 percent of WDC's opex costs are made up of employment, hired and contracted services, power, and materials and consumables. Power costs will not reduce significantly as a result of administrative amalgamations. Some minor cost savings are possible for materials and consumables in the Reform Scenario (for example, as a result from buying in bulk). However, none of the opex costs are likely to fall by 50 percent.

Labour cost reductions, including direct employment costs and hired and contracted services, would not be expected to decrease, based on promises of no job losses from government representatives and Three Waters Steering Committee members:

- Rachel Reese, Mayor of Nelson and Three Waters Steering Committee member stated: "all of our staff in our organisations… you will have a guaranteed role in the new service entities. The role will retain the features of your current role; your salary, your terms, and your location."[24]
- Grant Robertson, Minister of Infrastructure said, "The recognition of the workforce… the current workforce involved in this space… this is more work here, more jobs here, higher paid jobs here, that transitional process must include that workforce and must include you, and I want to give that commitment to you today."[25]

Figure 2.6: WDC three waters operating expenditure breakdown



Source: Whangārei District Council RFI, averaged data from 2019-2021

[24] Rachel Reese, Mayor of Nelson and Three Waters Steering Committee member – Thursday 15th July 2021, LGNZ Conference Speech [00:23:12:00], available at https://www.lgnz.co.nz/about/lgnz-conference/2021-lgnz-conference/videos-conference-2021/

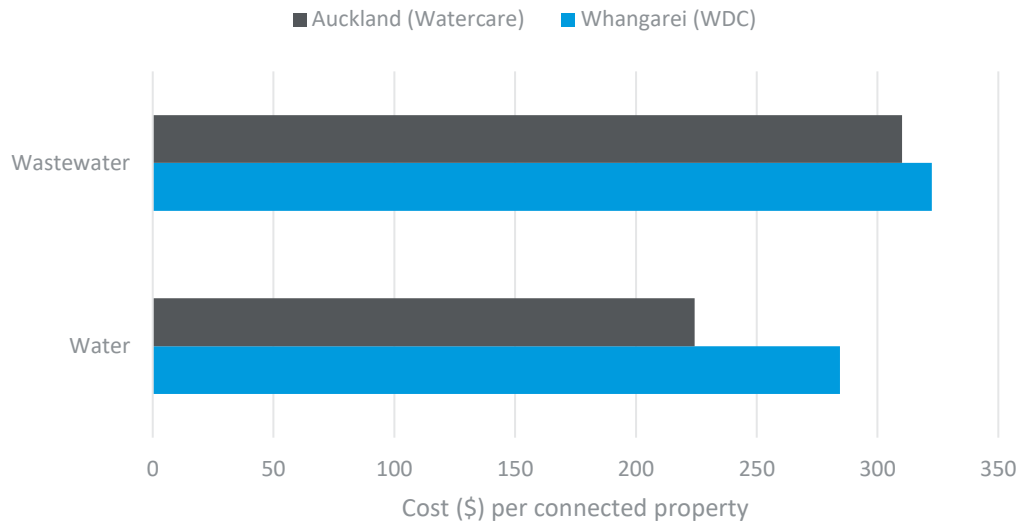
[25] Grant Robertson, Minister of Infrastructure – Thursday 15th July 2021, LGNZ Conference Speech [00:33:40:00], available at https://www.lgnz.co.nz/about/lgnz-conference/2021-lgnz-conference/videos-conference-2021/

WDC's opex costs are similar to Watercare's suggesting WDC is already performing efficiently

Despite serving a significantly smaller customer base compared to Auckland (~25,000 compared to ~525,000 connected properties) WDC has similar opex per connected property for water as Watercare in Auckland: $284 compared to $224. The relative difference in opex per connected property for wastewater is even lower for WDC and Watercare: $322 compared to $310.

This suggests that Whangārei is already operating to a level of efficiency close to that of Watercare, which already represents 95 percent of the connections of the Reform Scenario Entity A. It is difficult to understand how scale could improve opex efficiency at WDC given that it has comparable opex costs to Watercare.

Figure 2.7: Operating expenditure cost per connected property



Source: Whangārei and Auckland RFI

WDC, and other local authorities already outsource operational capability to scale providers

Many New Zealand water companies already outsource operational capability to specialist providers. Several large-scale providers deliver services across all of New Zealand, such as Downer, CityCare Water and Veolia (a global specialist water services company). Other large-scale providers operate on a regional basis, such as Watercare (which provides services around Auckland).

Outsourced services amount to around 20 percent of WDC's annual opex costs. Outsource providers already achieve economies of scope and scale across regions and New Zealand. This is because outsourced service providers can offer specialist expertise on a contracted basis, where full-time employment of staff may not be warranted. Outsource providers also compete with one another for council contracts. This ensures prices tend towards costs and it incentivises efficiency improvements. Cost reductions of up to 50 percent in the already competitive outsource service provider market is implausible.

2.3 WICS analytical approach has other methodological flaws

WICS' analytical approach has a range of other flaws.

WICS uses an unconventional method that back-solves the revenue path

Typical best practice for calculating the cost of service and tariff levels for water utilities and other regulated services in developed and developing countries is to use the "building blocks approach". The building blocks approach is used by the New Zealand Commerce Commission for a range of regulated infrastructure industries, Australian water economic regulators such as IPART and Essential Services Commission, and by Ofwat in the UK. The building blocks approach reveals a more accurate cost of service, and therefore the revenues required to meet costs.

However, WICS uses a novel method to estimate household bill levels. The projected revenues which result in the "household bills" are calculated based on a hard coded revenue path. Typically, a model used to predict costs (and therefore revenues required to cover costs) should determine the revenue path as an output of the model, informed by the assumptions. However, the revenue path is back solved and has been hard-coded to align with the debt ratios (250 percent of revenue for the Opt-Out Scenario).

Key discretionary assumptions made by WICS inevitably lead to the Reform Scenario demonstrating superior results

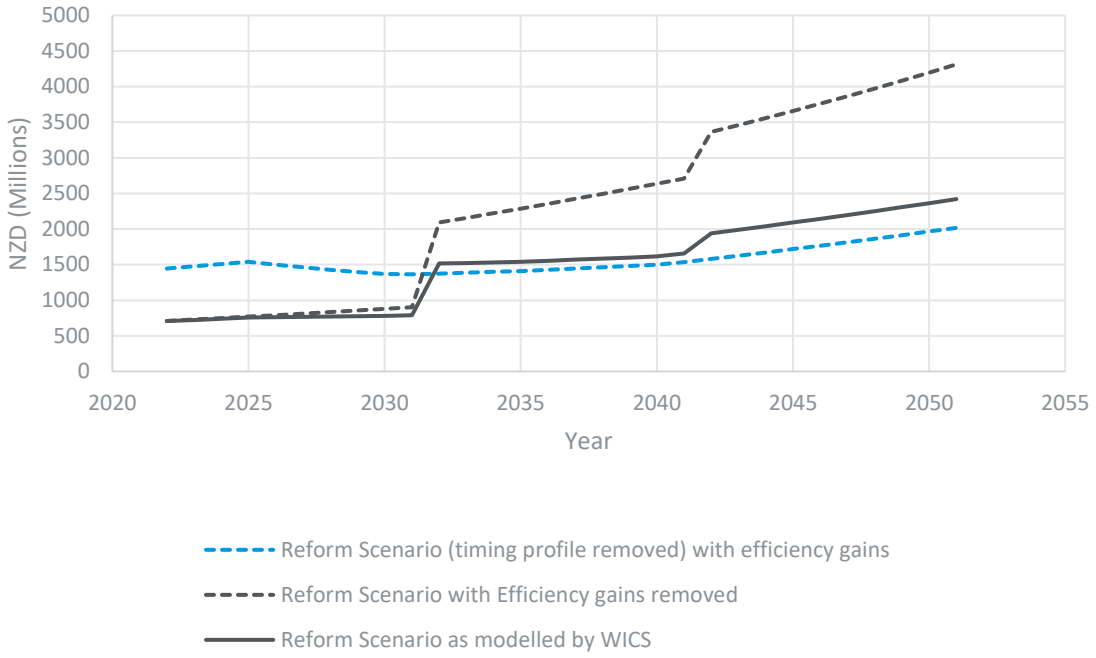
WICS modelling approach uses a number of key discretionary assumptions that are highly favourable for the Reform Scenario and highly unfavourable for the Opt-Out Scenario. With such assumptions, it was inevitable that WICS modelling would reach the conclusions that it did.

The model assumes that capex efficiency can only begin to be realised if the council's population size is greater than 59,000. The efficiency factor increases progressively to 50% when a threshold of 800,000 population is crossed. This 'limit' set by WICS automatically assumes that many councils, including WDC, will not realize any efficiency gains, while every amalgamated entity will realize efficiency gains of over 50%.

Further, the net investment profile is modelled differently in the Reform Scenario compared to the Opt-Out Scenario. In the Reform Scenario, WICS has only included the large investment requirements after 2031. Yet, in the Opt-Out Scenario, WICS included the large investment requirements from 2021. The effect is that, in the Reform scenario, the benefits of the new investment are delayed by up to a decade, while the costs arrive just in time to be reduced by the maximum efficiency gains assumed in the model. We note that 2031 is the first year when the WICS model allows maximum efficiency gains to be realised.

The figure below demonstrates the effect of WICS' time-profile adjustment on the Reform Scenario. The solid black line shows WICS' stated new investment path, while the blue dashed line shows what that path would have been without the manual adjustment WICS made to the time-profile of the investment. For illustrative purposes, the black dashed line also shows what the new investment path looks like before WICS applies efficiency gains.

Figure 2.8: Impact of time-profile adjustment on new investment path under the reform scenario



3 WDC's Opt-Out household bills are likely to be much lower than government estimates

The government's analysis of the benefits of reform compares the Reform Scenario to a situation where no reform and no service improvement takes place (the Opt-Out Scenario). This is an incorrect assumption and leads to significant overstatement of the modelled and claimed benefits. In the Opt-Out Scenario, several factors are likely to lead to improved water services, as well as efficiencies, even if more investment is required.

3.1 WICS overlooks WDC's current high relative performance

WICS have overlooked WDC's current performance relative to other water service providers across a range of measures. Because WICS's analysis is conducted at a top-down, national level, it cannot incorporate WDC's current high relative performance. WICS prediction of WDC's performance under the Opt-Out Scenario is much worse than the performance WDC can actually expect, given its track record.

WDC is performing well compared to other Entity A water providers

WDC is already meeting high performance standards for drinking water quality, environmental outcomes and economic performance. WDC had only 9 drinking water complaints per 1,000 properties compared to 7, 13 and 78 for Watercare, Kaipara District and Far North District respectively. WDC has significantly fewer wastewater complaints than Watercare, Kaipara District and Far North District per 1,000 properties in FY2020[26]. WDC water services "continued to produce A-grade water from all seven water treatment plants"[27] achieving 100% Health Act compliance in FY 2020. WDC had 88.9% discharge permit compliance compared to 50% in Auckland in FY 2020. Non-compliance was related to smaller schemes reflected by a 2.3% population equivalent metric. WDC also recorded 0 wastewater sewer collapses in FY2020[28].

Whangārei has significantly lower levels of three waters debt compared to Auckland Far North and Kaipara. WDC retained a Standard and Poors credit rating of AA+, on par with the Crown.[29] WDC is expected to increase capex by $231 million until 2031 under current capital expenditure plans.

WDC has close to 100 percent metering—unlike other parts of New Zealand and unlike Scotland

Water meters enable service providers to monitor consumption, detect leaks, and target investment where it is most needed. Water meters enable opex efficiency savings and can lower overall capex. Demand management initiatives are enabled. Demand management can

[26] Castalia review of local authority and water provider annual reports.

[27] Whangārei District Council 2020 Annual Report, p. 50

[28] Castalia review of local authority and water provider annual reports.

[29] Local Government Funding Authority, List of LGFA Guarantors, available at: https://www.lgfa.co.nz/files/documents/List%20of%20LGFA%20Guarantors%2016%20March%202021%20CURRENT.pdf

include peak demand pricing, or pricing during periods of drought or other water scarcity. Demand-side management can reduce a provider's need to invest in additional capacity, thereby reducing overall investment requirements.

Very few households have water meters in Scotland. 2016/17 data reported to the Scottish Parliament states that only 0.016 percent of all households in Scotland had water meters (400 out of 2.4 million households).[30] In England (which has been subject to regulation and a privatised sector since 1989) and Wales (subject to regulation, owned by a not-for-profit corporation) only around half of all households have water meters.[31]

Therefore, the claim that WDC cannot match the improvements WICS claims to observe in Scotland and elsewhere in the UK is likely wrong.

3.2 Improved regulatory regimes will incentivise improved performance by WDC

The New Zealand regulatory regime for water services has been suboptimal. The government is reforming water quality regulation to improve compliance and lift the performance of water providers. The Reform Scenario also proposes to create a new economic regulator. Environmental outcome regulation will remain the responsibility of regional councils.

The government and WICS have assumed that WDC and other councils that opt-out of the Reform Scenario will not improve performance because of the new regulatory regimes, or that regulation will not apply. These underlying assumptions are flawed.

3.2.1 Water quality regulation will likely lead to improved performance by WDC

The New Zealand water reforms also involve significant change to the water quality regulatory regime. The Ministry of Health has been responsible for water quality regulation over the past 60 years (and pursued a solitary prosecution). The government introduced the Water Services Bill in July 2020. It is at the second reading stage. The Bill will formally establish the drinking water quality regulator Taumata Arowai.

The governments' objective for the Bill is to set a clear national policy direction for the three waters sector, ensure people can access water that is safe to drink, effectively manage risks to drinking water safety, and strengthen compliance, monitoring and enforcement[32].

The government claims the new regulator will provide sector leadership, technical and scientific expertise, greater clarity on what is expected of councils and increased support for compliance. Specifically, the government claims that WDC, and other water service providers will improve performance as a result of Taumata Arowai's assistance and intervention. The government notes that Taumata Arowai will:

---

[30] Commitee on Climate Change (2016), Scottish Climate Change Adaptation Programme: An Independent Assessment for Scottish Parliament, available at: https://www.climatexchange.org.uk/media/3578/bw-briefing-note-uptake-of-water-metering-2018.pdf

[31] Water UK website: https://www.water.org.uk/advice-for-customers/water-meters/

[32] 1 July 2019, Cabinet Paper: Strengthening the Regulation of Drinking Water, Wastewater and Stormwater, Offices of the Ministers of/for Local Government, Health and Environment, pg 2, available at: Cabinet-Paper-and-minute-Strengthening-regulation.pdf (dia.govt.nz)

- be "responsible for oversight and monitoring of drinking water safety, public communications, ensuring coordination across the sector, leading or overseeing the response to drinking water emergencies, and emergency response planning"[33].
- "strengthen the approach to drinking water compliance, monitoring and enforcement" by centralising these functions and responsibilities leading to more consistent application[34].
- "work with suppliers and training providers to ensure suitable training is available and being taken up, and ensure the sector has sufficient capability to fulfil its responsibilities."[35]
- "become a centre of technical and scientific expertise. It would provide best practice advice and guidance to suppliers, councils, and other entities involved in drinking water safety, supply and management; and facilitate research into drinking water science."[36]

The government also notes that it will ensure the new regulator "has the powers and resources needed to perform these functions consistently and effectively".[37].

Water quality regulation will improve the performance of WDC and other councils in supplying water services. There will be greater clarity regarding what requirements WDC must fulfil and resources to assist WDC in meeting these requirements.

3.2.2 Possible improvements from economic regulation regime have been overlooked

The proposed economic regulation regime could improve WDC's performance. Economic regulation, if well-designed, can enable benchmarking between providers and incentivise water service providers to improve service quality and lower costs. The details of the economic regulation regime have not been designed, and only high-level descriptions of the regime are available.

However, the government and WICS have assumed that the proposed economic regulation regime either cannot apply to councils that opt-out of the Reform Scenario, or will have no material effect on the performance of those councils. This assumption is flawed. Even if WDC is not subjected to economic regulation, it is likely to make improvements based on benchmarking and performance comparisons.

Government's assumption that economic regulation cannot apply to numerous council-owned water services is seriously flawed

The government assumes that it is not feasible to regulate 67 water service providers. The government and its advisors at Ministry of Business, Innovation and Employment and

[33] 1 July 2019, Cabinet Paper: Strengthening the Regulation of Drinking Water, Wastewater and Stormwater, Offices of the Ministers of/for Local Government, Health and Environment, page 24

[34] 1 July 2019, Cabinet Paper: Strengthening the Regulation of Drinking Water, Wastewater and Stormwater, Offices of the Ministers of/for Local Government, Health and Environment, page 16

[35] 1 July 2019, Cabinet Paper: Strengthening the Regulation of Drinking Water, Wastewater and Stormwater, Offices of the Ministers of/for Local Government, Health and Environment, page 25

[36] 1 July 2019, Cabinet Paper: Strengthening the Regulation of Drinking Water, Wastewater and Stormwater, Offices of the Ministers of/for Local Government, Health and Environment, page 25

[37] 1 July 2019, Cabinet Paper: Strengthening the Regulation of Drinking Water, Wastewater and Stormwater, Offices of the Ministers of/for Local Government, Health and Environment, page 16

Department of Internal Affairs have not identified a maximum number that would be feasible.[38]

The government and its advisors have overlooked the global evidence of effective regulation applied to multiple water service entities. Some examples include:

- In Florida, the Public Service Commission regulates 147 investor-owned water utilities[39].
- In Victoria, the Essential Services Commission regulates 15 businesses providing urban water and sewerage services to residential customers[40].
- In Western Australia, the Economic Regulation Authority regulates 30 licensed water service providers[41].
- Columbia has a regulatory regime spanning 1,122 municipalities that provide water services either directly or via public service companies. It is a much less developed country than New Zealand, with a GDP per capita of just over $5,300 US[42] and has experienced benefits of economic regulation. The resources available for investment in the water service provisions have increased significantly over the last 15 years since regulation began[43].

New Zealand's Commerce Commission already has experience regulating multiple electricity distribution businesses. The Commerce Commission regulates electricity distribution under Part 4 of the Commerce Act 1986. It sets price and quality controls for 17 local lines companies and sets quality standards in the form of annual limits for the average number and duration of power outages across the region. The Commission applies information disclosure regulation to a further 12 consumer-owned lines companies, thus having oversight for 27 entities. In the period following the electricity reforms of the late 1990s until 2006, the Commission undertook price regulation of all electricity distribution businesses (even consumer-owned ones).

The Commerce Commission is likely to be the institution that regulates the water sector (adding to electricity distribution, gas pipelines, airports, dairy and telecommunications). It has demonstrated an ability to regulate more than four entities concurrently, and therefore the assumption that it could not regulate more than the four proposed water entities is mistaken.

Benchmarking and performance comparisons with regulated water corporations possible

Even if regulation is not applied to WDC and other councils that opt-out, benchmarking and performance comparisons will be possible. Until now, the only benchmarking tools available to council-owned water providers have been WaterNZ's annual performance report and high-

[38] Castalia email correspondence with MBIE and DIA 2020-2021.

[39] Florida Public Service Comission Annual Report (2020), available at www.floridapsc.com/Files/PDF/Publications/Reports/General/Annualreports/2020.pdf

[40] ESC website, https://www.esc.vic.gov.au/water/water-prices-tariffs-and-special-drainage/average-household-water-bills-victoria

[41] On Tap: Water Consumers Guide - Economic Regulation Authority Western Australia (erawa.com.au)

[42] World Bank Data (2020), Available at: https://data.worldbank.org/indicator/NY.GDP.PCAP.CD?locations=CO

[43] World Bank Report, charting a New Course: Structural Reforms in Colombia's Water Supply and Sanitation Sector (2010), edited by Luis A. Andres, David Sislen and Philippe Marin, Bogota, Colombia

level financial reporting in annual reports and statutory reporting to DIA. With a dedicated economic regulator collecting a wider range of standardised financial performance information and with Taumata Arowai collecting performance information, WDC will be able to better assess the performance of its water services. This is likely to lead to improvements in performance over time.

3.2.3 WDC management and operational competence likely to improve with competition between entities for staff

The government has noted that larger, corporate water entities are likely to improve management and operational competence. If this is the case, then one should expect WDC to also lift competence of its management and operations. This is because WDC will have to match the working conditions at the larger corporate entities, leading to improvements in performance over time.

3.3 WDC can increase access to finance to lower short-term costs

WICS base assumption is that WDC's financing headroom is 2.5 times revenue. In fact, the Local Government Funding Authority has approved WDC (and other local authorities with a credit rating of A+ or above) to borrow up to 2.8 times revenues[44]. Furthermore, the Opt-Out Scenario assumes that WDC can make no improvements to its financing arrangements.

Efficient use of finance can lower costs of service

Efficient financing is an important consideration in investment planning for water utilities. The term of loans should ideally match the useful life of the asset the loans are financing. If the loan is repaid over a shorter period of time, then water bills after the loan is repaid will be lower than they otherwise would be.

WICS assumes that amalgamated entities have greater access to financing and can make more efficient use of finance to lower the cost of service. We tested the change in average cost per household for 2051 across different financing option scenarios for both WDC in the Opt-Out Scenario and for the Reform Scenario (amalgamated entity). Table 3.1 and Table 3.2 show that a significant proportion of the claimed reduction in average cost per household for the Opt-Out Scenario compared to the Reform Scenario is due to changing the financing requirements.

Table 3.1: Average bill per household under different financing options for WDC in Opt-Out Scenario

	Average bill per household	% Change (Decrease in costs)
250 % Debt to revenue limit (WICS model assumption)	7,838.76	
280 % Debt to revenue limit	7,223.55	7.85
500 % Debt to revenue limit	4,574.92	41.64

[44] LGFA Annual Report (2020), page 53, Available online at: https://www.lgfa.co.nz/files/documents/LGFA_AnnualReport_2020_web%20version.pdf

Table 3.2: Average bill per household under different financing options for Reform Scenario

	Average bill per household	% Change (Increase in costs
582.44% Debt to revenue limit (WICS model assumption)	1,577.33	
280 % Debt to revenue limit	2,832.71	79.59
250 % Debt to revenue limit	3,075.51	94.98

Changes to financing arrangements for the Opt-Out Scenario cannot be ruled out

There are other ways that access to finance by New Zealand water providers can be improved. The government's Opt-Out Scenario does not consider these other options. Currently, almost all three waters services are provided by local authorities. Local authorities' borrowing limits, whether imposed by LGFA or due to ratings agency policies, are generally considered to impose limits on optimal investment planning in the water sector. In the Reform Scenario, the new statutory corporations will have separate balance sheets to local authorities, and will be able to raise finance without being impacted by these borrowing limits.

A number of other financing arrangements are already available for the water sector and could apply in the Opt-Out Scenario. Other financing changes could be implemented with law and other institutional reform:

- Central government has recently introduced the Infrastructure Financing Facility[45] which enables finance to be raised from the private sector, ring-fenced from eligible local authorities' balance sheets
- Long-term concession contracts have been used in New Zealand (in Papakura, signed by Papakura Council prior to the creation of Auckland Council) under which a third-party provides water services for a fixed term (30 years in Papakura) and collects water rates or tariffs directly from customers. Usually, the concession contract requires the third-party to invest in and maintain the water assets and network and meet certain performance metrics. The third-party provider accesses private capital markets to finance the capital investment needs (growth, renewals and maintenance)
- Revenue bonds are a common way for municipal government entities in the United States to raise finance for infrastructure investment, often in the water sector. Investors in these bonds are repaid from income created by the projects the bonds fund. These are separate from the general obligations debt raised by the municipal government.

[45] Minister for Urban Development statement, 24 July 2020: https://www.beehive.govt.nz/release/law-help-infrastructure-financing-passes

4 WDC residents face risks and costs from Reform Scenario

There are risks and costs to the Whangārei community from the Reform Scenario.

4.1 Local accountability for significant public asset and public service will be lost

Accountability to customers is important for water service performance. Under the Reform Proposal, Whangārei water customers will lose the ability to hold those tasked with governing water services to account. Elected councillors are accountable to voters, and water issues can be election issues.

Under the Reform scenario, local government's autonomy to appoint board members to water utilities will be constrained, thus accountability to customers and coordination in planning will be mostly lost. It is more difficult for the local community to have any issues heard at the regional or national political level in the Reform Scenario. If there are management or governance problems, it is more difficult for the Whangārei community to influence the indirectly appointed board. Whangārei's representation for water services will be diluted.

4.2 Local variability in service and quality levels will be lost

The regional Entity A is likely to be managed from Auckland. This reduces the ability for the service provider to reflect local differences in service expectations. Wastewater services often need to consider local needs. There are different options of treating and discharging treated wastewater. Some communities, including local hapu, may have different expectations and needs in respect of wastewater. A water services entity headquartered in Auckland is unlikely to have the same ability to reflect these local variations in demands.

4.3 Loss of economies of scope increases average cost of remaining council services by $1.9 million per annum

WDC currently incurs a range of costs shared across a range of services (water, transport, parks and recreation, and other services). WDC achieves economies of scope by providing these services together; it lowers costs for WDC to provide all the services together compared to if these were provided separately. Following reform, WDC will continue to incur fixed costs related to non-water council services.

WDC's RFI reports that for FY 2020, the total operating cost for water services was $16,806,000. There are multiple overhead cost items that will not reduce even when WDC provides no water services. As estimated from the RFI, these include nine indirect general

management and support employees and 460 square metres of office/ laboratory space. This shared overhead cost amounts to $1.9 million[46] per annum.

5 Recommended next steps

This report has shown that the Reform Scenario is founded on unsound evidence and faulty analysis. The promised benefits of reform are unlikely to materialise. There are risks to the Whangārei community from losing control of water services, and accountability of those tasked with governance to local customers.

Water services are critical to wellbeing, so it is very important that the full range of options are considered that are locally appropriate. Other than opting out, the Reform Scenario is the only option that has been presented to WDC and other local authorities. Water services should be safe, resilient, reliable, and customer responsive, at least cost. Some reform of the sector is necessary in some parts of New Zealand. However, the analysis needs to done to determine where water services fall short of this objective, and for what reasons.

We recommend that WDC carry out a proper net benefit analysis, potentially with other local authorities that have a similar viewpoint. This is likely to be many councils, since the WICS analysis has consistent faults that apply to all local authorities. Such an analysis should include the full range of options together with transparent data and sound and contestable analysis so these options can be properly evaluated. There is plenty of analysis, evidence and now a rich data set in the RFI responses for WDC and like-minded local authorities to be able to identify alternative and better reform options. WDC could prepare a constructive counterproposal that achieves desirable objectives, while avoiding the risks and costs of the Reform Scenario.

[46] Average salary for Whangārei District Council Employee = NZ$ 100,000

Cost of each employee = 2*100000

Assuming annual rent of $300 per sq. m.

Economies of scope lost = 200000*9 + 300*460 = 1,938,000

Castalia is a global strategic advisory firm. We design innovative solutions to the world's most complex infrastructure, resource, and policy problems. We are experts in the finance, economics, and policy of infrastructure, natural resources, and social service provision.

We apply our economic, financial, and regulatory expertise to the energy, water, transportation, telecommunications, natural resources, and social services sectors. We help governments and companies to transform sectors and enterprises, design markets and regulation, set utility tariffs and service standards, and appraise and finance projects. We deliver concrete measurable results applying our thinking to make a better world.

WASHINGTON, DC
1747 Pennsylvania Avenue NW, Suite 1200
Washington, DC 20006
United States of America
+1 (202) 466-6790

SYDNEY
Suite 19.01, Level 19, 227 Elizabeth Street
Sydney NSW 2000
Australia
+61 (2) 9231 6862

AUCKLAND
74D France Street, Newton South
Auckland 1010
New Zealand
+64 (4) 913 2800

WELLINGTON
Level 2, 88 The Terrace
Wellington 6011
New Zealand
+64 (4) 913 2800

PARIS
64-66 Rue des Archives
Paris 75003
France
+33 (0)1 84 60 02 00

Thinking for a better world.

enquiries@castalia-advisors.com
castalia-advisors.com

CASTALIA

Thinking for a better world.

Addendum to Castalia's report on Water Reform to Whangārei District Council dated August 2021

24 September 2021

1 Introduction

On 10 September 2021, DIA issued a Departmental Statement on the Castalia Report for Whangārei District Council (DIA Departmental Statement) that related to Castalia's report on Water Reform to Whangārei District Council dated August 2021 (WDC Report) and Castalia's report on Economies of Scale in New Zealand Water Services for LGNZ dated September 2020 (one year ago). The Departmental Statement also referred to Castalia's 2017 report to DIA on management sophistication in New Zealand Three Waters. Appended to the DIA comments is an analysis of the Economies of Scale report by FarrierSwier.

Castalia stands by the analysis in its work for DIA (2017), three reports for LGNZ and the Joint Steering Committee (2020),[1] the WDC Report and reports and analysis for other local authority clients (issued in August and September 2021). There are several incorrect statements and potentially misleading descriptions of our analysis in the DIA comments that need to be clarified.

This addendum addresses the following points regarding the government's evidence base and Castalia's analysis of it for local authorities:

- WICS modelling is flawed and, as a result, significantly overstates the required investment for WDC (section 2 below)
- DIA has overlooked or misinterpreted the overwhelming evidence that shows that significant cost savings are not generally available from administrative amalgamations of disparate water networks (section 3 below).

[1] Castalia completed three reports for LGNZ in support of its participation in the Three Waters Joint Steering Committee:

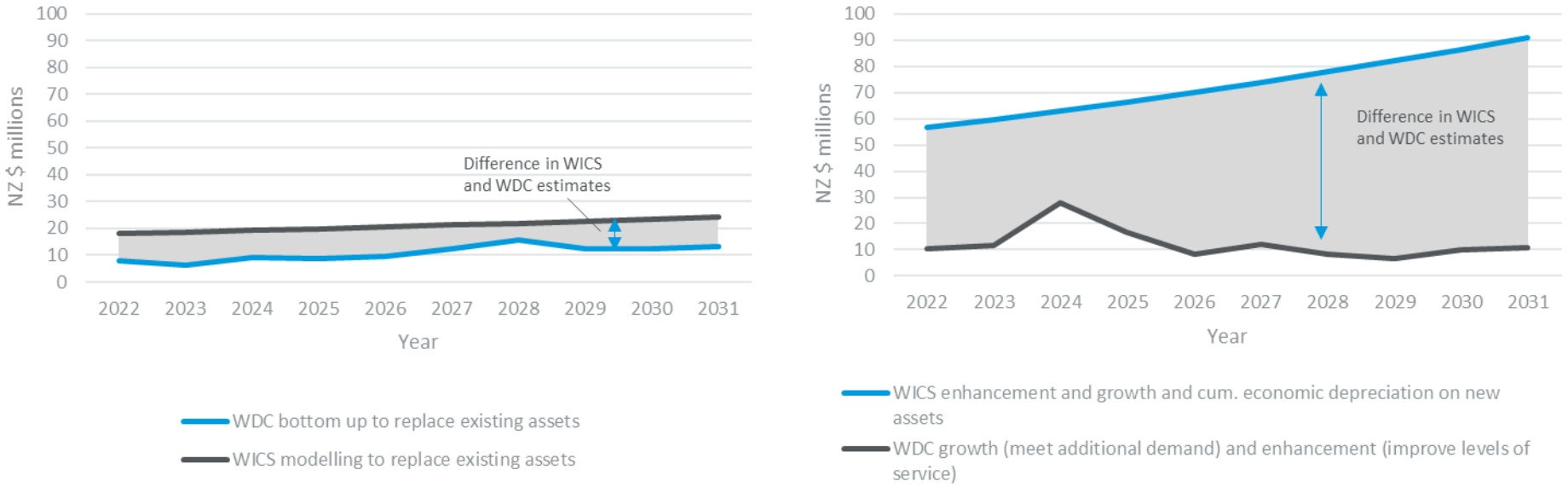
1. Criteria for evaluating water reform options dated July 2020 (Evaluation Criteria Report))
2. Comparative analysis of reform options for water services dated August 2020 (Reform Options Report)
3. Economies of scale dated August 2020 (Economies of Scale Report)

2 WICS overstates required investment and uses inappropriate comparators

Castalia stands by its analysis that the government's WICS modelling overstates the required level of investment for WDC's water services. It also uses inappropriate comparators to model projected investment. We acknowledge that future regulatory requirements will likely increase the level of investment needed in water networks in some parts of New Zealand. Nevertheless, WICS' modelling has flaws that make it inappropriate as a basis for assessing the required level of investment for New Zealand, and WDC specifically.

WICS models a significantly higher level of required investment than the forecasts from WDC's investment planning. Enhancement and growth capex and the cumulative economic depreciation on that new capex amounts to 85 percent of WICS calculated investment above WDC's own forecasts. Only 15 percent of the discrepancy between WICS and WDC relates to differences in estimates for replacement capex on existing assets. This is illustrated in Figure 2.1 below:

Figure 2.1: Comparing WICS and WDC's approaches to estimating replacement of existing assets and enhancement and growth investment



WICS uses three components to estimate the future investment for local authorities:

- Cumulative economic depreciation on new assets
- Required enhancement and growth capital expenditure
- Capital maintenance on existing assets (that is, replacement of existing assets).

DIA claims that local authorities' own investment plans are not a good basis to estimate required future investment.[2] DIA also says that WICS' modelling "projects future renewals investment based on the applicable rates of economic depreciation"[3] and that this is a superior approach to predicting the required level of investment. The WICS approach is unconventional and inflates the investment projections.

2.1 Cumulative economic depreciation is not a valid method to forecast replacement capital expenditure for brand new assets

Incorporating cumulative economic depreciation on new assets (the third component) inflates the level of investment in an unconventional and incorrect way. The impact on WICS' modelling for WDC and other local authorities is profound.

The use of cumulative economic depreciation on new assets essentially assumes that future replacement capital expenditure will be exactly equal to estimated future depreciation. This is an incredibly crude assumption. The depreciation-derived estimates are far inferior to the bottom-up capex forecasts developed by WDC and other local authorities for the purposes of their long-term plans.

Standard regulatory approaches do not equate economic depreciation with capital expenditure. To our best knowledge, neither OFWAT, OFGEM, AER, Australian State regulators, nor the New Zealand Commerce Commission (to name a few) have set capital expenditure allowances based on economic depreciation. Local Government New Zealand has issued guidance to local authorities that depreciation should not be confused with replacement capital expenditure.[4]

> *As depreciation reflects the consumption of the asset over its useful life, there are two critical factors in determining this expense. The first is the asset cost or revalued amount, and the second is the asset's useful life. It is therefore not related to the physical wearing out of the asset. The purpose of depreciation is not to provide for the replacement of the asset(s), however this may be an intended or unintended consequence.*

The inclusion of cumulative economic depreciation **overestimates replacement capital expenditure** by approximately $88.2 million to 2031 and **$1.16 billion** over the modelling horizon to 2051 (expressed in projected outturn prices). Figure 2.2 illustrates the components of WICS' modelling of total required investment for WDC, separating this into the three

---

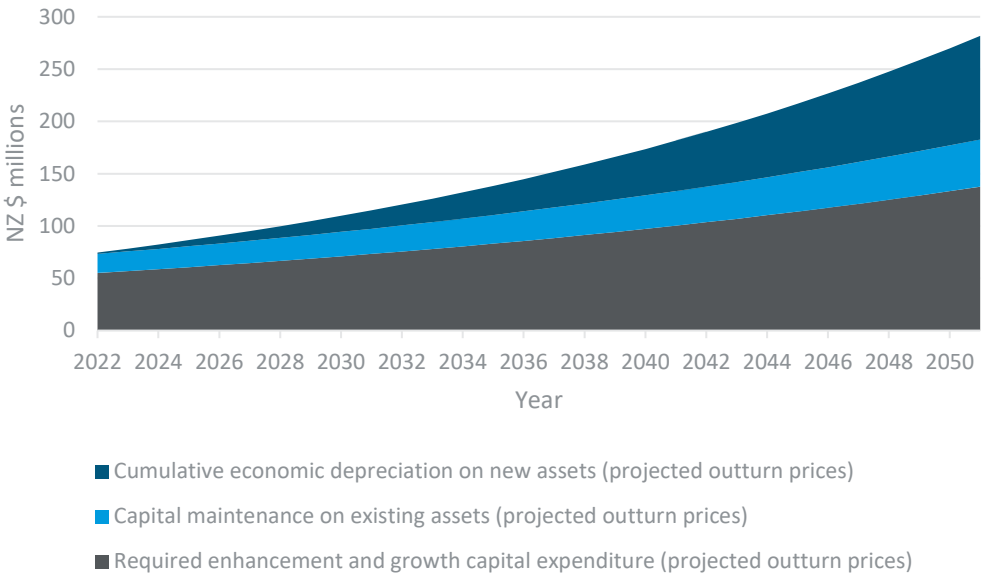
[2] Departmental Statement, p. 3

[3] Departmental Statement, p. 3

[4] LGNZ, Depreciation in the local government context, available at: https://www.lgnz.co.nz/assets/Induction-Extras/78d9041b79/Depreciation-paper-final.pdf

components. Cumulative economic depreciation on new assets (dark blue area) makes up a significant portion (24.4 percent) of total investment requirement for WDC.

Figure 2.2: Required investment after capital price inflation for WDC (WICS modelling)



2.2 WICS' enhancement and growth expenditure estimates are based on inappropriate Scottish and UK models

WICS uses Scottish comparators as the basis for its modelling of enhancement and growth expenditure. WICS acknowledges this at various places in its Phase 2 slides on required investment.[5] WICS even comments on why it uses Scottish comparators: "These models have the advantage that they come from a single jurisdiction that has many geographical and economic similarities to New Zealand". It is accurate and fair to say that WICS' investment estimates are based on Scottish levels of investment.

We reiterate that Scotland is not the only relevant comparator for New Zealand. There are many reasons why Scotland should not be used as the only comparator, or even a good comparator, which we outline in the WDC Report.

No evidence that Whangārei-specific variables included in the model

DIA asserts that WICS used "WDC asset values and asset lives… [and] population density, topography and geographic variables" as inputs into its modelling. However, the models released to stakeholders do not show that such variables were in fact used for WDC or any other local authority.

[5] WICS, May 2021, Supporting Materials Part 1: Required levels of investment, at slides 13-14, 26, 58, 59, https://www.dia.govt.nz/diawebsite.nsf/Files/Three-waters-reform-programme/$file/wics-supporting-material-1-required-investment.pdf

The detailed RFI responses provided by each local authority run over 66 tabs in excel spreadsheets. However, WICS' released models use only eight data points from the RFI responses. The data used by WICS is basic information such as connected population, asset values, water-related debt and current water-related revenues. The WICS models released to date do not use any Whangārei or indeed any New Zealand-specific variables other than total population and asset values.

We have been unable to find any inputs or calculations in the models that relate to population density, topography or geographical variables. It is possible that there may be another layer of modelling that has not been released to, or reviewed by, any expert other than WICS.

DIA cite the expert reports it commissioned to review WICS' work in support of its claims that UK and Scottish models are appropriate for New Zealand. Nothing in those expert reports suggests that the authors verified whether any New Zealand-specific variables were included. Nothing in the FarrierSwier review suggests a review of New Zealand-specific inputs or calculations was undertaken.

Beca New Zealand[6] compared the regulatory environment and industry practices in Scotland. However, Beca New Zealand does not compare whether the level of investment modelled by WICS is appropriate, only that the assumptions about the regulatory environment bear similarities. Beca New Zealand's report explicitly does not cover differences in financial or accounting practices (such as asset depreciation and renewals, asset insurance, debt management and so on) between Scottish Water utilities and New Zealand local authorities. Crucially, it is these matters that have undermined WICS' estimates of required investment.

It is true that some additional investment is needed in some parts of New Zealand to comply with future regulatory requirements, and to improve the resilience of water services to climate change. Beca New Zealand's report is useful to compare the regulatory regimes and network technical similarities. However, Beca New Zealand's report cannot (and does not) provide a view on whether WICS' top-down analysis and crude modelling techniques give accurate insights on the level of investment required.

WICS states that it assumes that New Zealand-specific input variables (which are not disclosed and cannot be verified) will have the same impact on the required investment as they do in Scotland.[7] While other relationships were considered by WICS, the model and commentary released rely heavily on Scottish information and data. Our analysis in the WDC Report shows that the Scottish relationship is very different to the relationship in Australia, for example.

Modelling approach is unconventional to best of our knowledge

DIA also claims that the models were "developed by OFWAT and used and applied by WICS and other economic regulators throughout Europe".[8] To our best knowledge, OFWAT has never used this type of model to forecast capital expenditure. It may have used this type of modelling as part of a building blocks model approach to setting tariffs. Even in that case,

---

[6] Beca New Zealand (2021), DIA Three Waters Reform WICS Modelling Phase 2: Review of Assumptions between Scotland and New Zealand Three Waters Systems, available at: https://www.dia.govt.nz/diawebsite.nsf/Files/Three-waters-reform-programme/$file/beca-report-dia-three-waters-reform-wics-modelling-phase-2.pdf

[7] WICS, May 2021, Supporting Materials Part 1: Required levels of investment, for example at slides 58, 59, https://www.dia.govt.nz/diawebsite.nsf/Files/Three-waters-reform-programme/$file/wics-supporting-material-1-required-investment.pdf

[8] Departmental Statement, p. 3.

OFWAT would not have equated a capital expenditure forecast with depreciation amounts (as set out in section 2.1). These are entirely separate concepts. We would appreciate being directed to the OFWAT models that WICS' work is based on.

2.3 WDC's planned investment is valid starting point for future investment needs

Regulators generally prefer asset managers' own estimates of required investment over crude modelling based on depreciation. The asset manager knows the condition of the assets. For example, it would be highly unusual for an economic regulator such as the Commerce Commission to use depreciation calculations to over-ride bottom-up forecasts from an electricity distribution business when setting a capital expenditure allowance. This is especially the case given the important interlinkages and potential optimisation that can arise between replacement and enhancement capex. WICS's approach is incapable of recognising such interlinkages and optimisation because it sums up replacement and enhancement capex without any adjustment. As noted above, the discrepancy between WICS' and WDC's forecasts for replacement accounts for 15 percent of the total discrepancy ($102.36 million of $603.63 million) between the two sets of capital expenditure forecasts.

3 Only relatively minor cost savings available from administrative amalgamations

Castalia stands by the considerable evidence that the claimed cost savings from amalgamation are implausible. The evidence of relatively minor cost savings from administrative amalgamation is summarised in the WDC Report and in Castalia's Economies of Scale Report to LGNZ dated October 2020. DIA commissioned a FarrierSwier review of that report which unfortunately does not address the central issue, and only partially assesses the relevant evidence Castalia prepared for LGNZ that contributed to the Joint Steering Committee's consideration of water reform issues.

DIA, WICS and FarrierSwier overlook that economies of scale in the capital costs of water services are not available from the administrative amalgamation of water and wastewater services

Castalia's central point in the Economies of Scale report is that savings in the **capital costs** of water and wastewater networks and water and wastewater production (drinking and wastewater plants) are unlikely. The empirical evidence, including the evidence collected by DIA and cited in its regulatory impact statement (RIS), is clear: economies of scale are not available for **administrative amalgamations** of the type proposed for New Zealand. DIA has not produced any analysis—other than WICS' modelling—that refutes Castalia's central point. DIA cites evidence in its RIS,[9] but manages to misinterpret it. The key point being missed by DIA in its public statements on water reforms and in advice to the Minister and Cabinet is:

[9] Department of Internal Affairs, May 2021, Regulatory Impact Statement: Policy decisions on the reform of three waters service delivery arrangements, pp, 39-40

- There are lower average costs in water networks that serve large cities with concentrated populations compared to more rural areas or small towns
- Those savings in capital costs are a function of the **geography and urban density**
- It does not follow that, by carrying out an administrative merger to reach 800,000 connections (for example, merging Tairāwhiti to Takaka), those cost savings will automatically arise.

The Economies of Scale report reached three other key findings on the evidence base, which have not been refuted.

FarrierSwier appear to have only been given partial information by DIA, and reviewed the 2020 Economies of Scale Report as if it was a full options review

FarrierSwier appear to have been asked by DIA to review the 2020 Economies of Scale report as if it were a full review of reform options. Castalia prepared a review of available reform options, reviewing global evidence of reform episodes in a separate Reform Options Report. This was presented to the Joint Steering Committee in October 2020 and presumably has not been referred to FarrierSwier for review. DIA and FarrierSwier criticise Castalia's Economies of Scale Report because it focuses mainly on economies of scale. Yet, that was the specific purpose of that particular report as part of a wider body of analysis contained in a number of reports. We encourage DIA and interested stakeholders to review our Reform Options Report, which assesses the government's proposed option and three other globally common sector structuring options along with **seven criteria,** including management sophistication. The Reform Options Report shows that the government's proposed option has significant risks compared to the alternative options. Castalia's advice to LGNZ is available here: https://www.lgnz.co.nz/assets/LGNZ-release-of-Castalia-reports-context-and-response-v2.pdf

FarrierSwier agrees with Castalia (for example, Castalia's 2017 report to DIA) that some cost savings are possible in larger water entities from improved management and specialist services, and from coordinating procurement. Castalia goes on to note that these cost savings are minor **in comparison to** the more significant costs of network and production services (emphasis added). FarrierSwier does not address the relative size of cost savings from improving management to the more significant costs of network and production services. Neither FarrierSwier nor DIA discuss the costs of reform, which need to be weighed against such relatively minor benefits. Furthermore, as Castalia notes in the Reform Options Report, the proposed reform is not the only way to achieve these management and procurement gains. Other available options include the joint procurement and management model used by Southland electricity distribution companies, and the Wellington Water management services model.

DIA only released the underlying WICS models in July 2021. Castalia has reviewed these models in its reports to WDC and other local authorities. Our review of the modelling confirms the findings from 2020 in the Economies of Scale Report and the Reform Options Report: the very large cost savings claimed for capex and opex are implausible given the nature of New Zealand's disparate water networks and current operating expenditure profile.

None of the new points raised change the conclusions on implausibility of claimed efficiency gains

DIA refers to a 2018 Frontier Economics paper to claim that "efficiency gains have been well documented".[10] That report analyses efficiencies from **privatisation** and does not deal with efficiencies from **amalgamation**. Amalgamation of the English and Wales water companies occurred in 1972. Privatisation of the 10 companies occurred in 1989. The nine English companies remain private companies. Therefore, the conclusions on efficiency improvements have only limited relevance. We pointed this out in the Reform Options Report.

DIA also claims that benefits to Watercare from greater borrowing capacity from balance sheet separation is an "efficiency improvement". We agree with the Board of Watercare (and advised its management) that increased borrowing capacity from balance sheet separation enables greater investment which is currently constrained. However, this has nothing to do with efficiency.

DIA says that incremental operating efficiency improvements eventually add up to significant amounts. However, the improvements are still implausible relative to the counterfactual. The government and LGNZ representatives have promised that there will be no job losses which means opex savings from workforce changes will not occur. WICS and DIA also assume that WDC will not benefit from any operating efficiencies if it opts out of the reforms. This is unlikely given the opex profile of WDC, as we point out (outsourcing, documented evidence of performance improvement over time, and the fact that regulation will incentivise and support performance improvements). DIA and WICS provide no evidence that WDC "has been assessed as significantly below industry-standard benchmarks for service efficiency". There may be potential for 'catch up' efficiency in some places in New Zealand, but WICS does not show this is true for WDC or any specific local authority in the materials released to date.

Full options analysis would assist in understanding all the costs and benefits of reform

Focussing on one aspect of reform—apparent benefits of scale—can lead to a premature selection of a preferred option. Indeed, both Castalia's Evaluation Criteria Report and Reform Options Report note that there are major risks in a process that does not consider the full range of options.[11] There are common models from around the world that have not been discussed in the reform policy process (apart from Castalia raising these, but receiving no material engagement on this from DIA or the Joint Steering Committee). The policy process should also consider the costs of the reform, which may outweigh the relatively small cost savings from greater scale.

[10] Departmental Report, p. 4.

[11] We also note that contrary to DIA's assertion, Castalia has not recommended a "regulation-only" scenario for New Zealand in any report.

Northland Infrastructure Unit

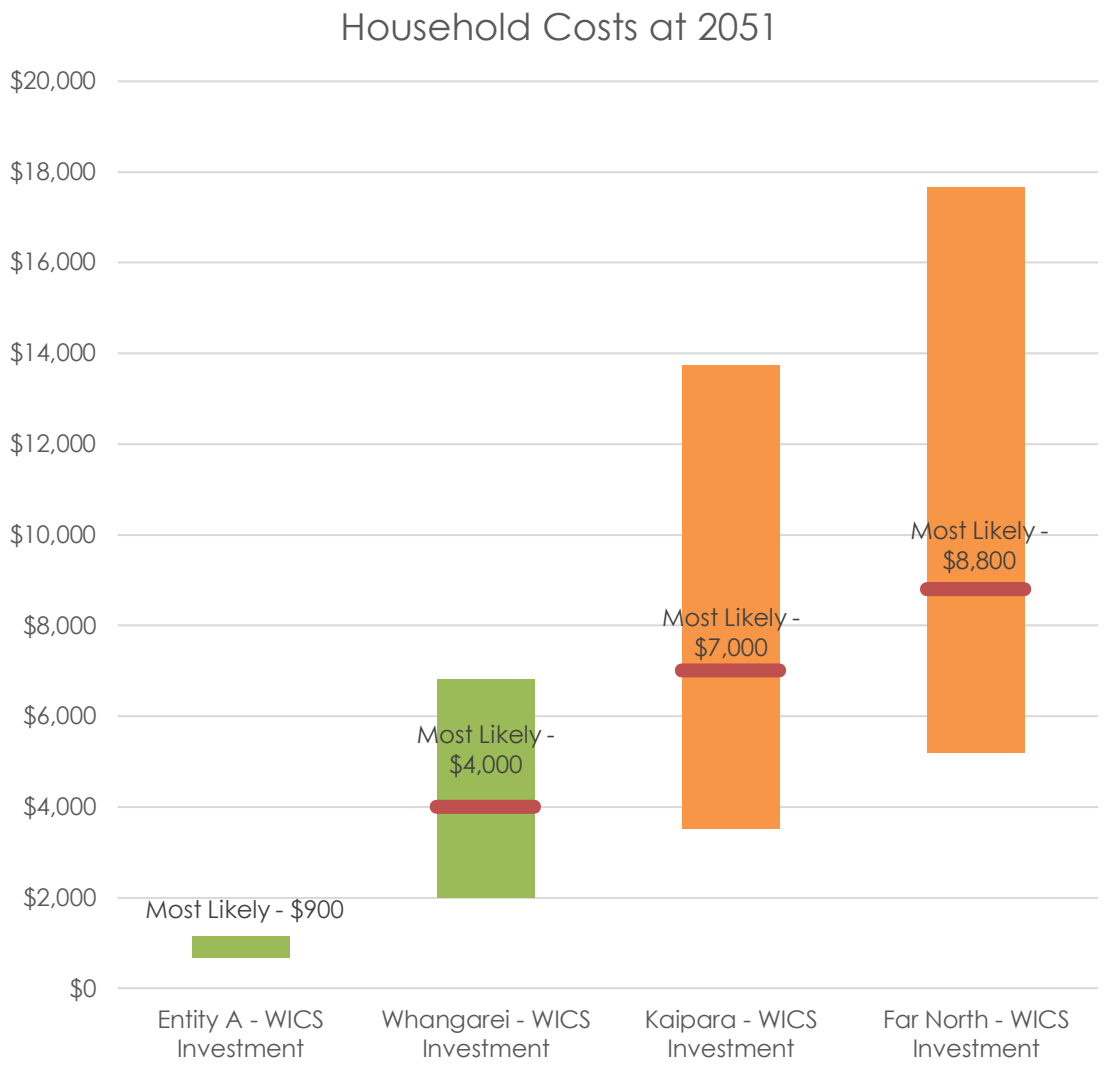
Financial Modelling and Comparison to WICS "Entity A"

Summary Results and Interpretation

Rationale was engaged to undertake a high-level investigation of the financial viability of a Northland Infrastructure Unit

The starting point

- The modelling undertaken by the Water Industry Commission for Scotland (WICS) shows:
  - significant cost increases for each council if they opt-out of Entity A
  - significant variation in charges (resulting from different assumptions) for each council if they opt-out of Entity A
- Many of their assumptions are overly optimistic and biased towards Entity A



Summary Results and Interpretation

Issues with WICS assumptions

- Over inflated enhancement costs
  - The future investment to bring three water services up to standard (referred to as enhancement costs) appears to be over inflated
  - Based on United Kingdom models and values which have questionable relevance to New Zealand
  - Enhancement costs are added on top of replacement costs rather than enhancement being included in the replacement of assets
  - Significant questions over whether the resources (people) are available to deliver the investment
- Overly optimistic efficiency gains
  - Efficiency assumptions are severely biased towards Entity A
  - Questionable evidence that gains observed in Scotland will be achievable in New Zealand

Summary Results and Interpretation

Alternative assumptions and modelling

- Enhancement costs
  - Rather than rely on future enhancement costs estimated by WICS, more realistic expenditure forecasts have been used that are based on the unconstrained forecasts included in the request for information (RFI) completed by each council for the Department of Internal Affairs (DIA).
- Efficiency gains
  - Rather than debating likely efficiency gains for each entity all efficiency gains have been removed (set to zero)
  - This way you can compare the real household cost savings of sharing the total costs over a larger population
  - This gives a better base case to then debate which entity is likely to achieve the greater efficiency gains moving forward
  - i.e., **How would a Northland Infrastructure Unit stack up?**

Summary Results and Interpretation

Key modelling assumptions

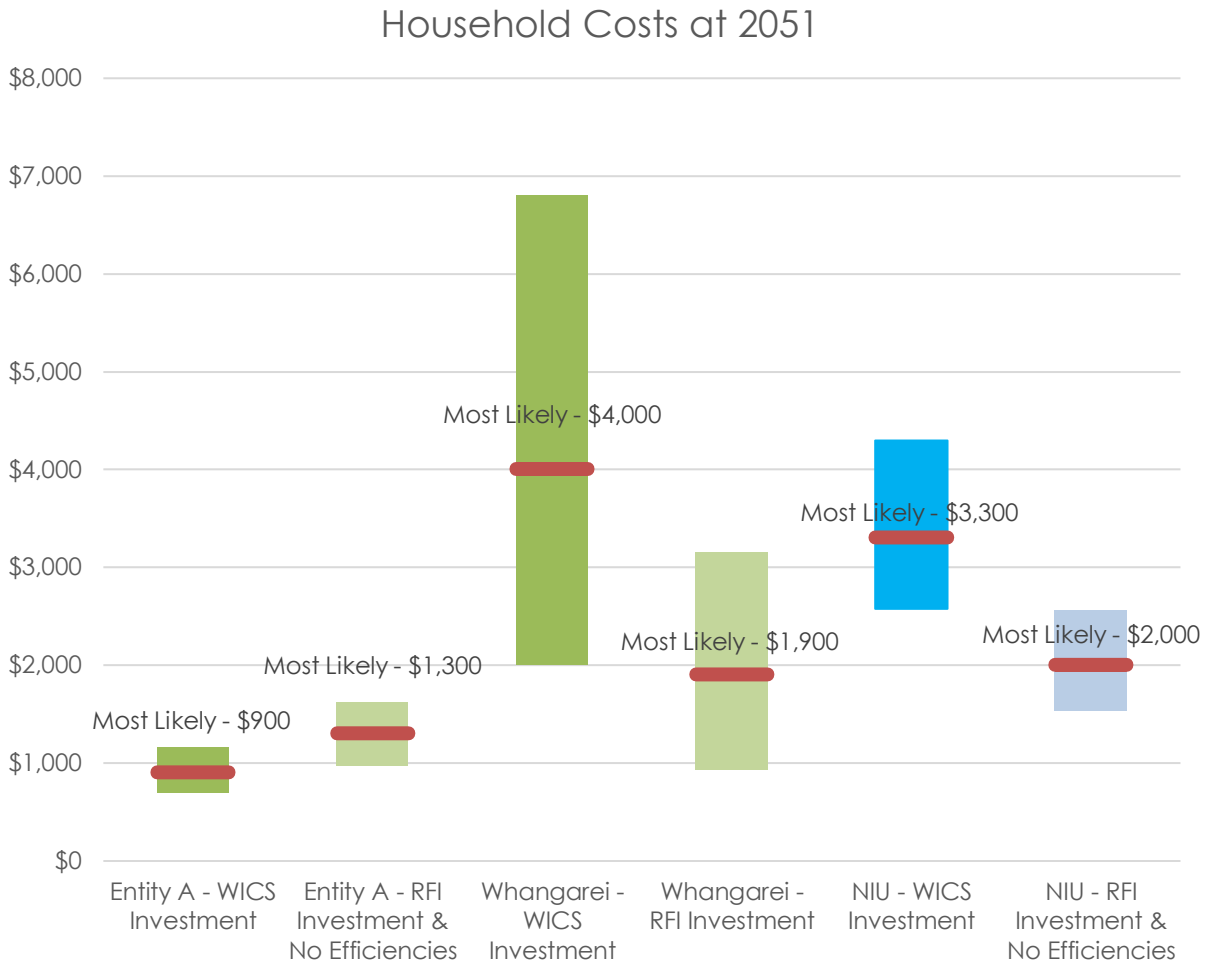
- One price for all
  - All households pay the same price for three water services within each entity
- Debt limits
  - Assumes that increased borrowing limits will be allowed by credit agencies
- Enhancement and efficiency
  - Revised assumptions/inputs are summarised below

	Entity A		**Whangarei**		**Northland Infrastructure Unit**	
	WICS Scenario	Alternate Scenario	WICS Scenario	Alternate Scenario	WICS Scenario	Alternate Scenario
Key Inputs						
3W Investment (30-Year Enhancement and Growth)	$27.3B	$16.0B	$1.6B	$0.5B	$3.8B	$1.1B
Efficiencies	50-53%	0%	0%	0%	12-13%	0%
Key Outputs						
Max Debt to Revenue	6.0	5.2	2.5	2.5	5.4	4.8

Summary Results and Interpretation

Results

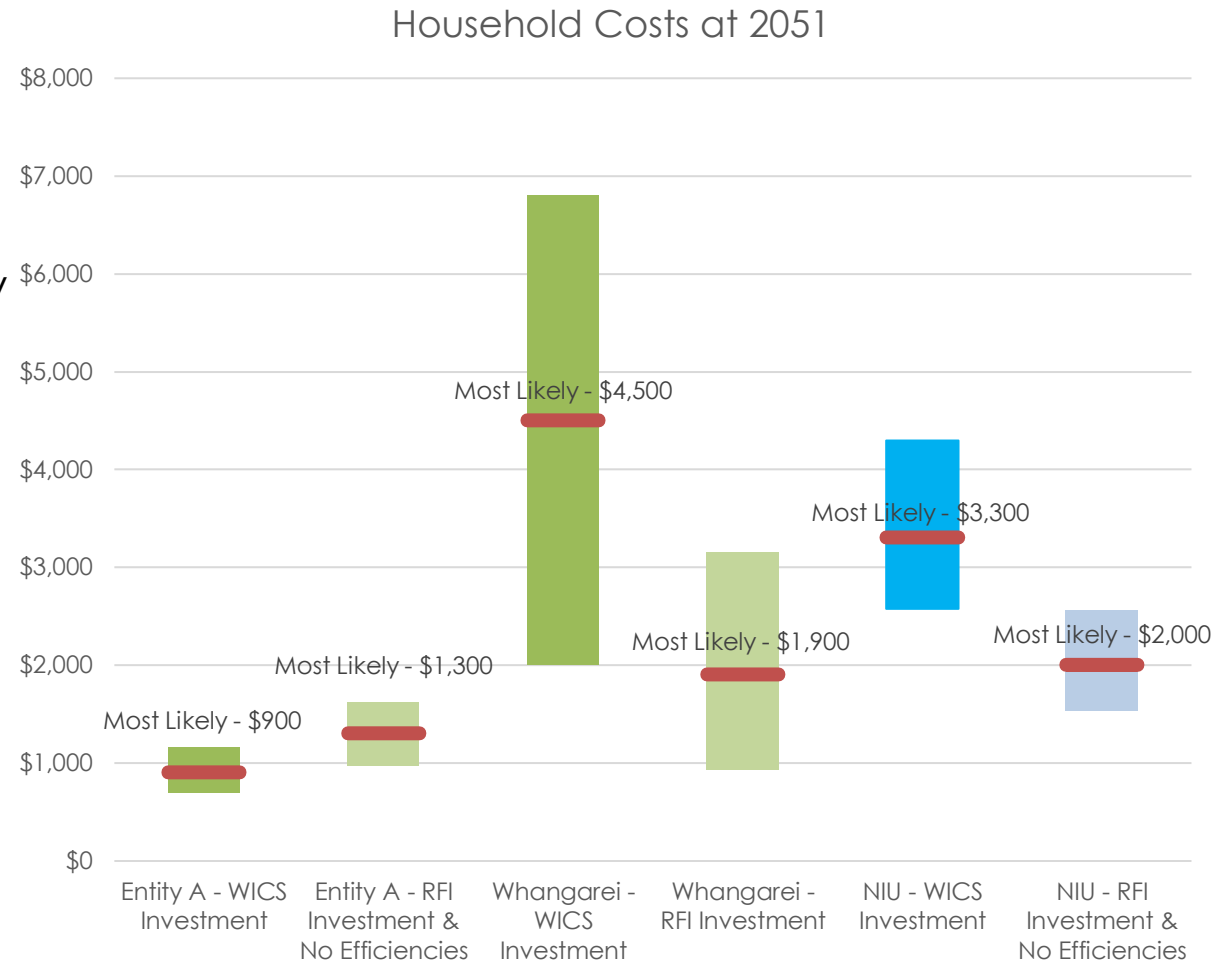
- If you replace the questionable WICS assumptions
- Then Whangarei District Council (WDC) and a Northland Infrastructure Unit (NIU) compare much better to Entity A
  - ~$1,900 (WDC) and ~$2,000 (NIU) vs
  - ~$1,300 (Entity A)
- A premium of around $600 and $700 per household over Entity A to have greater control and influence over your future



Summary Results and Interpretation

Discussion

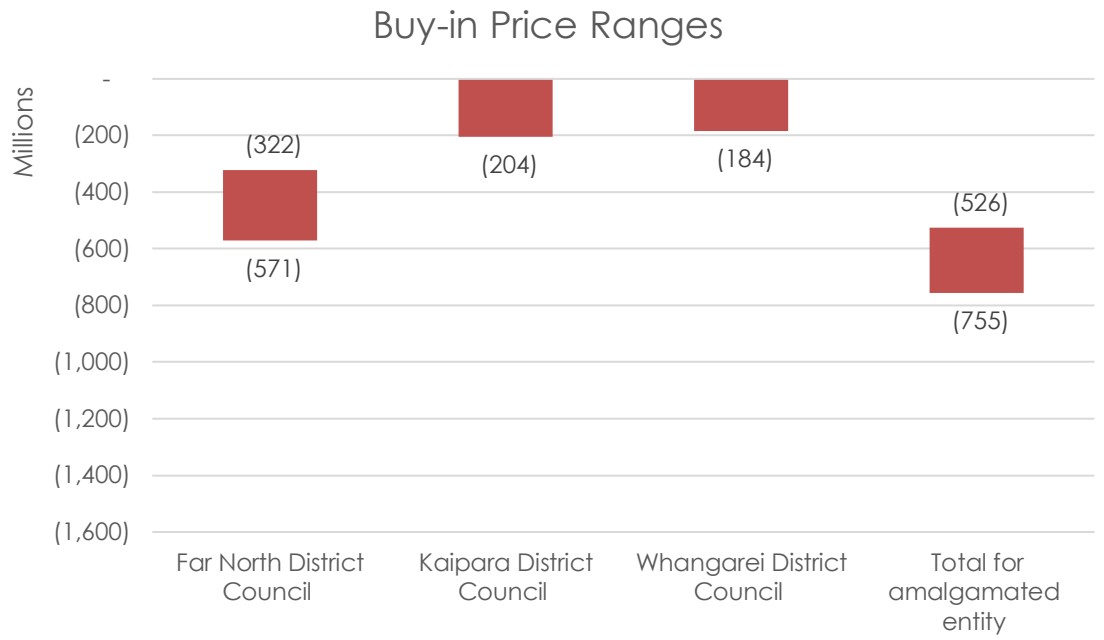
- The future investment is likely to sit somewhere between WICS and the alternate assumptions
- Efficiency gains, if any, between the different entity models will lower the alternate scenario household costs
- Further household cost reductions could result if it was decided to 'socialise' the costs further across all properties not just those connected
- A Northland Infrastructure Unit is only worth considering further if:
  - this unit can deliver better efficiencies than standalone
  - there is acceptance of the 'one price for all' funding basis



Buy-in Price

Summary

- A range has been calculated by using WICS assumptions for one scenario and using RFI(unconstrained LTP) assumptions for another
- Surprisingly the council with the lowest buy-in swaps depending on the scenario
  - Whangarei using RFI assumptions
  - Kaipara using WICS assumptions
- Total buy-in value ranges from $526M to $755M



Buy-in Price

Approach (RFI)

- Buy-in price

  = Balance Sheet – Future Liabilities

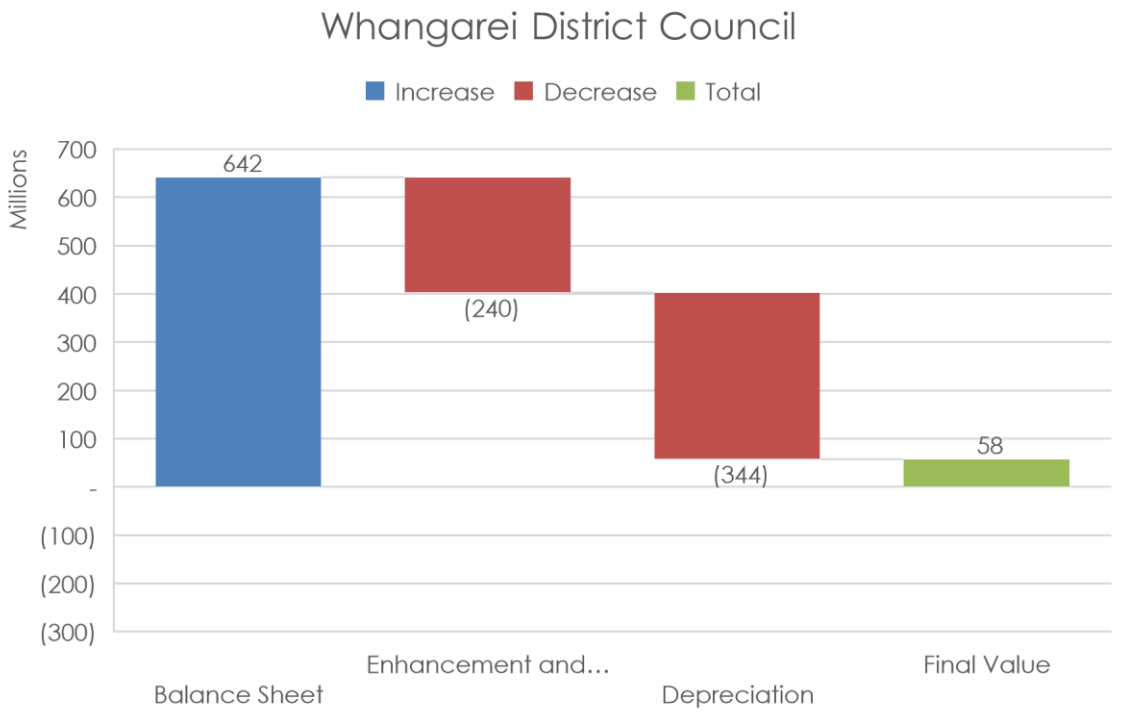
- Balance Sheet

  = Carrying amount – debt + reserves (depreciation + development contributions)

- Future Liabilities

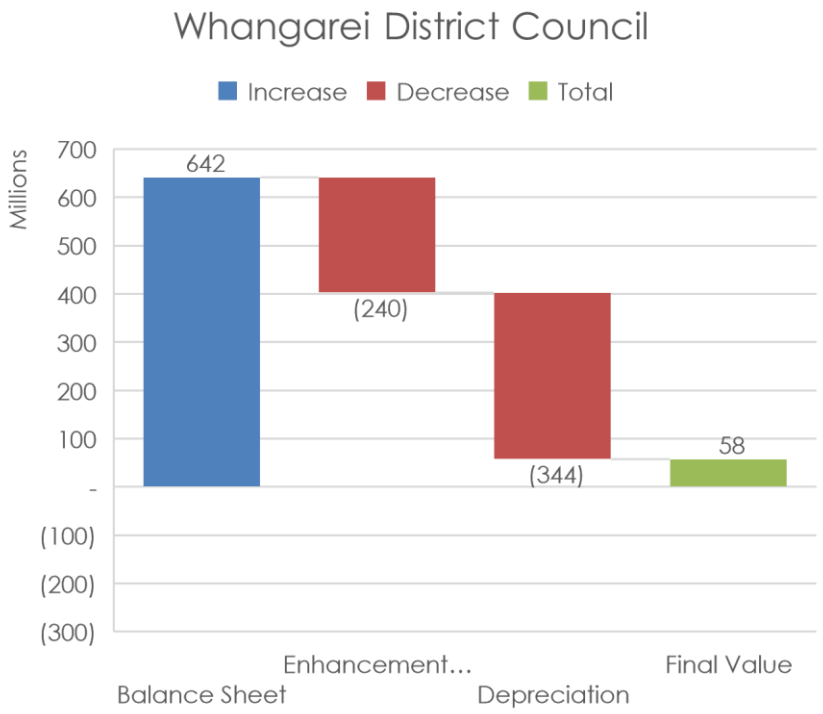
  = Enhancement and growth costs + Depreciation costs

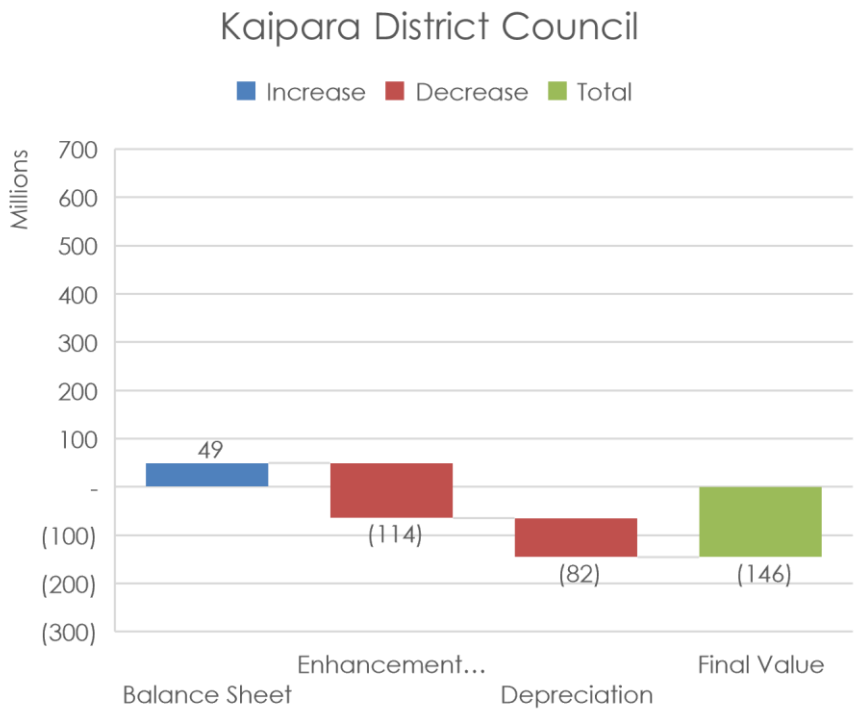
  These have been forecast for 30 years and discounted down to present values (5% discount rate)

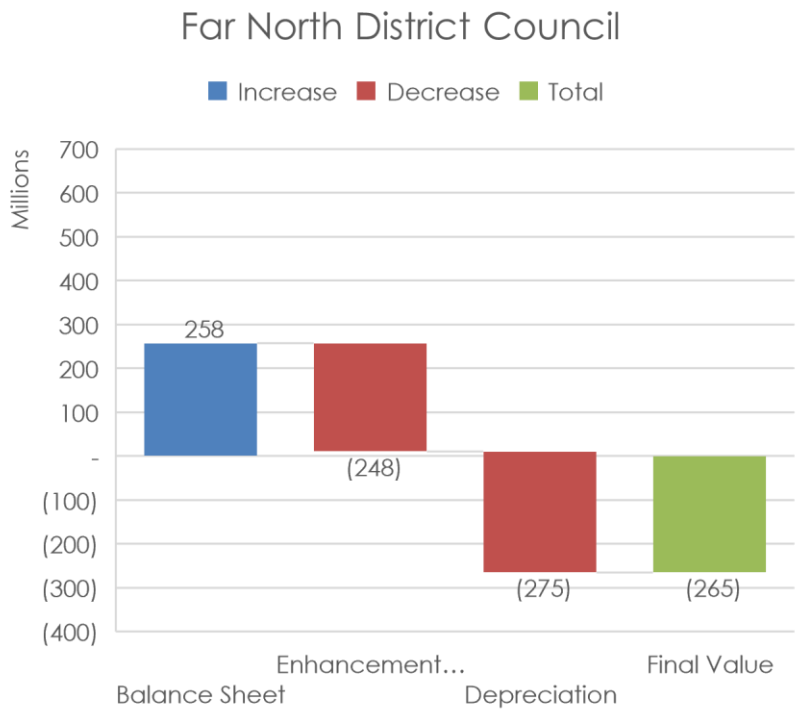


Buy-in Price

Approach (RFI)

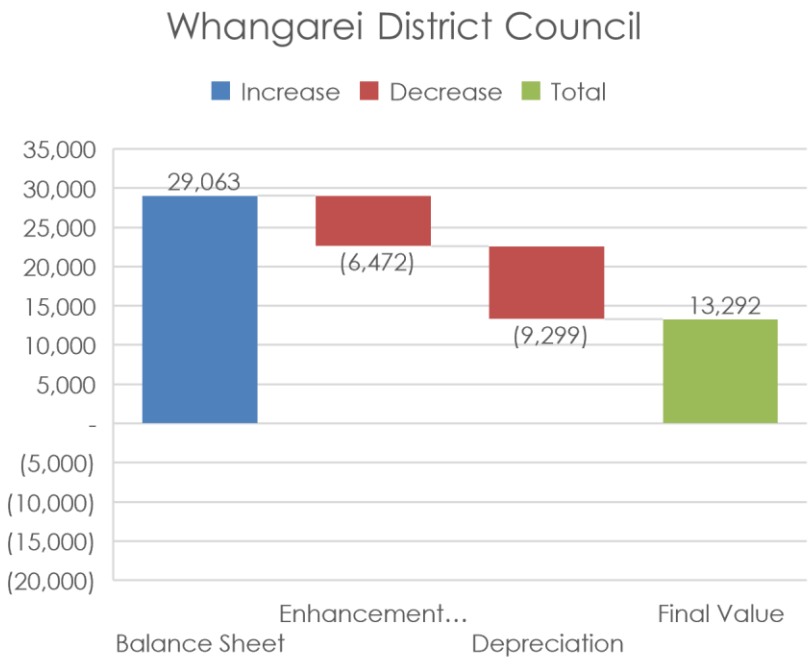


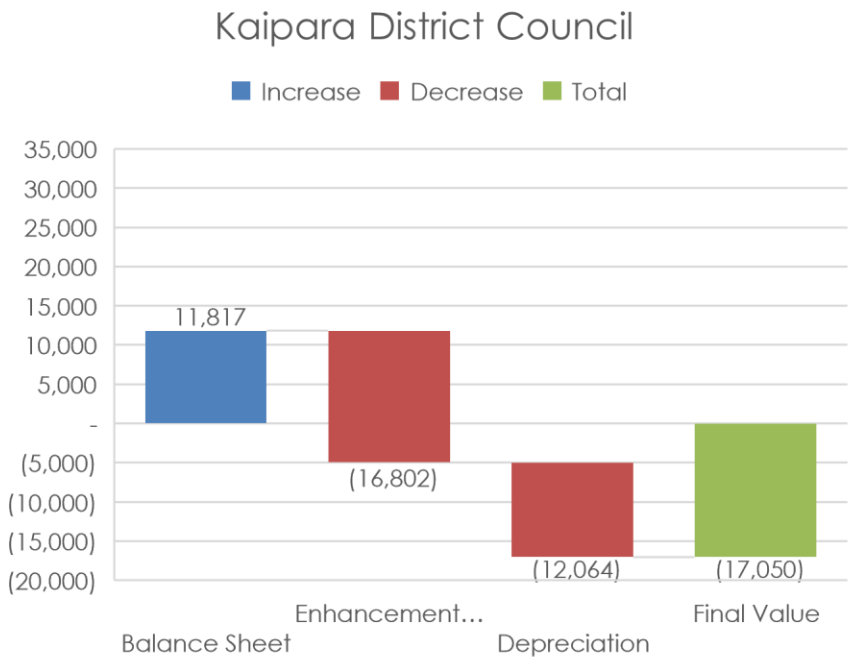


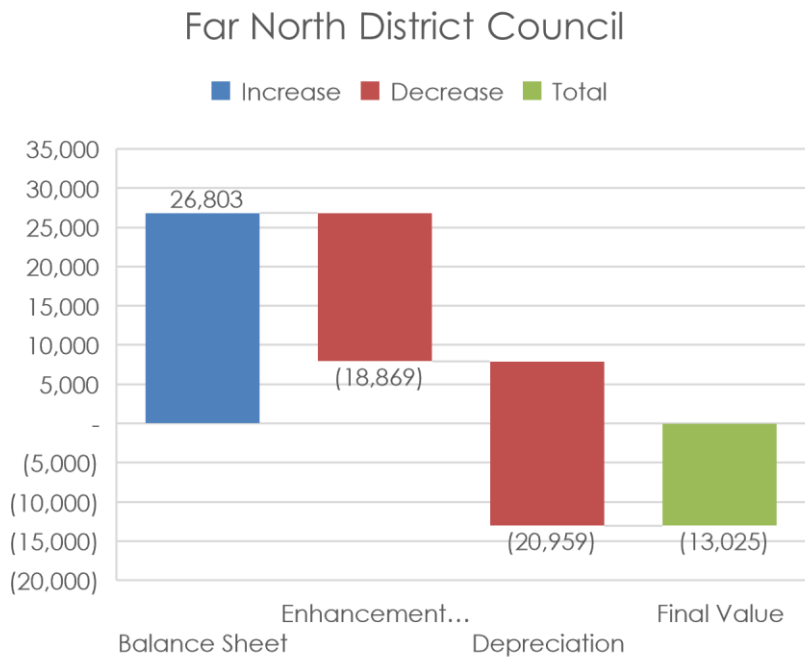


Buy-in Price

Approach (RFI) – per connected property basis







Buy-in Price

Approach (RFI)

Council	Balance Sheet	Enhancement and growth	Depreciation	Final Value	Buy-in Price (RFI)
Far North District Council	258,103,032	247,650,576	275,093,155	(264,640,699)	(322,424,037)
Kaipara District Council	49,143,000	113,615,592	81,577,386	(146,049,978)	(203,833,316)
Whangarei District Council	641,798,648	239,666,083	344,349,227	57,783,338	-
Total for amalgamated entity	949,044,680	600,932,252	701,019,768	(352,907,339)	(526,257,353)

Buy-in Price

Balance Sheet Approach (RFI)

Council	Asset Value	Carrying Amount	DRC/RV	less Debt	plus Reserves (Dep. & DC's)	Final Value
Far North District Council	499,643,000	278,786,000	56%	33,220,000	12,537,032	258,103,032
Kaipara District Council	165,584,501	132,917,000	80%	60,231,000	(23,543,000)	49,143,000
Whangarei District Council	1,089,828,972	633,590,000	58%	10,243,352	18,452,000	641,798,648
	-					
Total for amalgamated entity	1,755,056,473	1,045,293,000	60%	103,694,352	7,446,032	949,044,680

Contents

1. Objectives
2. Context (Entity A vs NIU)
3. Summary Results and Interpretation
4. Approach
5. Key inputs and assumptions (scenarios)
6. Weaknesses/Unknowns around WICs modelling
7. Alternative scenarios
8. Non-financial considerations
9. Summary

Objectives

What are we trying to achieve?

1. To understand the financial scale of the proposed Northland Infrastructure Unit.

2. To undertake a financial comparison to the modelling provided by WICS for Three Waters Reform.

3. To provide sufficient evidence to inform a decision on whether to pursue this alternative further, or not.

Context

- Northland under Three Water Reform would be combined with Auckland (Entity A)
- Northland is considering a Northland Infrastructure Unit as an alternative.
- It is assumed that this Northland Infrastructure Unit (NIU) would be responsible for:
  - Three Waters,
  - Transport,
  - Parks and Reserves,
  - Solid Waste and
  - Flood Protection

Approach

1. Develop a financial model for the Northland Infrastructure Unit
   a) Using the WICS "Entity A" model as a starting point
   b) Strip out the Auckland 3W inputs
   c) Add in inputs for other activities (taken from Funding Impact Statements from each council).
2. Identify key assumptions and develop low, medium and high scenarios.
3. Compare the financial impact of the Northland Infrastructure Unit to the WICS "Entity A".
4. Comment on potential shortfalls and bias in the WICS modelling.
5. Model alternate scenarios using different key assumptions

Key Inputs

Key Inputs

- Transport
- Parks and Reserves
- Solid Waste
- Flood Protection

Three Water Inputs

- As per WICS model for Entity A
- Auckland information removed and replaced with inputs above

Future Investment Scenarios

- Low, Medium, High

Key Inputs

Transport Inputs

- Due to the different activity groupings used by councils the following activities have been loaded into the NIU model
  - Roading & Footpaths (Far North)
  - Transportation (Kaipara)
  - Transportation (Whangarei)
- No adjustments have been made in relation to FAR contributions payable by Waka Kotahi

Flood Protection Inputs

  - n/a (Far North)
  - Flood Protection and Land Draining (Kaipara)
  - Flood Protection (Whangarei)

Key Inputs

Parks and Reserves Inputs

- Due to the different activity groupings used by councils the following activities have been loaded into the NIU model
  - District Facilities (Far North)
  - Open Spaces & Facilities (Kaipara)
  - Community Facilities & Services (Whangarei)

Solid Waste Inputs

  - Solid Waste Management (Far North)
  - Waste Minimisation (Kaipara)
  - Solid Waste (Whangarei)

Key Inputs

Opening Debt balances by activity

- The opening debt balances for each activity have been derived as follows:
- Three Waters
  - taken from the WICS model, for each council
- Other Activities
  - Deduct the Three Waters debt from the total council debt (per 2021-31 LTP)
  - Allocate this remaining balance on a pro-rata basis to the other activities, based on the relative size of each activity's asset base.

Key Inputs

Future Investment Scenarios – Enhancement and Growth

- Low = 80% of medium
- Medium = WICS for Three Waters and based off LTP's for other activities
  = 10-year LTP x 3 = 30-year investment
- High = 120% of medium

	Entity A	Whangarei 3W	NIU - Low	NIU - Medium	NIU - High
Adjustments			80%	100%	120%
Future Investment – WICS based	$27.3B	$1.6B	$5.3B	$6.6B	$7.9B
Future Investment – RFI based	$16.0B	$0.5B		$1.1B	

Key Assumptions

1. **Efficiencies of scale**
2. **Debt limits**
3. **Household cost range – connected households vs total households**

Key Assumptions

Efficiencies of Scale

- WICS have modelled efficiencies of scale based on population size, with Auckland achieving the maximum level of efficiency possible in New Zealand.

Council Area	LGNZ classification	Population served (thous)	Log of population	Assessed catch-up based on observed experience
Auckland	Metro	1,758	7.47	100%
Christchurch	Metro	385	5.95	55.1%
Wellington City	Metro	223	5.41	38.9%
Hamilton	Metro	162	5.09	29.6%
Tauranga	Metro	143	4.97	25.9%
Dunedin	Metro	121	4.80	21.0%
Palmerston North	Metro	89	4.49	11.8%
New Plymouth	Provincial	64	4.16	2.0%
Hastings	Provincial	64	4.15	1.9%
Upper Hutt	Metro	63	4.14	1.6%
Rotorua Lakes	Provincial	62	4.13	1.3%
All other Councils		<60	4.1	0%

Key Assumptions

Efficiencies of Scale

- Comparing the **connected** population of Northland, an efficiency rate of approximately 15% compared to Auckland would be appropriate.
- Comparing the **total** population of Northland, an efficiency rate of approximately 35% would be appropriate.

Total Population = 195,000

Connected Population = 97,000

Council Area	LGNZ classification	Population served (thous)	Log of population	Assessed catch-up based on observed experience
Auckland	Metro	1,758	7.47	100%
Christchurch	Metro	385	5.95	55.1%
Wellington City	Metro	223	5.41	38.9%
Hamilton	Metro	162	5.09	29.6%
Tauranga	Metro	143	4.97	25.9%
Dunedin	Metro	121	4.80	21.0%
Palmerston North	Metro	89	4.49	11.8%
New Plymouth	Provincial	64	4.16	2.0%
Hastings	Provincial	64	4.15	1.9%
Upper Hutt	Metro	63	4.14	1.6%
Rotorua Lakes	Provincial	62	4.13	1.3%
All other Councils		<60	4.1	0%

Key Assumptions

Efficiencies of Scale

- 25% efficiency gain has been modelled
- The midpoint of the two options compared to Auckland/Entity A.
- This actually means 25% of the efficiency gains assumed by Entity A
  - Entity A has assumed 53.3% operating efficiency gains
  - Entity A has assumed 50% capital efficiency gains
  - Plus, a further total factor productivity challenge of 0.4% per annum
- Hence, the following has been modelled:
  - 25% of 53.3% = 13.3% operating efficiency gains
  - 25% of 50% = 12.5% capital efficiency gains
  - Plus, a further total factor productivity challenge of 0.4% per annum

Entity A ~ 65% efficiency

NIU ~ 28% efficiency

Key Assumptions

Debt limits

- WICS consider that an amalgamated water entity should be able to borrow on terms consistent with Moody's definition of an investment grade credit for a regulated water company, namely either a Ba or Baa credit rating

Metric	Ba	Baa	Consistent with Ba or Baa
Funds from operations (FFO) / net debt	6-10%	10-15%	8-12%
Adjusted interest coverage or FFO interest coverage	1.2-1.5x or 1.8-2.5x	1.5-2.5x 2.5-4.5x	2.0-3.0x
Net debt / RAB or debt/capitalisation	70-85%	55-70%	
Retained cash flow (RCF) / net debt	4-6%	6-10%	

- Accordingly, WICS has targeted an FFO/net debt ratio of at least 10% and FFO interest coverage of at least 2.5 times over the 30-year period

Key Assumptions

Debt limits

- The same assumptions used by WICS for Entity A have been used for the NIU
  - Funds from operations (FFO)/net debt ratio of at least 10%
  - FFO interest coverage of at least 2.5 times

Metric	Ba	Baa	Consistent with Ba or Baa
Funds from operations (FFO) / net debt	6-10%	10-15%	8-12%
Adjusted interest coverage or FFO interest coverage	1.2-1.5x or 1.8-2.5x	1.5-2.5x 2.5-4.5x	2.0-3.0x
Net debt / RAB or debt/capitalisation	70-85%	55-70%	
Retained cash flow (RCF) / net debt	4-6%	6-10%	

Key Assumptions

Household cost range – connected households vs total households

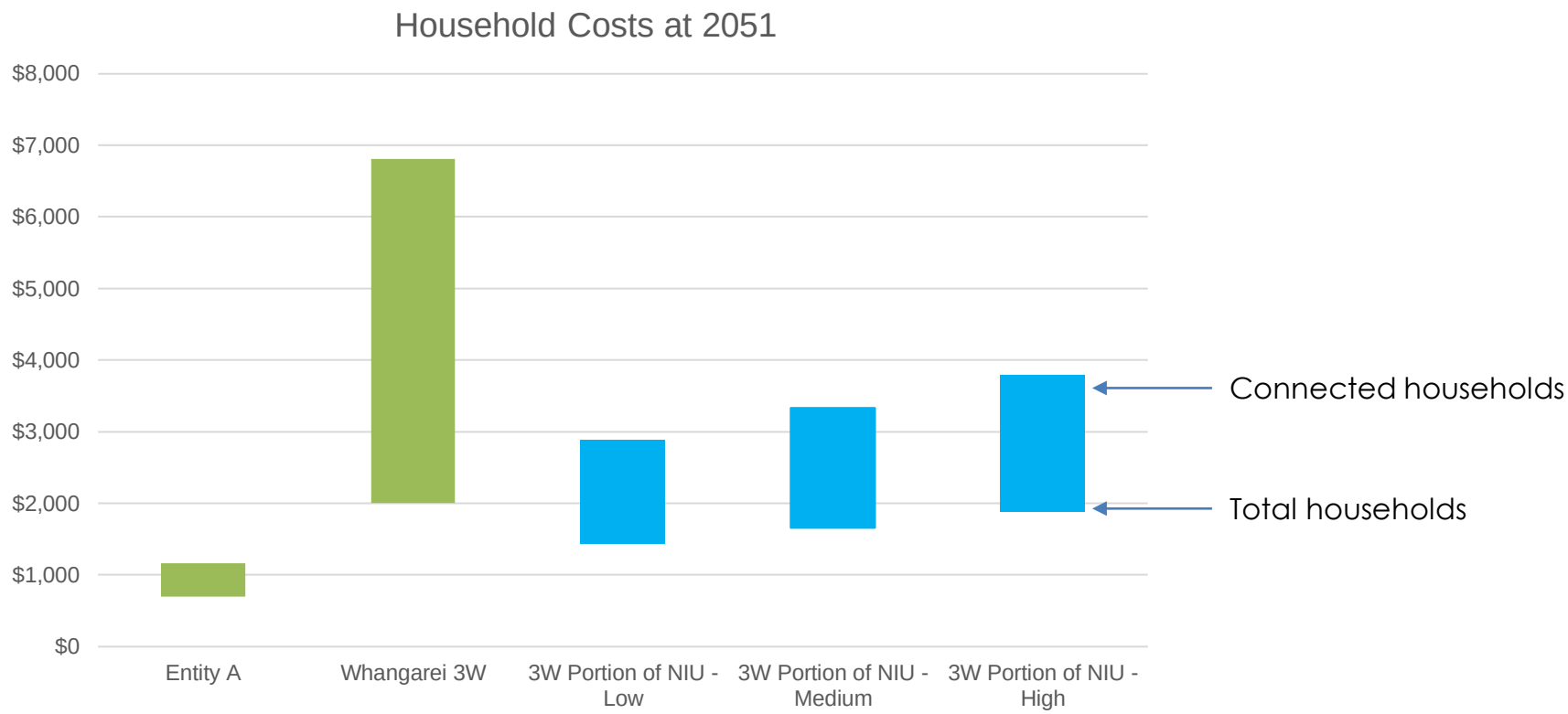
- WICS have modelled 97,000 connected population in Northland Region
- The total population of Northland is 195,000
- 98,000 people in Northland are currently not connected to 3W services

- We would expect that a portion of the 98,000 would be connected and rated for transport and other services
- A portion would also be likely to connect to 3W infrastructure

- Hence costs have been modelled against connected and total households

Key Assumptions

Household cost range – connected households vs total households



Key Issues with WICS Modelling

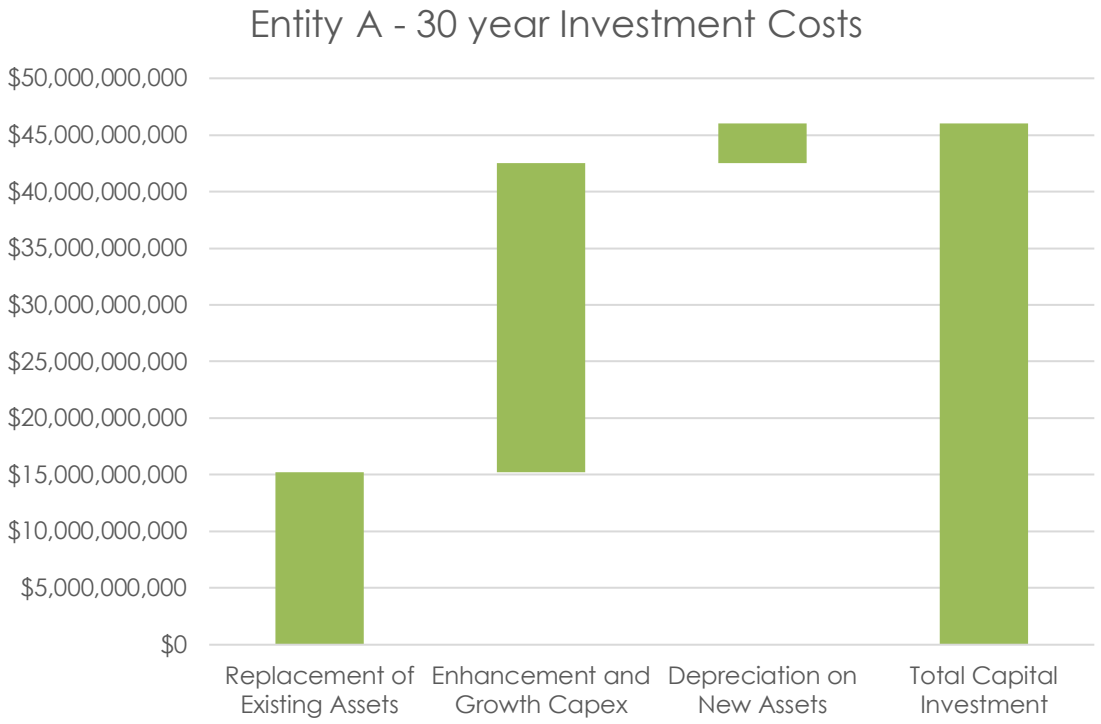
1. **Future investment – is it appropriate to add enhancement costs on top of asset replacement costs?**
2. **Efficiency gains – is it realistic to achieve these in the NZ/Northland context?**

Key Issues with WICS Modelling

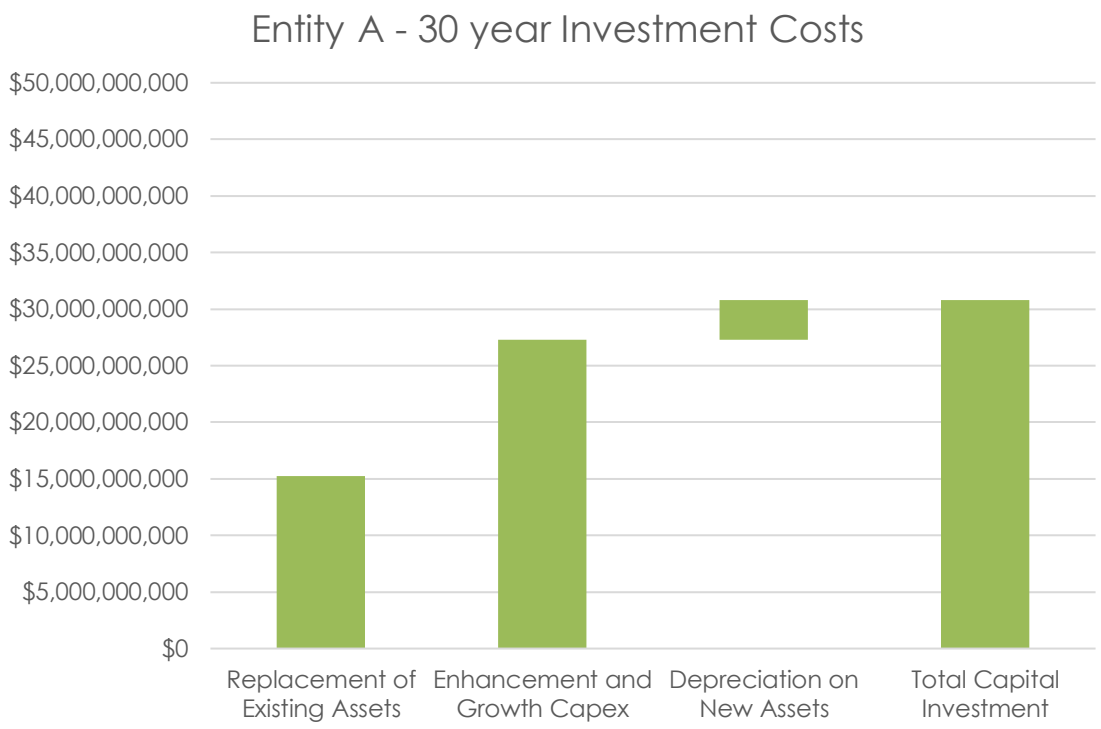
Future investment

- Do the modelled enhancement costs include a replacement component?

WICS Assumptions



Alternative Assumptions

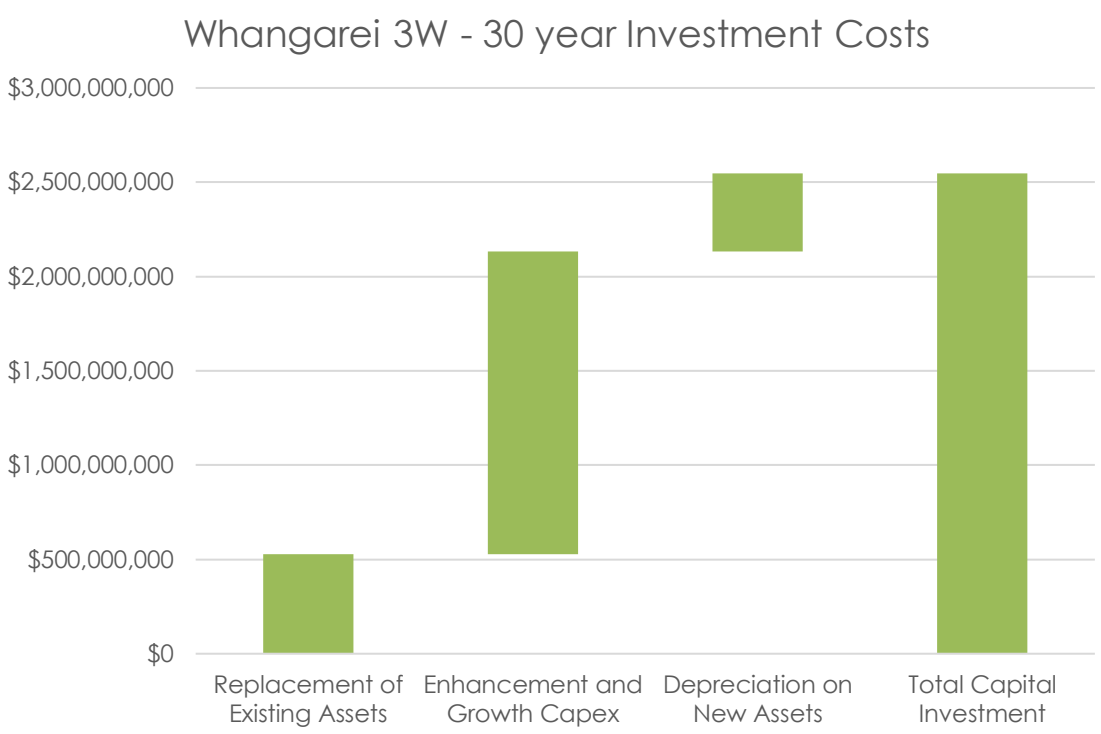


Key Issues with WICS Modelling

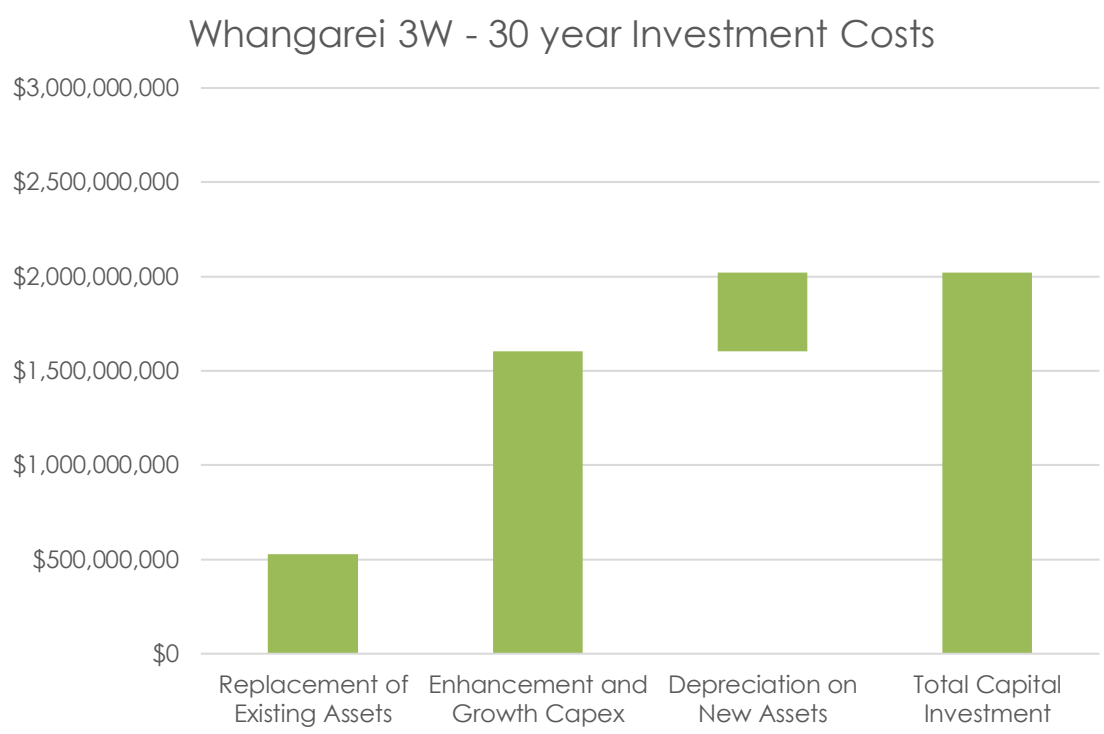
Future investment

- Do the modelled enhancement costs include a replacement component?

WICS Assumptions



Alternative Assumptions



Key Issues with WICS Modelling

Efficiency gains

- In the WICS models for the individual councils, there is an allowance of 3% per annum to operate new assets constructed for enhancement and growth.
- This 3% allowance is **not** applied to the Entity A model.

Comparing the key assumptions for the Net Present Cost analysis…

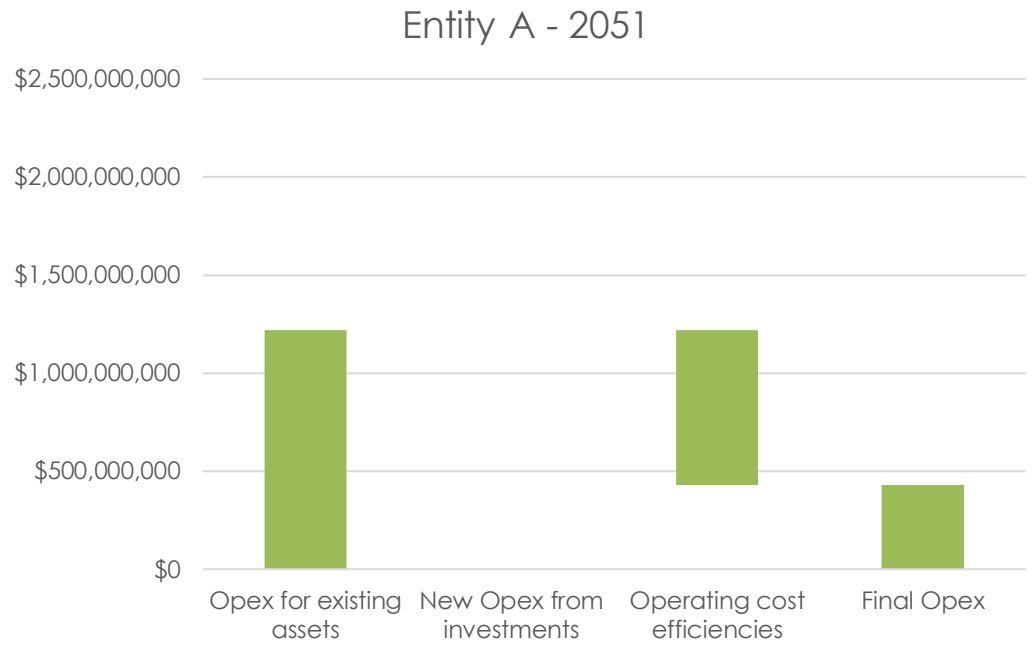
water industry commission FOR SCOTLAND

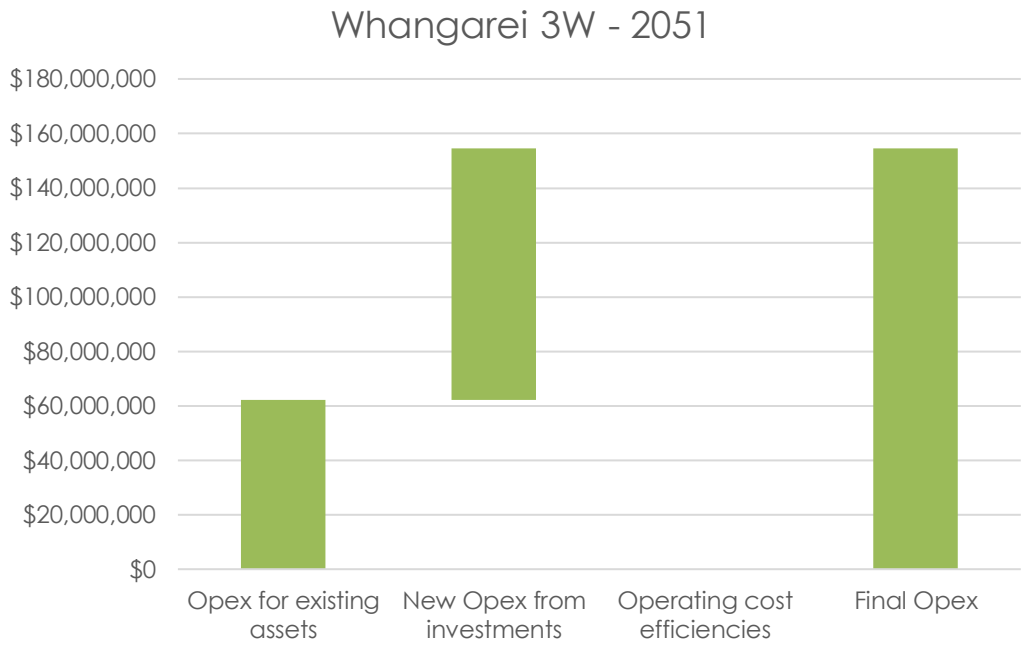
Parameter	Assumption for councils on a stand-alone basis	Assumption for amalgamated entities
Starting operating costs	NZ$1.2 Billion across New Zealand as reported in RFI Table E1, E2 and E2b	Same
Annual change in operating expenditure	In line with the growth in connections are reported in RFI Table G1	Same
Allowed for new operating costs	3% of projected enhancement and growth investment	No allowance for new operating expenditure based on efficiency gaps to the water companies in Great Britain
Level of enhancement and growth investment	NZ$95-100 Billion across New Zealand based on modelling regional investment in Scotland	Same
Capital real price effects (per annum)	1% above operating expenditure inflation	No allowance for capital real price effects

Key Issues with WICS Modelling

Efficiency gains

- This is visualized below where Entity A has no new Opex but efficiency gains
- Whereas Whangarei has new Opex and zero efficiency gains



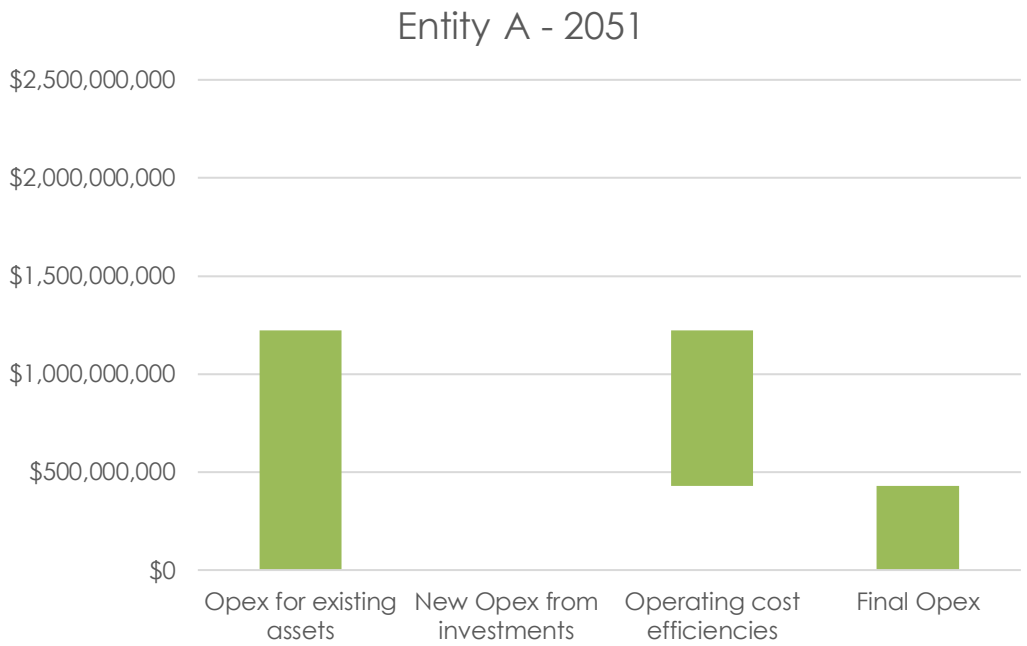


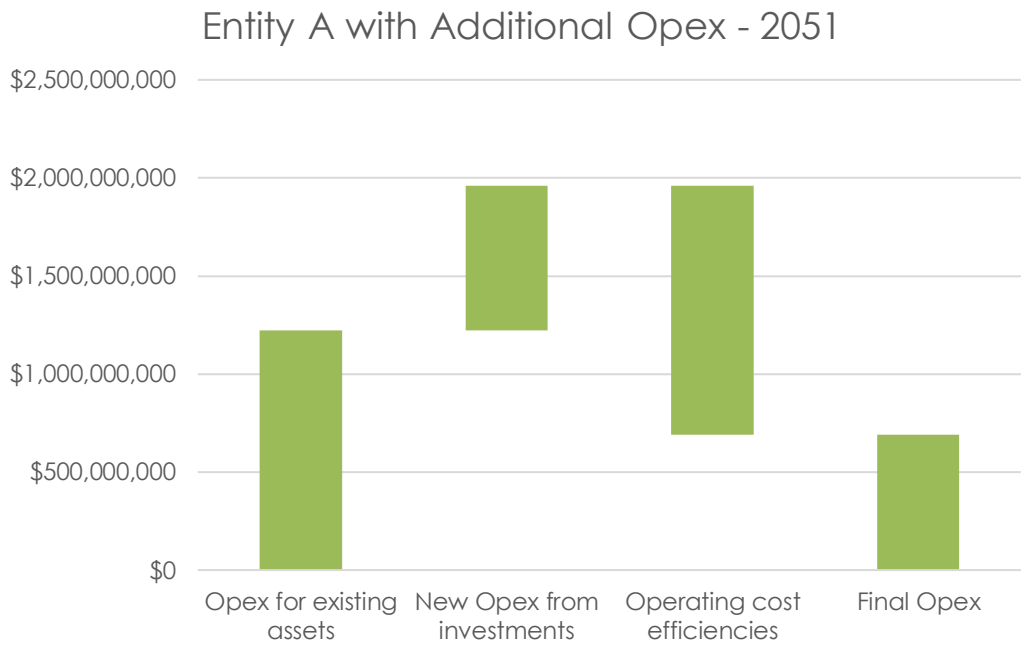
Key Issues with WICS Modelling

Is this realistic and achievable in the NZ/Northland context?

Efficiency gains

- Adding the allowance for Opex on new infrastructure
  - Suggests total efficiency gains at 65% of $1.27b vs $0.79b
  - Increasing the Opex by $260M per year by 2051
  - **OR** suggests total efficiency gains of $1.53b at 78%, with the same final opex





Alternative Scenario

Alternative assumptions and modelling

- Enhancement costs
  - Rather than rely on future enhancement costs estimated by WICS, more realistic expenditure forecasts have been used that are based on the unconstrained forecasts included in the request for information (RFI) completed by each council for the Department of Internal Affairs (DIA).
- Efficiency gains
  - Rather than debating likely efficiency gains for each entity all efficiency gains have been removed (set to zero)
  - This way you can compare the real household cost savings of sharing the total costs over a larger population
  - This gives a better base case to then debate which entity is likely to achieve the greater efficiency gains moving forward
  - i.e., **How would a Northland Infrastructure Unit stack up?**

Alternative Scenario

Changes to Inputs

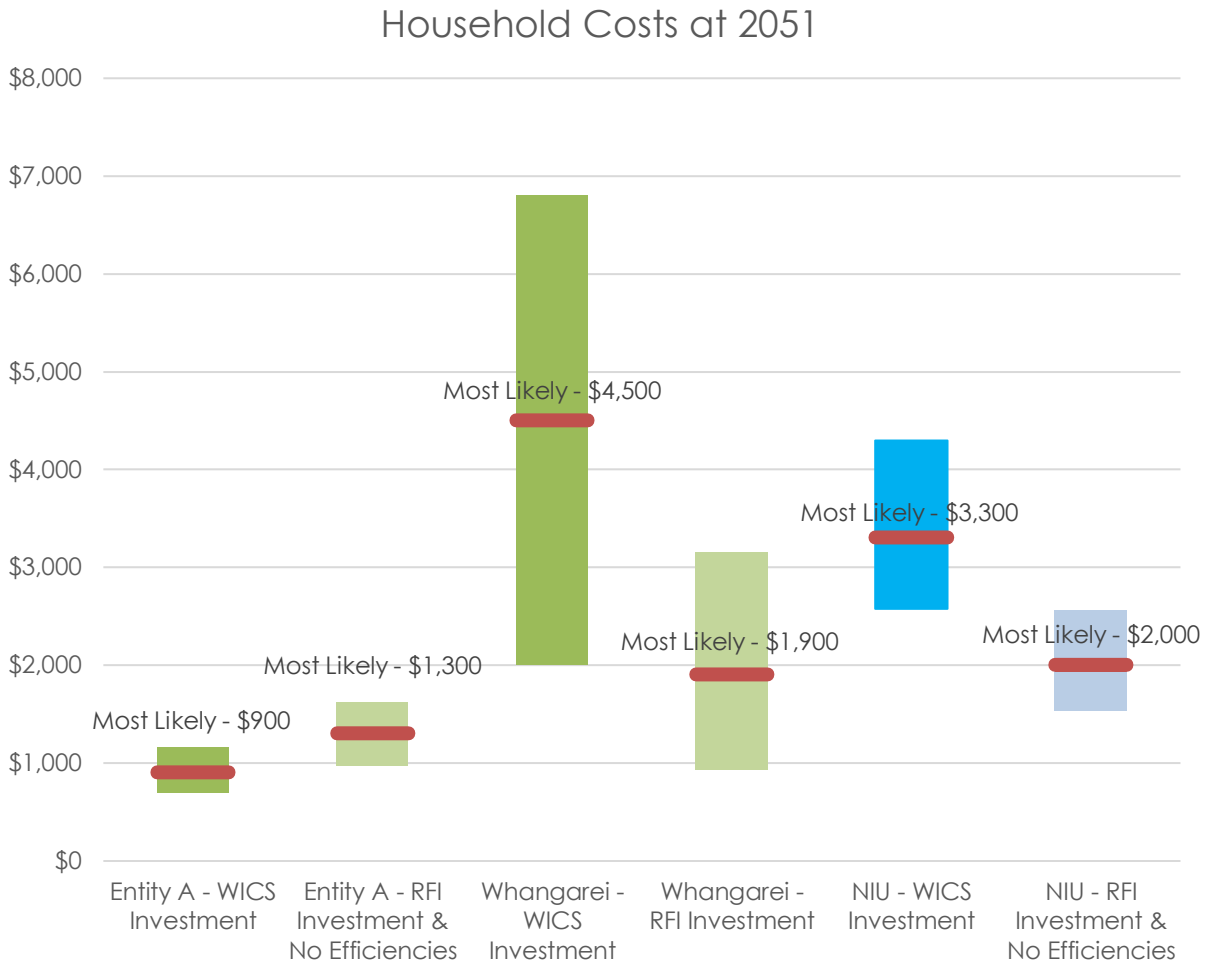
- 30 Year Growth and Enhancement from RFI data rather than WICS modelling
- Expected efficiency set to 0%

	Entity A		Whangarei		Northland Infrastructure Unit	
	WICS Scenario	Alternative Scenario	WICS Scenario	Alternative Scenario	WICS Scenario	Alternative Scenario
	Key Inputs					
3W Investment (30 Year Growth and Enhancement)	$27.3B	$16.0B	$1.6B	$0.5B	$3.8B	$1.1B
Efficiencies	50-53%	0%	0%	0%	12-13%	0%
	Key Outputs					
Max Debt to Revenue	6.0	5.2	2.5	2.5	5.4	4.8
Expected Cost per Household in 2051	$900	$1,300	$4,500	$1,900	$3,300	$2,000

Alternative Scenario

Results

- If you replace the questionable WICS assumptions
- Then Whangarei District Council (WDC) and a Northland Infrastructure Unit (NIU) compare much better to Entity A
  - ~$1,900 (WDC) and ~$2,000 (NIU) vs
  - ~$1,300 (Entity A)
- A premium of around $600 and $700 per household over Entity A to have greater control and influence over your future

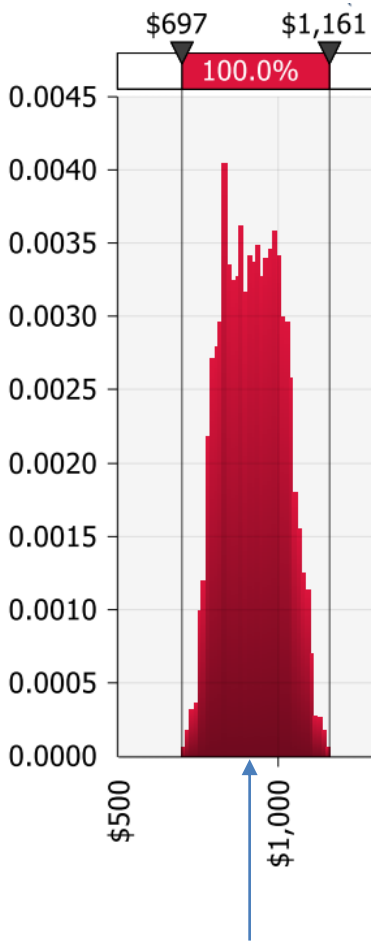


Alternative Scenario

Cost Range: Entity A

- The range of possible costs are taken from WICS slide pack for Entity A
- The most likely cost is the median of the distribution

- The alternative option has the same distribution (± x%) as the WICS option, but is centered around the most likely cost of $1,900



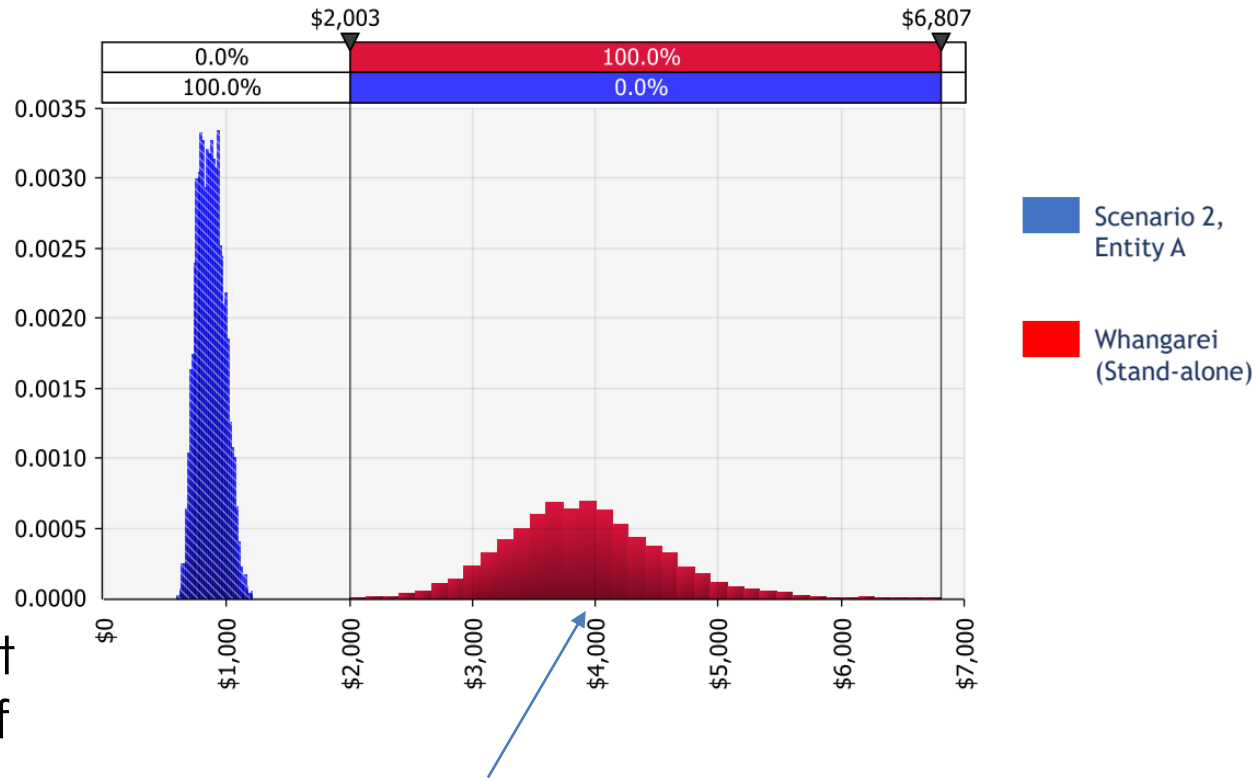
Most likely cost for Entity A ~ $900

Alternative Scenario

Cost Range: Whangarei

- The range of possible costs are taken from WICS slide pack for Whangarei
- The most likely cost is the median of the distribution

- The alternative option has the same distribution (± x%) as the WICS option, but is centered around the most likely cost of $1,300



Most likely cost for Whangarei ~ $4,000

Alternative Scenario

Cost Range: Northland Infrastructure Unit

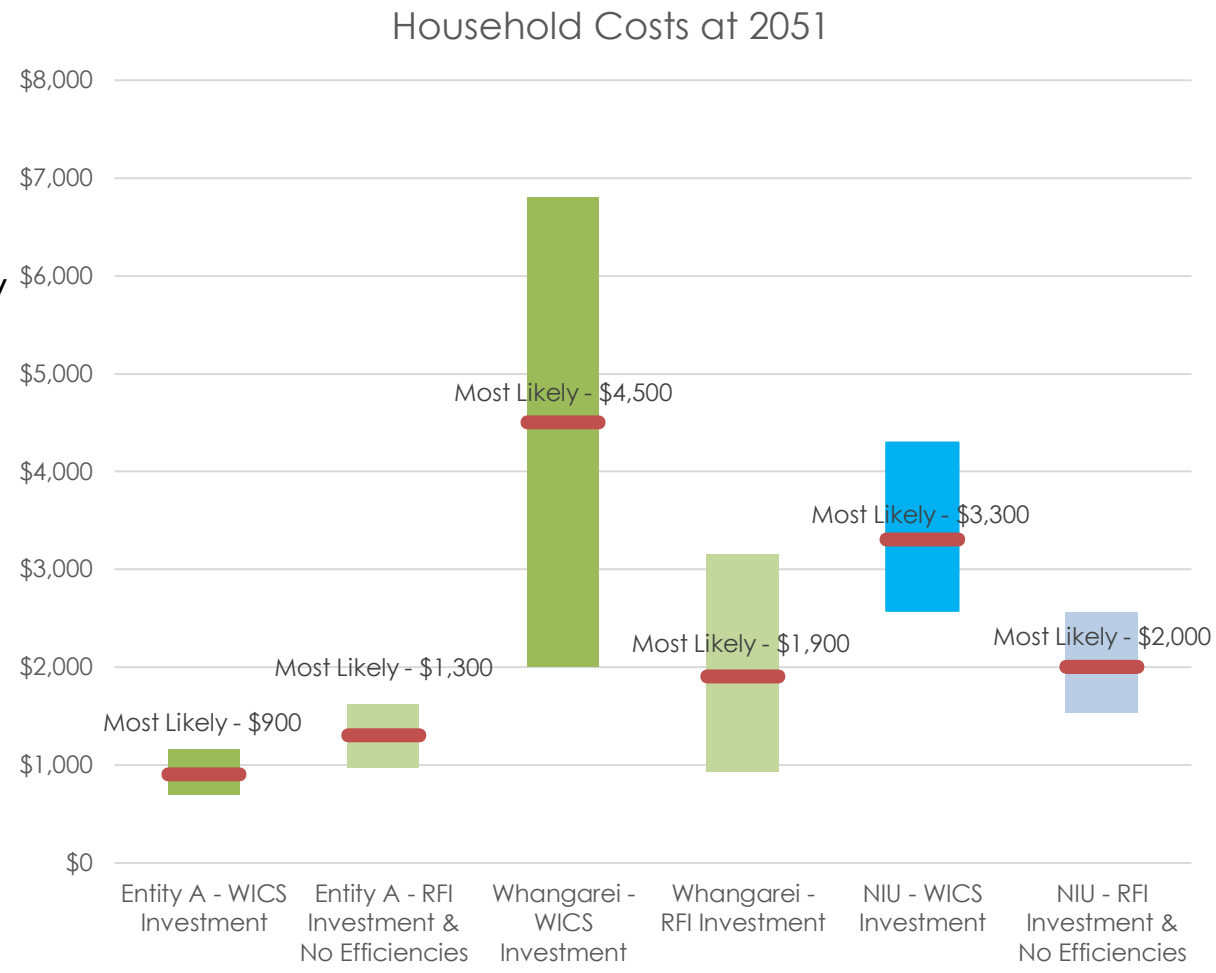
- The WICS investment option has the same distribution (± x%) as the WICS option for Entity A, but is centered around the most likely cost of $3,300

- The alternative option has the same distribution (± x%) as the WICS option for Entity A, but is centered around the most likely cost of $2,000

Alternative Scenario

Discussion

- The future investment is likely to sit somewhere between WICS and the alternate assumptions
- Efficiency gains, if any, between the different entity models will lower the alternate scenario household costs
- Further household cost reductions could result if it was decided to 'socialise' the costs further across all properties not just those connected
- A Northland Infrastructure Unit is only worth considering further if:
  - this unit can deliver better efficiencies than standalone
  - there is acceptance of the 'one price for all' funding basis



Non-financial considerations

Previous multi-criteria analysis (MCA)

- Considered the following key government objectives
  - Three Waters Reform
  - Taumata Arowai
  - Key design features of new entities
- Considered local objectives
  - Outcomes for Mana Whenua
  - Equitable access across the region
  - Local influence
- These have been summarised and presented

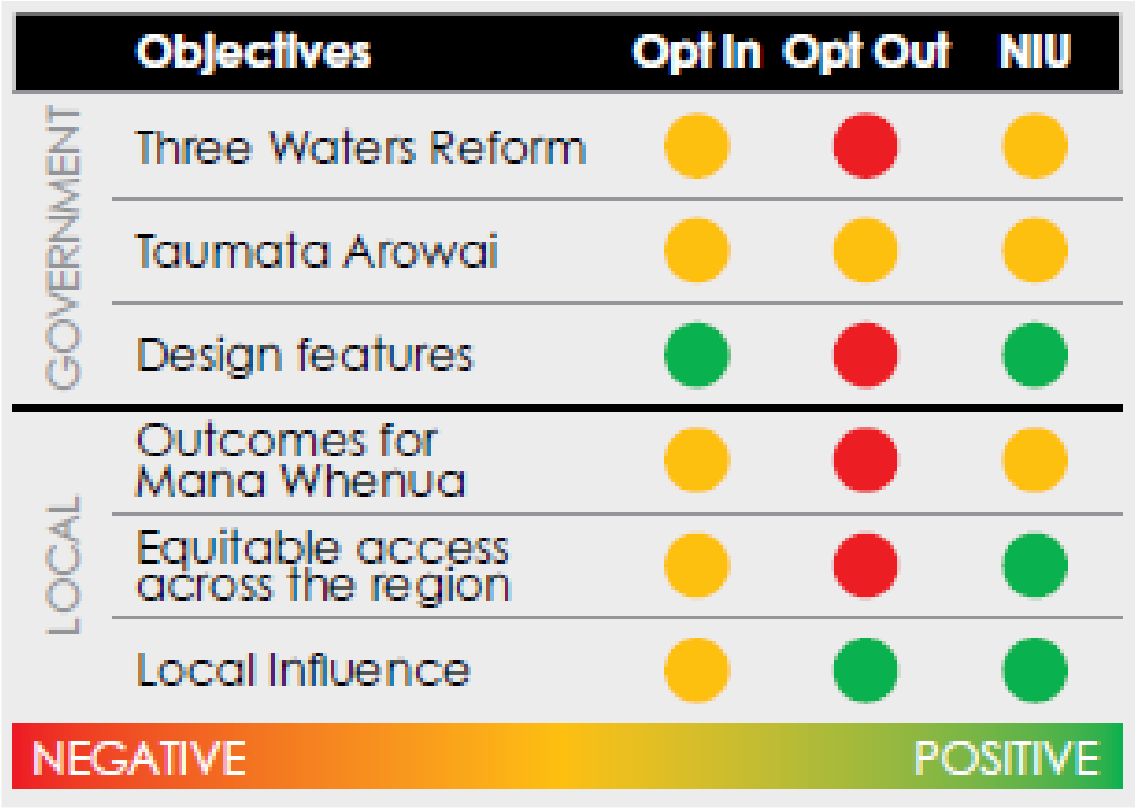
Non-financial considerations

Previous multi-criteria analysis (MCA)

- Suggests that a NIU should be able to deliver on Government objectives

- Plus

- Delivers better on the local objectives
  - Equitable access and
  - local influence



Summary

What are we trying to achieve?

- To provide sufficient evidence to inform a decision on whether to pursue this alternative further, or not.
  a) What is Northland willing to pay for greater influence and control over three waters into the future?
  – Is it greater than $600 per household?

  b) What is the risk around Entity A?
  – Total spend is very high
  – Efficiencies are very optimistic
  – Resourcing will be a key challenge

Far North District Council
Te Kaunihera o Tai Tokerau ki te Raki

KAIPARA DISTRICT
Kaipara te Oranganui • Two Oceans Two Harbours

Whangarei District Council

Te Tai Tokerau Water Collaboration – Initial Options Analysis

Final

April 2021

rationale > IMPROVING INFRASTRUCTURE OUTCOMES

Document Title:

Te Tai Tokerau Water Collaboration – Initial Options Analysis

Prepared for:

Far North District Council, Kaipara District Council, Whangarei District Council

Quality Assurance Statement

Rationale Limited
5 Arrow Lane
PO Box 226
Arrowtown 9351
Phone: +64 3 442 1156

Project Manager:	Emily Gualter
Prepared by:	Emily Gualter
Reviewed by:	Edward Guy
Approved for issue by:	Edward Guy
Job number:	J001131

Document Control History

Rev No.	Date	Revision Details	Prepared by	Reviewed by	Approved by
1.0	JAN 2021	Draft	ERG		
1.1	JAN 2021	Final Draft	ERG	EG	EG
2.0	JAN 2021	Final	ERG	EG	EG

Current Version

Rev No.	Date	Revision Details	Prepared by	Reviewed by	Approved by
3.0	APRIL 2021	FINAL - Updated	EW	TL	TL

Table of Contents

1 PURPOSE 4

2 SUMMARY 4

2.1 Next steps 4

3 CONTEXT 5

4 PROCESS 5

5 WORKSHOP OUTPUTS 6

5.1 Investment Logic Map 6

5.2 Multicriteria Analysis 6

5.2.1 Sensitivity Assessment 8

5.3 Options 9

6 NEXT STEPS 13

APPENDIX A. INVESTMENT LOGIC MAP 14

APPENDIX B. INVESTMENT LOGIC MAP – ISSUES LIST 15

APPENDIX C. MULTICRITERIA ANALYSIS 17

ADDENDUM – APRIL 2021 – ASSESSING OPTION 10: REGIONAL WATER ASSET OWNING CCO + NORTHLAND COMBINED AUTHORITY 18

OPTION 10 18

Multicriteria Analysis – Ten Options 19

Sensitivity Analysis 21

Updated Shortlist 21

1 Purpose

This report records the work completed at the two-day workshop in Whangarei on the 21st and 22nd of December 2020 and proposes the next steps for the three councils. It provides an initial assessment of options and acts as a guide for future thinking, alignment and collaboration.

The motivation for commencing these discussions has been the ongoing Three Waters Reform Programme driven by central government.

This report was drafted to aid in internal discussions and for the Mayoral and Chief Executive forums, and Councillors.

The report, and the workshop, did not intend to identify a preferred way forward for the Northland Councils or present public-facing information.

2 Summary

The two-day workshop comprised Investment Logic Mapping problems and benefits sessions and an initial options session.

The Investment Logic Mapping sessions were used to understand the issues being experienced currently and the benefits that could be achieved through collaboration and investment. The headline of the Investment Logic Map is "Three Water Services Delivering Wellbeing for the People of Northland" and the problem statements as defined by the group were:

1. A failure to build trust between local / central government and Mana Whenua, limits Maori participation and misses opportunities to improve outcomes.
2. A large geographic area, with dispersed population and variable socioeconomic standings, creates inequity of access and service levels across the region.
3. Historical under investment, with numerous challenges on the horizon, will require significant investment that is unaffordable for many.
4. Inadequate capability and capacity to provide specialist resources, inhibits good planning and decision making, delivering poor stakeholder confidence.

Outputs from the Investment Logic Mapping sessions were used to evaluate a range of options developed by participants to an initial shortlist of potential options that require further assessment. These are:

1. Regional Infrastructure Asset Owning CCO[1]
2. Multi-Regional Water CCO + Council Services remain as they are
3. Multi-Regional Water CCO + Regional Infrastructure Management CCO
4. Multi-Regional Water CCO + Northland Combined Authority

A description of each of the below options is provided in section 5.2. The full Investment Logic Map and optioneering exercise are detailed in the workshop outputs below.

There is a fifth option that was overlooked in the workshop which requires assessment, this is Regional Water CCO + Northland Combined Authority. An assessment of this option has been provided as an addendum.

2.1 Next steps

The recommended next steps for the Te Tai Tokerau / Northland Water Collaboration are:

- Assess Regional Water CCO + Northland Combined Authority option. This can be completed via a 1-hour MS Teams call – Completed

[1] A Regional Infrastructure Asset Owning CCO would include all infrastructure services currently provided by councils. However, it is acknowledged that it is uncertain if the ownership of transport assets can be transferred to such an organisation.

- Present report to the CE Forum – Draft report presented on 15 February 2021.
- Present findings to the Mayoral Forum – Completed
- Present findings to Councillors Whangarei District Councillors have been updated on the progress; however, it is unknown if Far North District Council and Kaipara District Council have done the same.
- Engage with the Department of Internal Affairs on alternative options prior to March 2021 roadshow. – this opportunity did not present itself to complete this action.
- Work alongside Mana Whenua to understand their capacity and capability for engagement. – Mana Whenua have been kept informed on Three Waters Reform but have not specifically engaged in this project.
    - Support development so co-design and co-governance can be achieved.
- Commence programme of work to understand regional investment prioritisation (this can be completed in parallel with Mana Whenua engagement). – yet to be completed.

3 Context

In July 2020, the Government launched the Three Waters Reform Programme. A three-year programme to reform local government three waters service delivery arrangements.

This reform programme builds on the progress made through the Three Waters Review, the establishment of Taumata Arowai and the Water Services Bill.

In 2021, the reform programme will:

- Engage with the sector and iwi on options of entity design (e.g., ownership and governance) and number of entities and boundaries,
- Commence design of entities and core reform proposals,
- Consult with the public on these proposals, and
- Ask councils to make decisions around participation in the reforms (including which entity they would be a part of and its core design features).

4 Process

The two-day workshop (21 and 22 December 2020) commenced a conversation about formal collaboration between the four Northland councils given the ongoing Government-led Three Waters Reform. This conversation built on the work the councils have been doing together through the 'Four Waters Advisory Group Northland'.

The objectives of the workshop were:

1. Establish a formal regional collaborative group between Far North District Council, Kaipara District Council, Whangarei District Council and Northland Regional Council.
2. Identify shared issues and opportunities.
3. Explore viable options, given the Department of Internal Affairs (DIA) current objectives and key features, to present to Council's for discussion.

The outputs produced from this work was an Investment Logic Map and a multicriteria analysis of options identified in the workshop which resulted in an initial shortlist for further consideration. These articles are appended.

Representatives from Far North District Council, Kaipara District Council and Whangarei District Council attended the workshop. Northland Regional Council were unable to attend.

5 Workshop Outputs

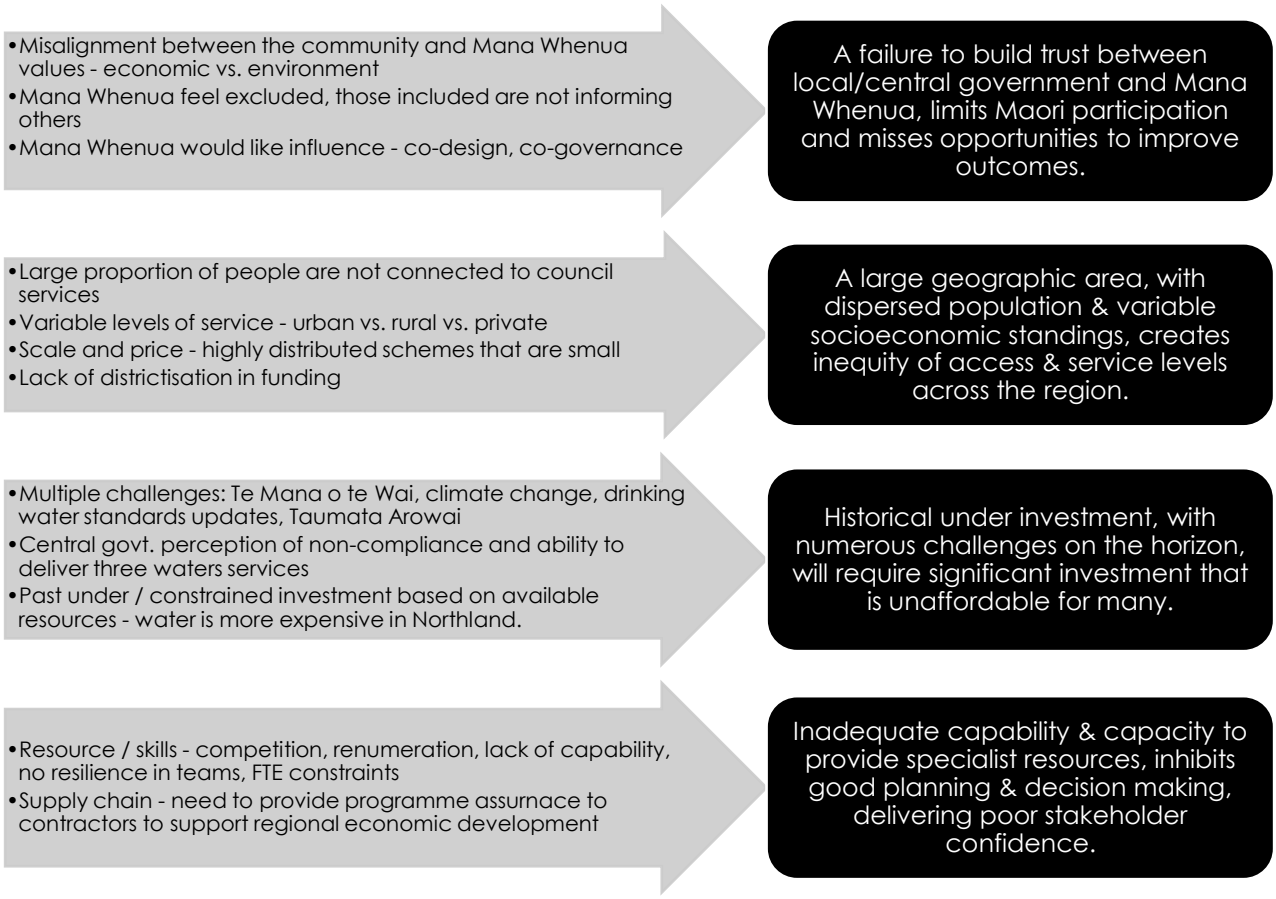
5.1 Investment Logic Map

An Investment Logic Map is a New Zealand Treasury supported investment tool that aims to communicate a complete investment story on a single page, using language and concepts that are understandable to a wide audience.

Investment Logic Mapping workshops look to understand what issues are currently being experienced and what benefits could be achieved through investment, or in this case collaboration.

The headline of the Northland Three Waters Investment Logic Map is: *Three Water Services Delivering Wellbeing for the People of Northland.*

As illustrated below there are several issues that contribute to each problem statement.



The benefits identified which could be achieved through collaboration and investment were:

- Meaningful role and outcomes for Mana Whenua
- Improving equitable access and service levels across the Region, enhancing wellbeing
- Improve investment availability and affordability
- Improving capability and capacity to deliver value across the supply chain

The full Investment Logic Map and issues list from the workshop have been appended.

5.2 Multicriteria Analysis

The group identified nine potential options for water services delivery moving forward. These were:

1. Do Min - Enhance SQ + Individual Councils manage and deliver waters + NTA remains as it is.
2. Water Shared Services Business Unit

3. Regional Management CCO
4. Regional Infrastructure Management CCO
5. Regional Waters Asset Owning CCO + Council services remain as they are
6. Regional Infrastructure Asset Owning CCO[2]
7. Multi-Regional Water CCO[3] + Council services remain as they are
8. Multi-Regional Water CCO + Regional Infrastructure Management CCO
9. Multi-Regional Water CCO + Northland Combined Authority

This longlist of options was evaluated against the following criteria:

- Investment Objectives
    - At this early stage these are the benefit statements from the Investment Logic Map.
- Strategic Alignment
    - Three Waters Reform and Taumata Arowai objectives and features
- Business Needs and Disbenefits
    - Identified by participants based on the needs and requirements of participating Territorial Authorities.
- Risks
    - Technical, operational, financial, stakeholder/political/public, environmental, safety, economic

Evaluation refined the longlist to an initial shortlist of four options: options six through nine. These will require further investigation and consideration before a preferred way forward can be determined. The benefits and risks of each option are discussed below.

NOTE: It is important to note that the scoring as shown in the multicriteria analysis, appended, remains as it was completed by the group at the workshop.

Options two through four were not assessed as they did not achieve the Department of Internal Affairs key features:

- Water service delivery entities that are:
    - Of significant scale (most likely multi-regional) to enable benefits from aggregation to be achieved over the medium- to long-term.
    - Asset owning entities with balance sheet separation, to support improve access to capital, alternative funding instruments and improved balance sheet strength, and
    - Structured as statutory entities with appropriate and relevant commercial disciplines and competency-based boards.
- Delivery of drinking water and wastewater as a priority, with the ability to extend to stormwater service provision only where effective and efficient to do so.
- Publicly owned entities, with a preference for collective council ownership.
- Mechanisms for enabling iwi/Maori and communities to provide input in relation to the new entities.

The full multicriteria analysis has been appended.

[2] A Regional Infrastructure Asset Owning CCO would include all infrastructure services currently provided by councils. However, it is acknowledged that it is uncertain if the ownership of transport assets can be transferred to such an organisation.
[3] Currently proposed by DIA, as part of the three waters reform programme, are statutory, multi regional water entities which own three waters infrastructure. The number and size of these entities is yet to be confirmed.

5.2.1 SENSITIVITY ASSESSMENT

A sensitivity assessment was undertaken to ensure the multicriteria analysis criteria weighing was robust. The weighting for each criteria grouping was varied as per the table below.

Cost and Revenue were not assessed and hence not rated against at this early stage.

Table 1. Criteria weighing.

Scenario	Initial	1	2	3	4	5
Investment Objectives	30%	70%	10%	10%	10%	25%
Cost						
Revenue						
Strategic Alignment	20%	10%	70%	10%	10%	25%
Business Needs	20%	10%	10%	70%	10%	25%
Risks	30%	10%	10%	10%	70%	25%
Check Sum	**100%**	**100%**	**100%**	**100%**	**100%**	**100%**

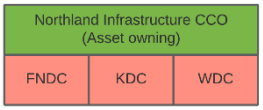
The following table displays the results of the sensitivity analysis, clearly identifying an initial shortlist of options six through nine.

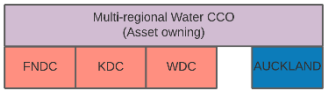
Table 2. Sensitivity Analysis of Multicriteria Analysis.

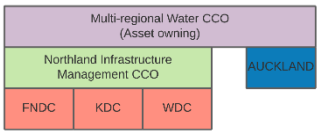
Scenario	Option 1	Option 2	Option 3	Option 4	Option 5	Option 6	Option 7	Option 8	Option 9
Initial	6				5	3	4	2	1
1	6				5	4	3	2	1
2	6				5	4	3	2	1
3	2				4	1	6	5	3
4	6				5	4	3	2	1
5	6				5	2	4	3	1

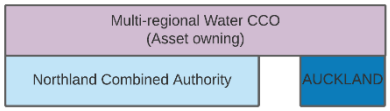
Scenario three was discarded as inappropriate due to the low weighting of investment objectives and risks.

5.3 Options

Option 6	Regional Infrastructure Asset Owning CCO
Definition  	An asset owning CCO to deliver core infrastructure services to the Northland region. The CCO and the directors will be accountable for the performance of the water entity. They would be responsible for delivering all operational and capital three waters, transport, solid waste, and parks services for the people of Northland. The CCO would also recover costs from individual customers. Council would define its expectation of the CCO, monitor performance and potentially have governance representation. Mana Whenua would also potentially have governance representation and be involved in the co-design of the organisation.
Benefits over status quo	• Opportunity for development of a new structure that enables participation of Mana Whenua from the outset – co-governance and co-design. • Delivers cost savings through scale and capacity as well as controlling the revenue stream and investment decisions. • Regionalising costs is likely to improve affordability for all infrastructure. • The creation of an infrastructure CCO provides an opportunity for advancement and job enrichment. • Reduces competition between councils for resources. • Increases resilience of organisation through creating a greater breadth and depth of resources. • Strategic capability to be developed within the CCO for all infrastructure. • Integration of assets for strategic and spatial planning. • The structure ensures resources remain in the Northland regional area.
Misalignment to national objectives	• Is not a multi-regional entity. • Is not a dedicated water entity.
Risks and disbenefits	• Trade-offs between investment in three waters and other infrastructure. • The model requires significant change to the three district councils. • Development of co-governance and co-design will place additional pressure on Council and Mana Whenua resources to participate fully.

Option 7	Multi-Regional Water CCO + Council services remain as they are
Definition  	Northland would combine with other regions (currently unknown) to create a multi-regional CCO, which would own assets and be responsible for delivering all operational and capital three waters services for the multi-regional area. The CCO and the directors will be accountable for the performance of the water entity and recover costs from individual customers. The councils would define its expectation of the CCO, monitor performance and potentially have governance representation. It is currently unknown the level of influence Northland Councils will have. Mana Whenua would also potentially have governance representation and be involved in the co-design of the organisation. This model may provide cost savings and efficiencies of scale. However, it is likely the main office would be based outside the region.
Benefits over status quo	• Opportunity for development of a new structure that enables participation of Mana Whenua from the outset – co-governance and co-design. However, due to the large scale of a multi-regional water CCO, the level of influence is currently unknown. • Delivers cost savings for water through scale and capacity as well as controlling the revenue stream and investment decisions. • Multi-regionalising costs is likely to improve affordability for water. • The creation of an infrastructure CCO provides an opportunity for advancement and job enrichment. • Increases resilience of organisation through creating a greater breadth and depth of resources. • Strategic capability to be developed within the CCO for water.
Misalignment to national objectives	• Probable partners have significant issues which will likely be of higher priority for investment, i.e., Watercare's imminent problems. • The remaining council services are left for councils to individually resource. This will likely increase competition and pressures on existing resources.
Risks and disbenefits	• The model requires a high rate and level of change to be successful. • Development of co-governance and co-design will place additional pressure on Council and Mana Whenua resources to participate fully. • The remaining council resources will be under further pressure to deliver other services. • Stranded assets e.g., offices, overheads, administration. • Disaggregation of district strategic and spatial planning. • Resource management consenting, remaining with council, will require infrastructure knowledge.

Option 8	Multi-Regional Water CCO + Regional Infrastructure Management CCO
Definition  	Similarly, to option 7, Northland would combine with other regions to create a multi-regional CCO, which would be accountable for its performance, own assets and deliver three water services. In addition to this, the Northland Territorial Authorities would create a management CCO to operate all remaining infrastructure – transport, solid waste, parks and, if not included in the multi-regional CCO, stormwater. The management CCO would have a professional board who along with the CCO would be accountable for the performance of the CCO; however, the councils would remain responsible for funding decisions based on the investment recommendations of the management CCO. Mana Whenua would also potentially have governance representation and be involved in the co-design of the organisation.
Benefits over status quo	• Opportunity for development of a new structure that enables participation of Mana Whenua from the outset – co-governance and co-design. However, due to the large scale of a multi-regional water CCO, the level of influence is currently unknown. • Delivers cost savings for water through scale and capacity as well as controlling the revenue stream and investment decisions. • Multi-regionalising costs is likely to improve affordability for water. • The creation of an infrastructure CCO provides an opportunity for advancement and job enrichment. • Increases resilience of organisation through creating a greater breadth and depth of resources. • Strategic capability to be developed within the CCO for water. • The creation of a regional infrastructure management CCO will support the remaining infrastructure left with council reducing competition and pressure on resources.
Misalignment to national objectives	• Probable partners have significant issues which will likely be of higher priority for investment, i.e., Watercare's imminent problems. • Removing all infrastructure from councils will put additional pressure on overheads and stretch resources for remaining functions.
Risks and disbenefits	• Individual Territorial Authorities may no longer be viable organisations due to the removal of all infrastructure. • This model requires a high rate and level of change to be successful. • Development of co-governance and co-design in two organisations will place additional pressure on resources for Council and Mana Whenua to participate fully in both. • Stranded assets e.g., offices, overheads, administration.

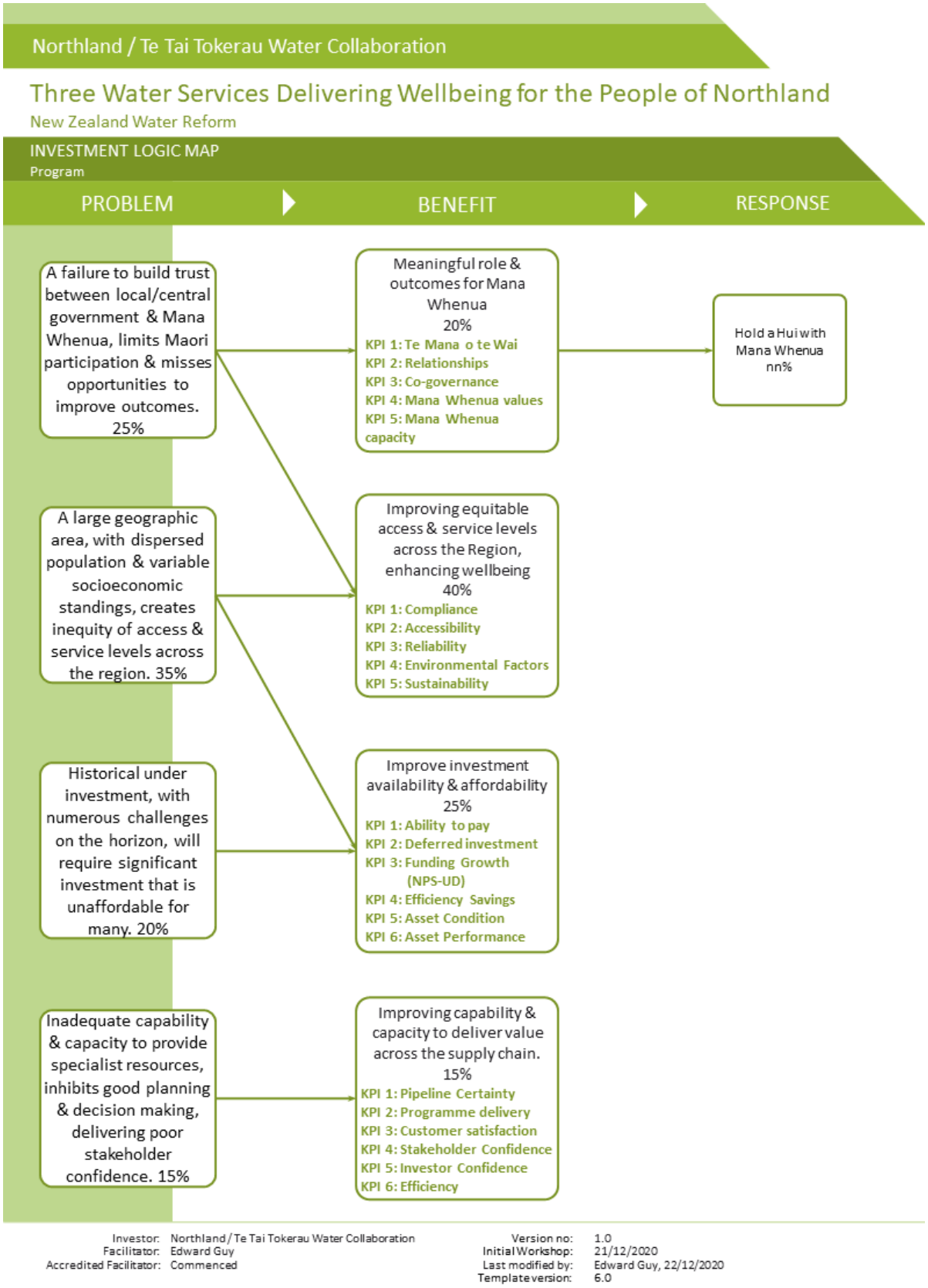
Option 9	Multi-Regional Water CCO + Northland Combined Authority
Definition  	Similarly, to option 7, Northland would combine with other regions to create a multi-regional CCO, which along with the directors would be accountable for its performance, own assets and deliver operational and capital three water services. In addition to this, the four Northland councils would create a Combined Authority to deliver all other territorial authority and regional authority services. Mana Whenua, councils and the CCO will all have the same roles and responsibilities in regard to the multi-regional asset owning three waters CCO, as described in option 7.
Benefits over status quo	• Opportunity for development of a new structure that enables participation of Mana Whenua from the outset – co-governance and co-design. However, due to the large scale, the level of influence is currently unknown. • Delivers cost savings for water through scale and capacity as well as controlling the revenue stream and investment decisions. • Multi-regionalising costs is likely to improve affordability for water • The creation of an infrastructure CCO provides an opportunity for advancement and job enrichment. • Increases resilience of organisation through creating a greater breadth and depth of resources. • Strategic capability to be developed within the CCO for water. • The creation of a Combined Authority supports the remaining functions in council, reducing competition and pressure on resources. • Enhances affordability for services other than water. • Improved affordability for non-water assets. • Reduced overheads and administration costs. • Streamlines of governance.
Misalignment to national objectives	• Probable partners have significant issues which will likely be of higher priority for investment, i.e., Watercare's imminent problems.
Risks and disbenefits	• This model requires a high rate and level of change to be successful. • The development of co-governance and co-design in two organisations will place additional pressure on Mana Whenua resources to participate fully.

6 Next Steps

The recommended next steps for the Te Tai Tokerau / Northland Water Collaboration are:

- Assess Regional Water CCO + Northland Combined Authority option. This can be completed via a 1-hour MS Teams call – Completed
- Present report to the CE Forum – Draft report presented on 15 February 2021.
- Present findings to the Mayoral Forum – Completed
- Present findings to Councillors Whangarei District Councillors have been updated on the progress; however, it is unknown if Far North District Council and Kaipara District Council have done the same.
- Engage with the Department of Internal Affairs on alternative options prior to March 2021 roadshow. – this opportunity did not present itself to complete this action.
- Work alongside Mana Whenua to understand their capacity and capability for engagement. – Mana Whenua have been kept informed on Three Waters Reform but have not specifically engaged in this project.
    - Support development so co-design and co-governance can be achieved.
- Commence programme of work to understand regional investment prioritisation (this can be completed in parallel with Mana Whenua engagement). – yet to be completed.

Appendix A. Investment Logic Map



Appendix B. Investment Logic Map – Issues List

Improving the wellbeing outcomes of Northland people in the face of three waters change.

Te Tai Tokerau / Northland Water

ILM Problem	Item	Issues
1	1.	Misalignment between the community and mana whenua values – economic first (crown) vs. environment first (iwi)
2,3	2.	Historical non-compliance and future unknown compliance (changing drinking water standards, Te Mana o te Wai / receiving waters environmental demands)
2,3,4	3.	Lack of trust from Central Govt. perception of non-compliance and ability to deliver three water services
2	4.	Large proportion of people are not connected to council supplies
2	5.	Population growth – expecting growth, meet demands, increased community expectations (LOS), investment
3,4	6.	Multiple challenges: Te Mana o te Wai, climate change, drinking water standards updates, Taumata Arowai,
4	7.	Resources / skills – competition, renumeration, lack of capability, no resilience in teams
3,4	8.	Elected Member intervention: FTE constraints
2,3	9.	Under / optimised investment
	10.	Tourism impacts – growth in parts,
4	11.	Supply chain – need to provide programme assurance to contractors to support the economic development of the region, professional services are not well established in the region, localism / sustainable procurement – create local jobs
	12.	Uncertainty
1	13.	Mana Whenua – feel excluded, those included are not informing others
1	14.	Mana Whenua – different dialogue, different priorities (co-design, co-governance), equity
2,3	15.	Consistency: systems, wider consistency, maturity, LOS,
4	16.	Investment: Planning, Risk
3	17.	Risk appetite: gold plate vs. risk taking
2,3	18.	Variable LOS: urban vs. rural vs. private (changing as the population demographic changes)

1,2,3	19.	Borderline achievement of environmental outcomes
3	20.	Ability to pay – water is more expensive in Northland,
3	21.	Lack of investment
4	22.	Don't understand our assets
2,3,4	23.	Inefficiencies – asset systems
2,3	24.	Challenges of the future direction:
3,4	25.	Historical mixed bag of investment decision making.
3	26.	Constrained investment based on available resources
2	27.	Scale and price – highly distributed schemes that are quite small. Lack of districtisation in funding. Inconsistencies in design / construction
2	28.	Pockets of affluence in a sea of deprivation

In attendance:

Simon Weston, GM Infrastructure (WDC)

Shelly Wharton, Stormwater (WDC)

Simon Charles, Wastewater (WDC)

Andrew Venmore, Water Supply (WDC)

Jim Sephton, GM infrastructure (KDC)

Donnick Mugutso, Water Supply and Wastewater (KDC)

Glenn Rainham, Alliances Manager (FNDC)

Tony McCartney, Acting Asset Manager (FNDC)

Edward Guy, Rationale Ltd (Facilitator)

Emily Gualter, Rationale Ltd (Support)

Appendix C. Multicriteria Analysis

rationale >

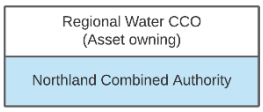
Northland / Te Tai Tokerau Water Collaboration

Investor: **Northland / Te Tai Tokerau Water Collaboration**
Facilitator: **Edward Guy**
Initial Workshop: **21/12/2020**
Version No.: **1**
Last Modified by: **Emily Gualter 21/12/2020**

			Activity options							
			Option 1	**Option 2**	**Option 3**	**Option 4**	**Option 5**	**Option 6**	**Option 7**	**Option 8**	**Option 9**
			Do Min - Enhance SQ Individual Councils manage and deliver waters NTA remains as it is.	**SSBU** (Not assessed)	**Regional Management CCO** (Not assessed)	**Regional Infrastructure Management CCO** (Not assessed)	**Regional Waters Asset Owning CCO** Council services reamin as they are.	**Regional Infrastructure Asset Owning CCO**	**Multi-Regional Water CCO** Council services remain as they are. **Auckland + Northland + ??CCO**	**Multi-Regional Water CCO + Regional Infrastructure Management CCO**	**Multi Regional Water CCO + Northland Combined Authority**
Outcome: Improving the wellbeing outcomes of Northland people in the face of three waters change.			This approach would see no material change to the existing service delivery arrangements. It would require signifcant additional resource and investment to meet the changes to three waters regulations	A regional business unit would provide oversight to the management and delivery of three waters services, councils would retain ownership and significant additional resource and investment would be required to meet the changes.	A non asset owning CCO too deliver three waters services, would employ its own people but the councils would need to fund the organisation, retiaining influence over budgets. The cost falls where they lie, the benefits of scale is not achieved.	Provide the core services to the region through a non asset owning CCO, that employees its own people but relies on the council for funding and strategic approval. Costs fall where they lie, the benefits of scale are not achieved.	An asset owning CCO to deliver three water services across the region. Council would have a governance role, monitor performance and be accountable for performance.	An asset owning CCO to deliver **core infrastructure services** to the region. Council would have a governance role, monitor performance and be accountable for performance. 3Waters, Transport, Solid Waste, Parks	Northland would be included in a wider upper North Island CCO to deliver three waters services. This might provide more savings and effficiencies of scale. It is likely the main office would be based outside the region.	As with option 7, but the Northland Councils would also create a management CCO to operate all remaining infrastructure (option 4)	As with option 7, but the four northland councils would combine to form a combined authority to deliver all other territorial and regional authority services.
Council Responsibility			-service delivery -all asset ownership -resourcing (employees, consultants and contractors)	-staff but second them to the SSBU -asset ownership -relationship with public accountability for performance	-form a joint committee with other councils and mana whenua in a co-governance model -in a co-goverance role determine the objectives for a CCO -monitor the CCO performace -be accountable to the community for CCO performance -asset ownership -approve strategies, plans and funding	-form a joint committee with other councils and mana whenua in a co-governance model -in a co-goverance role determine the objectives for a CCO -monitor the CCO performace -be accountable to the community for CCO performance -asset ownership -approve strategies, plans and funding	-form a joint committee with other councils and mana whenua in a co-governance model -in a co-goverance role determine the objectives for a CCO -monitor the CCO performace -be accountable to the community for CCO performance	-form a joint committee with other councils and mana whenua in a co-governance model -in a co-goverance role determine the objectives for a CCO -monitor the CCO performace -be accountable to the community for CCO performance -retain ownership of the transport assets	-form a joint committee with other councils and mana whenua in a co-governance model -in a co-goverance role determine the objectives for a CCO -monitor the CCO performace -be accountable to the community for CCO performance -strategic land use water integration	-form a joint committee with other councils and mana whenua in a co-governance model -in a co-goverance role determine the objectives for a CCO -monitor the CCO performace -be accountable to the community for CCO performance -strategic land use water integration -in addition councils would be required to establish a management CCO for all other regional infrastructure. This differs from the asset owning CCO as individual councils would remain responsible for funding of the	-form a joint committee with other councils and mana whenua in a co-governance model -in a co-goverance role determine the objectives for a CCO -monitor the CCO performace -be accountable to the community for CCO performance -strategic land use water integration -in addition council reform would occur into a single organsation - Northland Combined Authority. They would be responsible for all territorial and regional council services.
Water Organisation Responsibility			-N/A	-second staff from each council into a single group -have regional strategic oversight of asset management and infrastructure delivery and would plan and deliver all the capital and operational works fro the region.	-accountable to the councils -resourcing (employees, consultants and contractors) -engage with public on three waters -regional strategic responsibility for network management and asset management. -deliver all capital and operational works -recover costs from each council based on funding model -be overseen by a Board of Directors and be accountable to joint committee	-accountable to the councils -resourcing (employees, consultants and contractors) -engage with public on three waters -regional strategic responsibility for network management and asset management. -deliver all capital and operational works -recover costs from each council based on funding model -be overseen by a Board of Directors and be accountable to joint committee	-accountable to the councils -own three waters assets -responsible for investment strategis and plans required for new infrastructure and to meet standards -consolidate operational and capital costs to develop economies of scale -recover costs from each customer -resourcing (employees, consultants and contractors) -engage with public on three waters -regional strategic responsibility for network management and asset management. -deliver all capital and operational works -be overseen by a Board of Directors and be accountable to joint committee	-accountable to the councils -own infrastructure assets (solid waste, parks, three waters) -responsible for investment strategis and plans required for new infrastructure and to meet standards -consolidate operational and capital costs to develop economies of scale -recover costs from each customer -resourcing (employees, consultants and contractors) -engage with public on infrastructure -regional strategic responsibility for network management and asset management. -deliver all capital and operational works -be overseen by a Board of Directors and be	-accountable to the councils -own three waters assets -responsible for investment strategies and plans required for new infrastructure and to meet standards -consolidate operational and capital costs to develop economies of scale -recover costs from each customer -resourcing (employees, consultants and contractors) -engage with public on three waters -strategic responsibility for network management and asset management. -deliver all capital and operational works -be overseen by a Board of Directors and be accountable to joint committee		
		Relative Importance of objective	**13%**	**0%**	**0%**	**0%**	**38%**	**44%**	**57%**	**64%**	**75%**
Investment Objective 1	Meaningful role & outcomes for Mana Whenua	20%	10%				40%	50%	35%	45%	60%
Investment Objective 2	Improving equitable access & service levels across the Region, enhancing wellbeing.	40%	15%				35%	40%	60%	65%	75%
Investment Objective 3	Improve investment availability & affordability	25%	20%				35%	35%	60%	70%	80%
Investment Objective 4	Improving capability and capacity to deliver value for money across the supply chain.	15%	0%				50%	60%	70%	75%	85%
Three waters Reform Objectives			**No Change**				**Some improvement**	**Achieved**	**Achieved**	**Achieved**	**Achieved**
Significantly improving safety and quality of drinking water services			Some improvement				Achieved	Achieved	Achieved	Achieved	Achieved
Ensuring all New Zealanders have equitable access			Negative improvement				Some improvement	Some improvement	Some improvement	Some improvement	Some improvement
Improving resource coordination and unlocking strategic oportunities			No Change				Some improvement	Achieved	Achieved	Achieved	Achieved
Increasing resilience of three waters service provision			No Change				Some improvement	Some improvement	Some improvement	Some improvement	Some improvement
Moving three waters services to a more financially sustainable footing			Negative improvement				Some improvement	Achieved	Achieved	Achieved	Achieved
Improving transparency and accountability in cost and delivery of three waters services			Some improvement				Some improvement	Some improvement	Achieved	Achieved	Achieved
Taumata Arowai			**Some improvement**				**Achieved**	**Achieved**	**Achieved**	**Achieved**	
Protect and promote safe drinking water and related public health outcomes			Some improvement				Some improvement	Some improvement	Some improvement	Some improvement	Some improvement
Effectively administer the drinking water regulatory system			Some improvement				Achieved	Achieved	Achieved	Achieved	Achieved
Build and maintain capability among drinking water suppliers and across the wider industry			No Change				Achieved	Achieved	Achieved	Achieved	Achieved
Give effect to Te Mana o te Wai, to the extent that Te Mana o te Wai applies to the functions and duties of Taumata Arowai			Some improvement				Some improvement	Some improvement	Some improvement	Some improvement	Some improvement
Provide oversight of environmental performance of wastewater and stormwater networks			No Change				Some improvement	Some improvement	Achieved	Achieved	Achieved
Promote public understanding of the environmental performance of wastewater and storm-water networks.			No Change				Achieved	Achieved	Achieved	Achieved	Achieved
Design Features			**No Change**				**Achieved**	**Achieved**	**Achieved**	**Achieved**	
Water service delivery entities that are: -of significnat scale -asset-owning entities -structured as statutory entities			Negative improvement				Some improvement	Achieved	Exceeds	Exceeds	Exceeds
Delivery of drinking water and wastewater services as a priority			Negative improvement				Achieved	Achieved	Achieved	Achieved	Achieved
Publicly owned entities			Achieved				Achieved	Achieved	Achieved	Achieved	Achieved
Mechanism for enabling iwi / Maori and communities			No Change				Achieved	Achieved	Achieved	Achieved	Achieved
Business Needs			**Moderate to large positive**				**Moderate to large positive**	**Moderate to large positive**	**Slight negative**	**Slight negative**	
Local Influence / input			Moderate to large positive				Moderate to large positive	Moderate to large positive	Slight negative	Slight negative	Slight postive
Representative goverance			Moderate to large positive				Slight postive	Slight postive	Moderate to large negative	Slight negative	Neutral
Dis Benefits			**Neutral**				**Slight negative**	**Neutral**	**Moderate to large negative**	**Slight negative**	
Stranded assets and systems in Councils			Neutral				Moderate to large negative	Slight negative	Moderate to large negative	Slight negative	Moderate to large negative
Spatial Planning / Integrated land use planning			Neutral				Slight negative	Slight postive	Slight negative	Neutral	Moderate to large positive
Stranded overheads and administration in Councils			Neutral				Slight negative	Slight negative	Moderate to large negative	Moderate to large negative	Moderate to large negative
Risks											
Technical			High				Medium	Medium	Low	Low	Low
Operational			High				Medium	Medium	Low	Low	Low
Financial			High				High	Medium	Low	Low	Low
Stakeholder/Political/Public			High	Low	Low	Low	Medium	Low	Medium	Medium	Medium
Environmental			High				Medium	Medium	Low	Low	Low
Safety			High				Medium	Medium	Low	Low	Low
Economic			High				Medium	Medium	Low	Low	Low
Ranking											
			6	**#N/A**	**#N/A**	**#N/A**	**5**	**3**	**4**	**2**	**1**

Addendum – April 2021 – Assessing Option 10: Regional water asset owning CCO + Northland Combined Authority

Option 10

Option 10	**Regional Water asset owning CCO + Northland Combined Authority –** Note: this option was assessed following the workshop.
Definition  	The four Northland councils would create a Combined Authority to deliver all territorial authority and regional authority services. In addition to this, a regional asset owning CCO would be formed to provide three water services to the region. The CCO and the directors will be accountable for the performance of the water entity. They would be responsible for delivering all operational and capital three waters services for the Northland area. The CCO would also recover costs from individual customers. The councils would define its expectation of the CCO, monitor performance and potentially have governance representation. Mana Whenua would also potentially have governance representation and be involved in the co-design of the CCO.
Benefits over status quo	• Opportunity for development of new structures enables participation of Mana Whenua from the outset – co-governance and co-design. However, due to the large scale, the level of influence is currently unknown. • Delivers cost savings through scale and capacity as well as controlling the revenue stream and investment decisions – for water and other council services. • The creation of an infrastructure CCO provides an opportunity for advancement and job enrichment. • Increases resilience for both organisations through creating a greater breadth and depth of resources. • Strategic capability to be developed within the CCO for water. • The creation of a combined authority supports the remaining functions in council, reducing competition and pressure on resources. • Enhances affordability for services other than water. • Improved affordability for non-water assets. • Reduced overheads and administration costs. • Streamlines of governance.
Misalignment to national objectives	• Is not a multi-regional entity.
Risks and disbenefits	• This model requires a high rate and level of change to be successful. • The development of co-governance and co-design in two organisations will place additional pressure on Mana Whenua resources to participate fully.

Multicriteria Analysis – Ten Options

As recommended in the next steps, Option 10: Regional Water asset owning CCO + Northland Combined Authority was evaluated against the same criteria listed in section 5.2 above. This assessment was completed by Rationale and key members of the Whangarei District Council three waters team[4].

The evaluation recommends including Option 10: Regional Water asset owning CCO + Northland Combined Authority to the shortlist of options to consider moving forward.

[4] Simon Weston, Shelly Wharton, Andrew Venmore, Simon Charles

rationale >

Northland / Te Tai Tokerau Water Collaboration

Investor: **Northland / Te Tai Tokerau Water Collaboration**
Facilitator: **Edward Guy**
Initial Workshop: **21/12/2020**
Version No.: **1**
Last Modified by: **Emily Gualter 20/04/2021**

Activity options

	Option 1	Option 2	Option 3	Option 4	Option 5	Option 6	Option 7	Option 8	Option 9	Option 10
	Do Min - Enhance SQ Individual Councils manage and deliver waters NTA remains as it is.	**SSBU** (Not assessed)	**Regional Management CCO** (Not assessed)	**Regional Infrastructure Management CCO** (Not assessed)	**Regional Waters Asset Owning CCO** Council services reamin as they are.	**Regional Infrastructure Asset Owning CCO**	**Multi-Regional Water CCO** Council services remain as they are. **Auckland + Northland + ??CCO**	**Multi-Regional Water CCO + Regional Infrastructure Management CCO**	**Multi Regional Water CCO + Northland Combined Authority**	**Regional asset owning Water CCO + Northland Combined Authority**
Outcome: Improving the wellbeing outcomes of Northland people in the face of three waters change.	This approach would see no material change to the existing service delivery arrangements. It would require signifcant additional resource and investment to meet the changes to three waters regulations	A regional business unit would provide oversight to the management and delivery of three waters services, councils would retain ownership and significant additional resource and investment would be required to meet the changes.	A non asset owning CCO too deliver three waters services, would employ its own people but the councils would need to fund the organisation, retiaining influence over budgets. The cost falls where they lie, the benefits of scale is not achieved.	Provide the core services to the region through a non asset owning CCO, that employees its own people but relies on the council for funding and strategic approval. Costs fall where they lie, the benefits of scale are not achieved.	An asset owning CCO to deliver three water services across the region. Council would have a governance role, monitor performance and be accountable for performance.	An asset owning CCO to deliver **core infrastructure services** to the region. Council would have a governance role, monitor performance and be accountable for performance. 3Waters, Transport, Solid Waste, Parks	Northland would be included in a wider upper North Island CCO to deliver three waters services. This might provide more savings and effficiencies of scale. It is likely the main office would be based outside the region.	As with option 7, but the Northland Councils would also create a management CCO to operate all remaining infrastructure (option 4)	As with option 7, but the four northland councils would combine to form a combined authority to deliver all other territorial and regional authority services.	As with option 5, the northland councils would combine to form a regional asset owning waters CCO. The four councils would also form a combined authority to deliver all other territorial authority and regional authority services. NOTE: this option was assessed following the workshop.
Council Responsibility	-service delivery -all asset ownership -resourcing (employees, consultants and contractors)	-staff but second them to the SSBU -asset ownership -relationship with public accountability for performance	-form a joint committee with other councils and mana whenua in a co-governance model -in a co-goverance role determine the objectives for a CCO -monitor the CCO performace -be accountable to the community for CCO performance -asset ownership -approve strategies, plans and funding	-form a joint committee with other councils and mana whenua in a co-governance model -in a co-goverance role determine the objectives for a CCO -monitor the CCO performace -be accountable to the community for CCO performance -asset ownership -approve strategies, plans and funding	-form a joint committee with other councils and mana whenua in a co-governance model -in a co-goverance role determine the objectives for a CCO -monitor the CCO performace -be accountable to the community for CCO performance	-form a joint committee with other councils and mana whenua in a co-governance model -in a co-goverance role determine the objectives for a CCO -monitor the CCO performace -be accountable to the community for CCO performance -retain ownership of the transport assets	-form a joint committee with other councils and mana whenua in a co-governance model -in a co-goverance role determine the objectives for a CCO -monitor the CCO performace -be accountable to the community for CCO performance -strategic land use water integration	-form a joint committee with other councils and mana whenua in a co-governance model -in a co-goverance role determine the objectives for a CCO -monitor the CCO performace -be accountable to the community for CCO performance -strategic land use water integration -in addition councils would be required to establish a management CCO for all other regional infrastructure. This differs from the asset owning CCO as individual councils would remain responsible for funding of the	-form a joint committee with other councils and mana whenua in a co-governance model -in a co-goverance role determine the objectives for a CCO -monitor the CCO performace -be accountable to the community for CCO performance -strategic land use water integration -in addition council reform would occur into a single organsation - Northland Combined Authority. They would be responsible for all territorial and regional council services.	-form a joint committee with other councils and mana whenua in a co-governance model -in a co-goverance role determine the objectives for a CCO -monitor the CCO performace -be accountable to the community for CCO performance -in addition council reform would occur into a single organsation - Northland Combined Authority. They would be responsible for all territorial and regional council services.
Water Organisation Responsibility	-N/A	-second staff from each council into a single group -have regional strategic oversight of asset management and infrastructure delivery and would plan and deliver all the capital and operational works fro the region.	-accountable to the councils -resourcing (employees, consultants and contractors) -engage with public on three waters -regional strategic responsibility for network management and asset management. -deliver all capital and operational works -recover costs from each council based on funding model -be overseen by a Board of Directors and be accountable to joint committee	-accountable to the councils -resourcing (employees, consultants and contractors) -engage with public on three waters -regional strategic responsibility for network management and asset management. -deliver all capital and operational works -recover costs from each council based on funding model -be overseen by a Board of Directors and be accountable to joint committee	-accountable to the councils -own three waters assets -responsible for investment strategis and plans required for new infrastructure and to meet standards -consolidate operational and capital costs to develop economies of scale -recover costs from each customer -resourcing (employees, consultants and contractors) -engage with public on three waters -regional strategic responsibility for network management and asset management. -deliver all capital and operational works -be overseen by a Board of Directors and be accountable to joint committee	-accountable to the councils -own infrastructure assets (solid waste, parks, three waters) -responsible for investment strategis and plans required for new infrastructure and to meet standards -consolidate operational and capital costs to develop economies of scale -recover costs from each customer -resourcing (employees, consultants and contractors) -engage with public on infrastructure -regional strategic responsibility for network management and asset management. -deliver all capital and operational works -be overseen by a Board of Directors and be	-accountable to the councils -own three waters assets -responsible for investment strategies and plans required for new infrastructure and to meet standards -consolidate operational and capital costs to develop economies of scale -recover costs from each customer -resourcing (employees, consultants and contractors) -engage with public on three waters -strategic responsibility for network management and asset management. -deliver all capital and operational works -be overseen by a Board of Directors and be accountable to joint committee				

		Relative Importance of objective	13%	0%	0%	0%	38%	44%	57%	64%	75%	43%
Investment Objective 1	Meaningful role & outcomes for Mana Whenua	20%	10%				40%	50%	35%	45%	60%	50%
Investment Objective 2	Improving equitable access & service levels across the Region, enhancing wellbeing.	40%	15%				35%	40%	60%	65%	75%	40%
Investment Objective 3	Improve investment availability & affordability	25%	20%				35%	35%	60%	70%	80%	35%
Investment Objective 4	Improving capability and capacity to deliver value for money across the supply chain.	15%	0%				50%	60%	70%	75%	85%	55%
Three waters Reform Objectives			**No Change**				**Some improvement**	**Achieved**	**Achieved**	**Achieved**	**Achieved**	**Achieved**
Significantly improving safety and quality of drinking water services			Some improvement				Achieved	Achieved	Achieved	Achieved	Achieved	Achieved
Ensuring all New Zealanders have equitable access			Negative improvement				Some improvement	Some improvement	Some improvement	Some improvement	Some improvement	Some improvement
Improving resource coordination and unlocking strategic oportunities			No Change				Some improvement	Achieved	Achieved	Achieved	Achieved	Some improvement
Increasing resilience of three waters service provision			No Change				Some improvement	Some improvement	Some improvement	Some improvement	Some improvement	Some improvement
Moving three waters services to a more financially sustainable footing			Negative improvement				Some improvement	Achieved	Achieved	Achieved	Achieved	Some improvement
Improving transparency and accountability in cost and delivery of three waters services			Some improvement				Some improvement	Some improvement	Achieved	Achieved	Achieved	Some improvement
Taumata Arowai			**Some improvement**				**Achieved**	**Achieved**	**Achieved**	**Achieved**	**Achieved**	**Achieved**
Protect and promote safe drinking water and related public health outcomes			Some improvement				Some improvement	Some improvement	Some improvement	Some improvement	Some improvement	Some improvement
Effectively administer the drinking water regulatory system			Some improvement				Achieved	Achieved	Achieved	Achieved	Achieved	Achieved
Build and maintain capability among drinking water suppliers and across the wider industry			No Change				Achieved	Achieved	Achieved	Achieved	Achieved	Achieved
Give effect to Te Mana o te Wai, to the extent that Te Mana o te Wai applies to the functions and duties of Taumata Arowai			Some improvement				Some improvement	Some improvement	Some improvement	Some improvement	Some improvement	Some improvement
Provide oversight of environmental performance of wastewater and stormwater networks			No Change				Some improvement	Some improvement	Achieved	Achieved	Achieved	Achieved
Promote public understanding of the environmental performance of wastewater and storm-water networks.			No Change				Achieved	Achieved	Achieved	Achieved	Achieved	Achieved
Design Features			**No Change**				**Achieved**	**Achieved**	**Achieved**	**Achieved**	**Achieved**	**Achieved**
Water service delivery entities that are: -of significnat scale -asset-owning entities -structured as statutory entities			Negative improvement				Some improvement	Achieved	Exceeds	Exceeds	Exceeds	Some improvement
Delivery of drinking water and wastewater services as a priority			Negative improvement				Achieved	Achieved	Achieved	Achieved	Achieved	Achieved
Publicly owned entities			Achieved				Achieved	Achieved	Achieved	Achieved	Achieved	Achieved
Mechanism for enabling iwi / Maori and communities			No Change				Achieved	Achieved	Achieved	Achieved	Achieved	Achieved
Business Needs			**Moderate to large positive**				**Moderate to large positive**	**Moderate to large positive**	**Slight negative**	**Slight negative**	**Moderate to large positive**	**Slight postive**
Local Influence / input			Moderate to large positive				Moderate to large positive	Moderate to large positive	Slight negative	Slight negative	Slight postive	Moderate to large positive
Representative goverance			Moderate to large positive				Slight postive	Slight postive	Moderate to large negative	Slight negative	Neutral	Slight postive
Dis Benefits			**Neutral**				**Slight negative**	**Neutral**	**Moderate to large negative**	**Slight negative**	**Slight negative**	**Slight negative**
Stranded assets and systems in Councils			Neutral				Moderate to large negative	Slight negative	Moderate to large negative	Slight negative	Moderate to large negative	Moderate to large negative
Spatial Planning / Integrated land use planning			Neutral				Slight negative	Slight postive	Slight negative	Neutral	Moderate to large positive	Moderate to large positive
Stranded overheads and administration in Councils			Neutral				Slight negative	Slight negative	Moderate to large negative	Moderate to large negative	Moderate to large negative	Moderate to large negative
Risks												
Technical			High				Medium	Medium	Low	Low	Low	Low
Operational			High				Medium	Medium	Low	Low	Low	Low
Financial			High				High	Medium	Low	Low	Low	Low
Stakeholder/Political/Public			High	Low	Low	Low	Medium	Low	Medium	Medium	Medium	Medium
Environmental			High				Medium	Medium	Low	Low	Low	Low
Safety			High				Medium	Medium	Low	Low	Low	Low
Economic			High				Medium	Medium	Low	Low	Low	Low
Ranking												
			7	**#N/A**	**#N/A**	**#N/A**	**6**	**4**	**5**	**3**	**1**	**2**

SENSITIVITY ANALYSIS

The following table displays the results of the sensitivity analysis, clearly identifying an initial shortlist of options six through ten.

Table 3. Sensitivity Analysis of Multicriteria Analysis.

Scenarios	Option 1	Option 2	Option 3	Option 4	Option 5	Option 6	Option 7	Option 8	Option 9	Option 10
Initial	7				6	4	5	3	1	2
1	7				6	5	3	2	1	4
2	7				6	4	3	2	1	5
3	2				5	1	7	6	4	3
4	7				6	5	4	3	1	2
5	7				6	3	5	4	1	2

Updated Shortlist

Following the additional evaluation it is recommended that the shortlist is extended to include options six through ten for any further assessment.

	Shortlisted options
Option 6	Regional Infrastructure Asset Owning CCO[5]
Option 7	Multi-Regional Water CCO + Council Services remain as they are
Option 8	Multi-Regional Water CCO + Regional Infrastructure Management CCO
Option 9	Multi-Regional Water CCO + Northland Combined Authority
Option 10	Regional Water asset owning CCO + Northland Combined Authority

[5] A Regional Infrastructure Asset Owning CCO would include all infrastructure services currently provided by councils. However, it is acknowledged that it is uncertain if the ownership of transport assets can be transferred to such an organisation.

Whangarei District Council

Whangarei Water - Options Analysis

Draft

April 2021

Document Title:

Whangarei Water - Options Analysis

Prepared for:

Whangarei District Council

Quality Assurance Statement

Rationale Limited
5 Arrow Lane
PO Box 226
Arrowtown 9351
Phone: +64 3 442 1156

Project Manager:	Emily Gualter
Prepared by:	Emily Gualter
Reviewed by:	Edward Guy
Approved for issue by:	Edward Guy
Job number:	J001199

Document Control History

Rev No.	Date	Revision Details	Prepared by	Reviewed by	Approved by
1.0	APRIL 2021	Draft	EW	TL	

Current Version

Rev No.	Date	Revision Details	Prepared by	Reviewed by	Approved by
1.0	APRIL 2021	Draft	EW	TL	

Table of Contents

1 PURPOSE 4

2 SUMMARY 4

2.1 Next steps 5

3 CONTEXT 5

4 PROCESS 5

5 WORKSHOP OUTPUTS 5

5.1 Investment Logic Map 5

5.2 Stage 1 – WDC Multicriteria Analysis 7

5.2.1 Sensitivity Assessment 7

5.3 Stage 2 – Combined Multicriteria Analysis 8

5.3.1 Sensitivity Assessment 8

5.4 Options 10

6 NEXT STEPS 13

APPENDIX A. INVESTMENT LOGIC MAP – ISSUES LIST 14

APPENDIX B. WDC MULTICRITERIA ANALYSIS 16

APPENDIX C. COMBINED MULTICRITERIA ANALYSIS 17

APPENDIX D. NORTHLAND OPTIONS 18

1 Purpose

Following the Te Tai Tokerau Water Collaboration – Initial Options Analysis, completed in January 2021[1], Whangarei District Council (WDC) wanted to understand what options they had if they were to go it alone in three waters reform. The motivation for commencing these discussions has been the ongoing Three Waters Reform Programme driven by central government.

This report was developed virtually due to a potential COVID-19 outbreak in Northland in early February 2021. It provides an initial assessment of options and acts as a guide for future thinking, alignment, and collaboration.

This report has been drafted to aid in internal discussions with staff and elected members. The report, and the workshop, did not intend to identify a preferred way forward for WDC or present public facing information.

2 Summary

Rationale worked with WDC water staff to develop an Investment Logic Map (ILM) and an initial option for WDC, should they decide to opt out of three waters reform.

The in-person workshops to facilitate the Investment Logic Mapping and options sessions were unfortunately cancelled by a potential COVID-19 outbreak in Northland. Therefore, the work was undertaken virtually.

Development of an Investment Logic Map was used to understand the current issues being experienced and the benefits that could be achieved through intervention. The headline of the Investment Logic Map is "Three water services delivering wellbeing to the people of the Whangarei District" and the problem statements are:

1. Insufficient scale of the activity, limits internal & external skills coverage & diminishes business resilience, impacting planning & service delivery.
2. Failure of decision makers to allocate available funding, as required, results in under investment, increasing risk & reduced service levels.
3. Uncertainty regarding future legislative change, climate change & growth, increases risk of not meeting standards & customer expectations.
4. Inadequate focus on our relationship with mana whenua & central government, creates conflict & inhibits advancement.

Outputs from the Investment Logic Mapping sessions were used to evaluate a range of options developed by WDC which resulted in an initial shortlist of potential options that require further assessment. These are:

1. Whangarei three water enterprise model
2. Whangarei infrastructure enterprise model
3. Whangarei infrastructure CCO

A description of each of the options is provided below in section 5.4. The full Investment Logic Map and optioneering exercise is detailed in the workshop outputs below.

Following the WDC specific analysis, a combined analysis was completed to understand how the Te Tai Tokerau Combined initial shortlisted options would benefit WDC. The aim of this assessment was to understand if WDC would get more benefits by opting in or out.

The shortlist from this combined assessment, requiring further assessment is:

1. Whangarei three water enterprise model
2. Whangarei infrastructure enterprise model
3. Multi Regional Water CCO + Northland Combined Authority
4. Regional asset owning Water CCO + Northland Combined Authority

[1] Te Tai Tokerau Water Collaboration – Initial Options Analysis, Final Report, April 2021

2.1 Next steps

The recommended next steps for are:

- Present report to the Executive Leadership Team and Elected Members to commence discussion around the pathway forward for WDC – opt-in or opt-out
- Engage with the Department of Internal Affairs on alternative options.
- Work alongside Mana Whenua to understand their capacity and capability for engagement.
    - Support development so co-design and co-governance can be achieved.
- Commence programme of work to understand district investment prioritisation (this can be completed in parallel with Mana Whenua engagement).

3 Context

This report builds on the Te Tai Tokerau Water Collaboration – Initial Options Analysis, Final Report, April 2021, which investigated initial options and provided guidance for future thinking, alignment, and collaboration for the three Northland District Councils.

This report specifically looks at the options available to WDC.

4 Process

The in-person workshops to facilitate the Investment Logic Mapping and options sessions were unfortunately cancelled by a potential COVID-19 outbreak in Northland. Therefore, the work was undertaken virtually.

To ensure the work continued, WDC facilitated their own internal Investment Logic Mapping session, collating issue statements and developing the initial problem statements. These were then further workshopped with Rationale to produce the agreed problem and benefit statements, shown below.

The group then developed a list of potential options for WDC, should they decide to opt-out of three waters reform.

The outputs produced from this work was an Investment Logic Map and a multicriteria analysis of options identified in the workshop which resulted in an initial shortlist for further consideration.

5 Workshop Outputs

5.1 Investment Logic Map

An Investment Logic Map is a New Zealand Treasury supported investment tool that aims to communicate a complete investment story on a single page, using language and concepts that are understandable to a wide audience.

Investment Logic Mapping workshops look to understand what issues are currently being experienced and what benefits could be achieved through intervention.

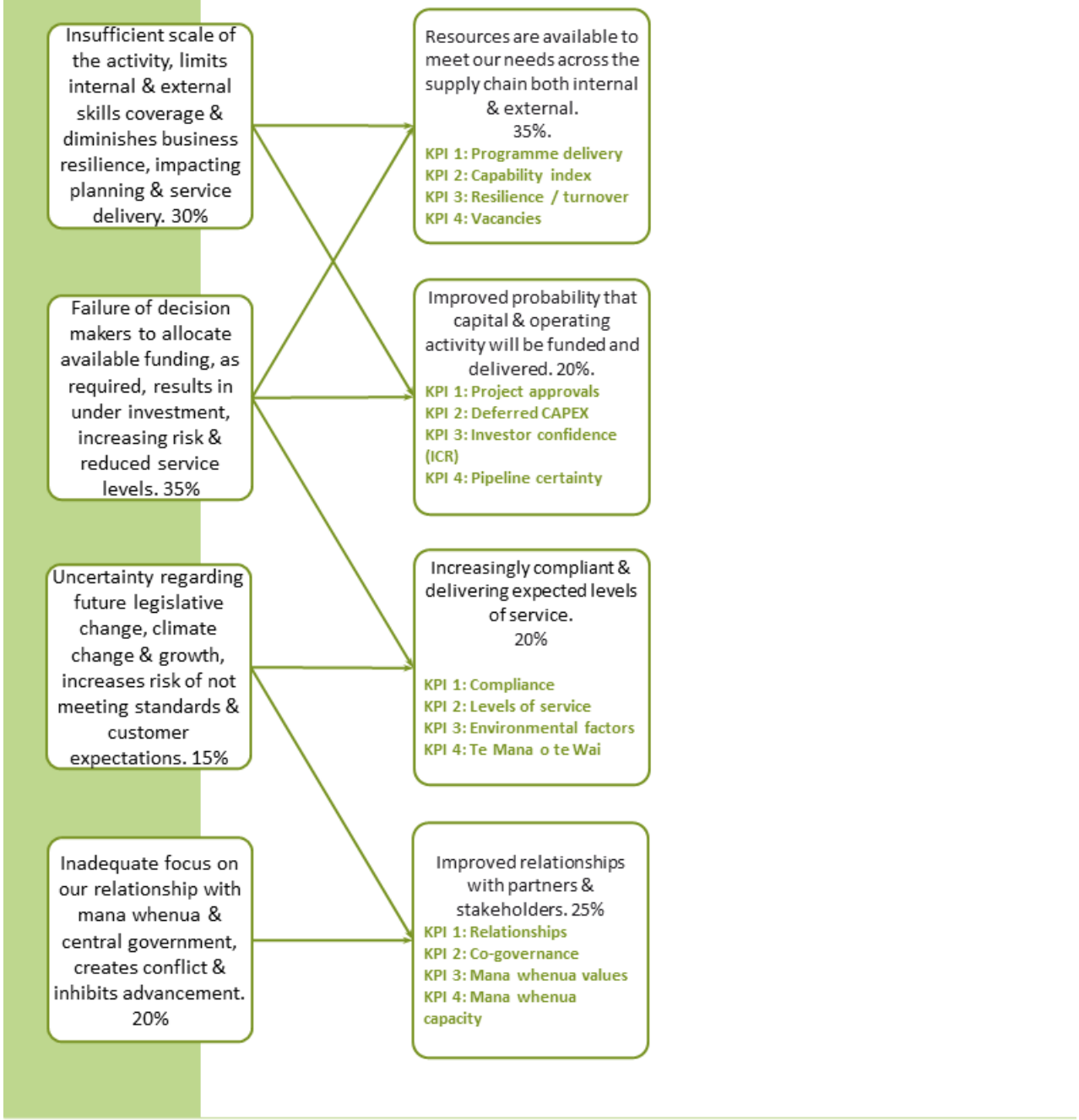
The headline of the Investment Logic Map is: *Three water services delivering wellbeing to the people of the Whangarei District.*

WHANGAREI DISTRICT COUNCIL

Three water services delivering wellbeing to the people of the Whangarei District

New Zealand Three Waters Reform

INVESTMENT LOGIC MAP
Program



Investor:	WDC – Simon Weston	Version no:	3.0
Facilitator:	This workshop was facilitated by WDC without	Initial Workshop:	25/01/2021
Accredited Facilitator:	moderation from trained facilitators Yes / No	Last modified by:	Edward Guy 23/02/2021
		Template version:	6.0

5.2 Stage 1 – WDC Multicriteria Analysis

The group identified nine potential options for water services delivery moving forward. These were:

	Potential options
Option 1	Do Nothing – no material change in meeting new regulatory requirements
Option 2	Do Min – enhanced status quo
Option 3	Whangarei Water – management CCO
Option 4	Whangarei Water – asset owning CCO
Option 5	Alliance Model
Option 6	Whangarei three waters enterprise model
Option 6a	Whangarei infrastructure enterprise model
Option 7	Joint venture
Option 8	Whangarei Infrastructure – asset owning CCO[2]

This longlist of options was evaluated against the following criteria:

- Investment Objectives
    - At this early stage these are the benefit statements from the Investment Logic Map.
- Strategic Alignment
    - Three Waters Reform and Taumata Arowai objectives and features
- Business Needs and Disbenefits
    - Identified by participants based on the needs and requirements of participating Territorial Authorities.
- Risks
    - Technical, operational, financial, stakeholder/political/public, environmental, safety, economic

Evaluation refined the longlist to an initial shortlist of three options: options six, six-a and eight. These will require further investigation and consideration before a preferred way forward can be determined. The benefits and risks of each option are discussed below.

NOTE: It is important to note that the scoring as shown in the multicriteria analysis, appended, remains as it was completed by the group at the workshop.

The multicriteria analysis has been appended.

5.2.1 SENSITIVITY ASSESSMENT

A sensitivity assessment was undertaken to ensure the multicriteria analysis criteria weighing was robust. The weighting for each criteria grouping was varied as per the table below.

Cost and revenue were not assessed and hence not rated against at this early stage.

[2] An Infrastructure Asset Owning CCO would include all infrastructure services currently provided by council. However, it is acknowledged that it is uncertain if the ownership of transport assets can be transferred to such an organisation.

Table 1. Criteria weighing.

	Initial	1	2	3	4
Investment Objectives	25%	70%	10%	10%	10%
Costs					
Revenue					
Strategic Alignment	25%	10%	70%	10%	10%
Business Needs	25%	10%	10%	70%	10%
Risks	25%	10%	10%	10%	70%
	100%	**100%**	**100%**	**100%**	**100%**

The following table displays the results of the sensitivity analysis, clearly identifying an initial shortlist of options six, six-a and eight.

Table 2. Sensitivity Analysis of Multicriteria Analysis.

Scenario	Option 1	Option 2	Option 3	Option 4	Option 5	Option 6	Option 6a	Option 7	Option 8
Initial	9	8	7	6	5	1	2	4	3
1	9	8	7	6	5	1	2	4	3
2	9	8	7	6	5	1	3	4	2
3	9	8	7	6	5	1	2	4	3
4	9	8	7	1	6	4	5	3	2

5.3 Stage 2 – Combined Multicriteria Analysis

A second stage of analysis was then completed to assess the WDC specific options against the initial shortlisted options identified in the Te Tai Tokerau Water Collaboration – Initial Options Analysis.

The additional options which were assessed were:

	Potential options
Northland – Option 7	Multi-Regional Water CCO + Council Services remain as they are
Northland – Option 8	Multi-Regional Water CCO + Regional Infrastructure Management CCO
Northland – Option 9	Multi-Regional Water CCO + Northland Combined Authority
Northland – Option 10	Regional Water asset owning CCO + Northland Combined Authority

The options were evaluated against the same criteria as identified above.

5.3.1 SENSITIVITY ASSESSMENT

A second sensitivity assessment was undertaken to ensure the multicriteria analysis criteria weighing was robust. The weighting for each criteria grouping was varied as per the table below.

Table 3. Criteria weighing.

	Initial	1	2	3	4
Investment Objectives	25%	70%	10%	10%	10%
Costs					
Revenue					
Strategic Alignment	25%	10%	70%	10%	10%
Business Needs	25%	10%	10%	70%	10%
Risks	25%	10%	10%	10%	70%
	100%	**100%**	**100%**	**100%**	**100%**

The following table displays the results of the sensitivity analysis. This does indicate a sensitivity to the ranking based on very high weight of individual criteria.

An initial shortlist can be identified to be options six, six-a and Northland options eight and nine.

Table 4. Sensitivity Analysis of Multicriteria Analysis.

Scenario	Option 4	Option 5	Option 6	Option 6a	Option 7	Option 8	Northland - Option 7	Northland - Option 8	Northland - Option 9	Northland - Option 10
Initial	9	8	3	4	7	6	10	5	1	2
1	10	8	3	4	7	6	5	2	1	9
2	10	9	3	6	7	4	5	2	1	8
3	7	6	1	2	5	4	13	12	8	3
4	5	10	8	9	7	6	4	3	1	2

5.4 Options

Option 6	Whangarei three waters enterprise model
Definition	Whangarei would develop a vertically integrated three waters asset owning CCO or CCOs or CCTO that delivers all functions of the asset owner, management, consultant and contractor. The CCO and the directors will be accountable for the performance of the water entity and recover costs from individual customers. The councils would define its expectation of the CCO, monitor performance and potentially have governance representation. Mana Whenua would also potentially have governance representation and be involved in the co-design of the organisation.
Benefits over status quo	• Opportunity for development of a new structure that enables participation of Mana Whenua from the outset – co-governance and co-design. • Delivers cost savings for water through capacity as well as controlling the revenue stream and investment decisions. • The creation of a dedicated water CCO provides the opportunity for advancement and job enrichment. • Increases resilience of organisation through creating a greater breadth and depth of resources. • The strategic capability to be developed within the CCO for water.
Misalignment to national objectives	• Remaining council services are left for council resource. This will likely increase competition and pressures on existing resources.
Risks and disbenefits	• The model requires a high rate and level of change to be successful. • The development of co-governance and co-design will place additional pressure on Council and Mana Whenua resources to participate fully. • Remaining council resources will be under further pressure to deliver other services. • Stranded assets e.g., offices, overheads, administration. • Disaggregation of district strategic and spatial planning. • Resource management consenting, remaining with council, will require infrastructure knowledge.

Option 6a	Whangarei infrastructure enterprise model
Definition	Whangarei would develop a vertically integrated infrastructure asset owning CCO or CCOs or CCTO that delivers all functions of the asset owner, management, consultant and contractor. The CCO and the directors will be accountable for the performance of the infrastructure entity and recover costs from individual customers. They would be responsible for delivering all operational and capital three waters, transport, solid waste, and parks services for the people of Whangarei. The CCO would also recover costs from individual customers. The councils would define its expectation of the CCO, monitor performance and potentially have governance representation. Mana Whenua would also potentially have governance representation and be involved in the co-design of the organisation.
Benefits over status quo	• Opportunity for development of a new structure that enables participation of Mana Whenua from the outset – co-governance and co-design. • Delivers cost savings for water through scale and capacity as well as controlling the revenue stream and investment decisions. • The creation of an infrastructure CCO provides an opportunity for advancement and job enrichment. • Increases resilience of organisation through creating a greater breadth and depth of resources. • Strategic capability to be developed within the CCO for water.
Misalignment to national objectives	• Remaining council services are left for councils to individually resource. This will likely increase competition and pressures on existing resources. • Is not a multi-regional entity. • Is not a dedicated water entity.
Risks and disbenefits	• Trade-offs between investment in three waters and other infrastructure. • The model requires a high rate and level of change to be successful. • The development of co-governance and co-design will place additional pressure on Council and Mana Whenua resources to participate fully. • Remaining council resources will be under further pressure to deliver other services. • Stranded assets e.g., offices, overheads, administration. • Disaggregation of district strategic and spatial planning. • Resource management consenting, remaining with council, will require infrastructure knowledge.

Option 8	Whangarei infrastructure asset owning CCO
Definition	An asset owning CCO to deliver core infrastructure services to the Whangarei District. The CCO and the directors will be accountable for the performance of the infrastructure entity. They would be responsible for delivering all operational and capital three waters, transport, solid waste, and parks services for the people of Whangarei. The CCO would also recover costs from individual customers. Council would define its expectation of the CCO, monitor performance and potentially have governance representation. Mana Whenua would also potentially have governance representation and be involved in the co-design of the organisation.
Benefits over status quo	• Opportunity for development of a new structure that enables participation of Mana Whenua from the outset – co-governance and co-design. • Delivers cost savings through scale and capacity as well as controlling the revenue stream and investment decisions. • The creation of an infrastructure CCO provides an opportunity for advancement and job enrichment. • . • Increases resilience of organisation through creating a greater breadth and depth of resources. • Strategic capability to be developed within the CCO for all infrastructure.
Misalignment to national objectives	• Is not a multi-regional entity. • Is not a dedicated water entity. • Remaining council services are left for councils to individually resource. This will likely increase competition and pressures on existing resources.
Risks and disbenefits	• Trade-offs between investment in three waters and other infrastructure. • The model requires significant change to WDC. • The development of co-governance and co-design will place additional pressure on Council and Mana Whenua resources to participate fully. • Remaining council resources will be under further pressure to deliver other services. • Stranded assets e.g., offices, overheads, administration. • Disaggregation of district strategic and spatial planning. • Resource management consenting, remaining with council, will require infrastructure knowledge.

6 Next Steps

The recommended next steps are:

- Present report to the Executive Leadership Team and Elected Members to commence discussion around the pathway forward for WDC – opt-in or opt-out
- Engage with the Department of Internal Affairs on alternative options.
- Work alongside Mana Whenua to understand their capacity and capability for engagement.
    - Support development so co-design and co-governance can be achieved.
- Commence programme of work to understand district investment prioritisation (this can be completed in parallel with Mana Whenua engagement).

Appendix A. Investment Logic Map – Issues List

Three water services delivering wellbeing for the people of the Whangarei District

ILM Problem	Item	Issues
	1.	Do not have the resources and ability to deliver capex/ renewals
	2.	New requirements by Taumata Arowai/ Economic Regulator
	3.	Specialists in the industry to do work.
	4.	Ability to recruit/ attract/ retain skilled staff.
	5.	In-house specialists – Lack of positions
	6.	Reactive – not proactive way of working
	7.	Spread too thinly across all infrastructure (transport, solid waste, 3 waters, parks) rather than being 3 waters focussed.
	8.	Lack of Internal/ Industry best practice guidelines
	9.	Lack of tech specs
	10.	Funding available but not all spent on 3 waters – balanced budget issues.
	11.	Not using full debt cap to resource due to political pressures.
	12.	Political constraints on opex/ rates rises
	13.	Access to 3 waters funding is problematic
	14.	Stormwater – no DCs charged – supply chain
	15.	Restricted pool of consultants/ contractors in the District - can't see pipeline of work into future (due to lack of internal resource/planning)
	16.	Uncertainty re. Taumata Arowai/ Water services legislation and standards/ environmental restrictions/ Te Mana o te Wai
	17.	No focus on demand management
	18.	Climate Change response
	19.	Perception of Local Government (from Central Government)
	20.	Impact of 3 water entity on rest of organisation/ small 3 waters entity.
	21.	Lack of Maori/ hapu involvement in decision making re. council/ 3 waters
	22.	Risk that TLA will have to resolve large areas of private supplies.
	23.	Lack of understanding of network condition
	24.	Historic underinvestment in stormwater – future planning needed

	25.	Access to software / analysts is difficult
	27.	Capability/ capacity (3 waters specific)
	28.	Investment supply chain
	29.	Governance/Mana Whenua (3 waters focus)
	30.	Forward planning (e.g. Climate change, growth, regulation charges)

In attendance:

These issues were compiled by Whangarei District Council with moderation from Rationale due to the COVID case that was identified in Northland on the eve of the workshop.

Simon Weston

David Drummond

Shelley Wharton

Fraser Campbell

Appendix B. WDC Multicriteria Analysis

rationale >

Whangarei 3 Waters Furtures

Whangarei District Council

Subject: **Whangarei 3-Waters**
Facilitator: **Edward Guy**
Initial Workshop: **17/02/2020 (limited)**
Version No.: **2.0**
Last Modified by: **Emily Walker 19/3/2021**

			Activity options								
			Option 1 **Do Nothing** No material change in meeting new regulatory requirements	**Option 2** **Enhanced Status Quo** Additional resources applied to being compliant with new public health and environmental regulations, and meeting climate change expectations.	**Option 3** **Whangarei Water - Management CCO** Council services remain as they are.	**Option 4** **Whangarei Water - Asset Owning CCO** Council services remain as they are.	**Option 5** **Alliance Model** Whangarei Water Asset Owning CCO + Management/Consultant/ Contractor Alliance	**Option 6** **Whangarei 3-Water Enterprise Model** Vertically integrated 3-Waters Asset Owning CCO or CCOs / CCTO, Delivering All Functions of Asset Owner, Management, Consultant & Contractor	**Option 6a** **Whangarei Infrastructure Enterprise Model** Vertically integrated Infrastructure Asset Owning CCO or CCOs / CCTO, Delivering All Functions of Asset Owner, Management, Consultant & Contractor	**Option 7** **Joint Venture Model** Whangarei Water Asset Owning CCO + JV with Multi-Regional Water CCO	**Option 8** **Whangarei Infrastructure CCO** All Whangarei infrastructure placed into an Asset Owning CCO.
Investment Objectives		Relative Importance of objective	**0%**	**10%**	**21%**	**43%**	**61%**	**71%**	**70%**	**59%**	**59%**
Investment Objectiv	Resources are available to meet our needs across the supply chain both internal & external.	35%	0%	10%	15%	30%	50%	70%	80%	60%	60%
Investment Objectiv	Improved probability that capital & operating activity will be funded and delivered.	20%	0%	10%	20%	60%	65%	70%	70%	50%	60%
Investment Objectiv	Increasingly compliant & delivering expected levels of service.	20%	0%	10%	20%	40%	65%	70%	60%	50%	40%
Investment Objectiv	Improved relationships with partners & stakeholders.	25%	0%	10%	30%	50%	70%	75%	65%	70%	70%
Strategic Alignment											
Three waters Reform Objectives			**No Change**	**No Change**	**Some improvement**	**Achieved**	**Achieved**	**Achieved**	**Achieved**	**Achieved**	**Achieved**
Significantly improving safety and quality of drinking water			No Change	Some improvement	Some improvement	Achieved	Achieved	Exceeds	Achieved	Exceeds	Achieved
Ensuring all New Zealanders have equitable access			No Change	No Change	No Change	Some improvement	Some improvement	Some improvement	Some improvement	Some improvement	Some improvement
~~Improving resource coordination and unlocking strategic opertunities~~			No Change	No Change	No Change	No Change	No Change	No Change	No Change	No Change	No Change
~~Increasing resilience of three waters service provision~~			No Change	No Change	No Change	No Change	No Change	No Change	No Change	No Change	No Change
Moving three waters services to a more financially sustainable footing			No Change	Negative improvement	Some improvement	Achieved	Achieved	Achieved	Achieved	Achieved	Achieved
Improving transparency and accountability in cost and delivery of three waters services			No Change	No Change	Some improvement	Achieved	Achieved	Achieved	Achieved	Achieved	Achieved
Taumata Arowai			**Negative improvement**	**No Change**	**Some improvement**	**Some improvement**	**Some improvement**	**Achieved**	**Achieved**	**Achieved**	**Achieved**
Protect and promote safe drinking water and related public health outcomes			No Change	No Change	Some improvement	Some improvement	Some improvement	Some improvement	Some improvement	Some improvement	Some improvement
Effectively administer the drinking water regulatory system			Negative improvement	No Change	Some improvement	Achieved	Achieved	Achieved	Achieved	Achieved	Achieved
Build and maintain capability among drinking water suppliers and across the wider industry			Negative improvement	Negative improvement	Negative improvement	Some improvement	Some improvement	Achieved	Achieved	Some improvement	Achieved
Give effect to Te Mana o te Wai, to the extent that Te Mana o te Wai applies to the functions and duties of Taumata Arowai			Negative improvement	No Change	Some improvement	Some improvement	Some improvement	Some improvement	Some improvement	Some improvement	Some improvement
Provide oversight of environmental performance of wastewater and stormwater networks			Negative improvement	No Change	No Change	Some improvement	Some improvement	Achieved	Achieved	Achieved	Achieved
Promote public understanding of the environmental performance of wastewater and storm-water networks.			Negative improvement	Some improvement	Achieved	Achieved	Achieved	Achieved	Achieved	Achieved	Achieved
Design Features			**Negative improvement**	**No Change**	**Some improvement**	**Achieved**	**Achieved**	**Achieved**	**Achieved**	**Achieved**	**Achieved**
Water service delivery entities that are: -of significnat scale -asset-owning entities -structured as statutory entities			Negative improvement	Negative improvement	Negative improvement	No Change	No Change	Some improvement	Some improvement	Some improvement	Achieved
Delivery of drinking water and wastewater services as a priority			Negative improvement	No Change	Some improvement	Achieved	Achieved	Achieved	Achieved	Achieved	Achieved
Publicly owned entities			Negative improvement	Negative improvement	Some improvement	Achieved	Achieved	Achieved	Achieved	Achieved	Achieved
Mechanism for enabling iwi / Maori and communities			Negative improvement	Some improvement	Some improvement	Achieved	Achieved	Achieved	Achieved	Achieved	Achieved
Business Needs			**Neutral**	**Neutral**	**Slight postive**	**Slight postive**	**Slight postive**	**Moderate to large positive**	**Moderate to large positive**	**Slight postive**	**Moderate to large positive**
Local Influence / input			Neutral	Neutral	Slight postive	Slight postive	Slight postive	Moderate to large positive	Moderate to large positive	Slight postive	Moderate to large positive
Representative goverance			Neutral	Neutral	Neutral	Slight postive	Slight postive	Moderate to large positive	Moderate to large positive	Slight postive	Slight postive
Dis Benefits			**Neutral**	**Neutral**	**Neutral**	**Neutral**	**Neutral**	**Neutral**	**Slight negative**	**Neutral**	**Slight negative**
Stranded assets and systems in Council			Neutral	Neutral	Slight negative	Slight negative	Slight negative	Slight negative	Moderate to large negative	Slight negative	Moderate to large negative
Spatial Planning / Integrated land use planning			Neutral	Neutral	Slight postive	Slight postive	Slight postive	Slight postive	Moderate to large positive	Slight postive	Moderate to large positive
Stranded overheads and administration in Council			Neutral	Neutral	Slight negative	Slight negative	Slight negative	Slight negative	Moderate to large negative	Slight negative	Moderate to large negative
Risks											
Technical			Low	Low	Medium	Medium	High	High	High	High	High
Operational			Medium	Medium	Medium	Medium	High	High	High	Medium	Medium
Financial			High	High	High	Medium	Medium	Medium	Medium	Medium	Medium
Stakeholder/Political/Public			High	High	High	Medium	Medium	Medium	Medium	Medium	Medium
Environmental			High	High	High	Medium	Medium	Medium	Medium	Medium	Medium
Safety			High	High	High	Medium	Medium	Medium	Medium	Medium	Medium
Economic			High	High	High	Medium	Medium	Medium	Medium	Medium	Medium
Ranking:											
			9	**8**	**7**	**6**	**5**	**1**	**2**	**4**	**3**

Appendix C. Combined Multicriteria Analysis

rationale >

Whangarei 3 Waters Futures

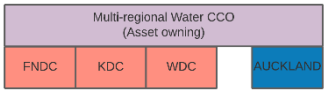
Whangarei District Council

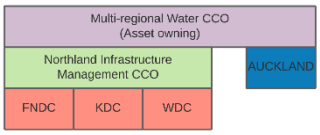
Subject: **Whangarei 3-Waters**
Facilitator: **Edward Guy**
Initial Workshop: **17/02/2020 (limited)**
Version No.: **2.0**
Last Modified by: **Emily Walker 19/3/2021**

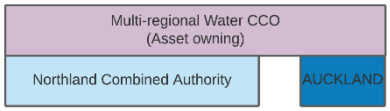
Activity options

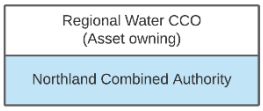
			Option 1	Option 2	Option 3	Option 4	Option 5	Option 6	Option 6a	Option 7	Option 8	Northland - Option 7	Northland - Option 8	Northland - Option 9	Northland - Option 10
			Do Nothing No material change in meeting new regulatory requirements	**Enhanced Status Quo** Additional resources applied to being compliant with new public health and environmental regulations, and meeting climate change expectations.	**Whangarei Water - Management CCO** Council services remain as they are.	**Whangarei Water - Asset Owning CCO** Council services remain as they are.	**Alliance Model** Whangarei Water Asset Owning CCO + Management/Consultant/ Contractor Alliance	**Whangarei 3-Water Enterprise Model** Vertically integrated 3-Waters Asset Owning CCO or CCOs / CCTO, Delivering All Functions of Asset Owner, Management, Consultant & Contractor	**Whangarei Infrastructure Enterprise Model** Vertically integrated Intrastructure Asset Owning CCO or CCOs / CCTO, Delivering All Functions of Asset Owner, Management, Consultant & Contractor	**Joint Venture Model** Whangarei Water Asset Owning CCO + JV with Multi-Regional Water CCO	**Whangarei Infrastructure CCO** All Whangarei infrastructure placed into an Asset Owning CCO.	**Multi-Regional Water CCO** Council services remain as they are. **Auckland + Northland + ?? CCO**	**Multi-Regional Water CCO + Regional Infrastructure Management CCO**	**Multi Regional Water CCO + Northland Combined Authority**	**Regional asset owning Water CCO + Northland Combined Authority**
Investment Objectives		Relative Importance of objective	**0%**	**10%**	**21%**	**43%**	**61%**	**71%**	**70%**	**59%**	**59%**	**75%**	**80%**	**85%**	**51%**
Investment Objectiv	Resources are available to meet our needs across the supply chain both internal & external.	35%	0%	10%	15%	30%	50%	70%	80%	60%	60%	70%	75%	80%	50%
Investment Objectiv	Improved probability that capital & operating activity will be funded and delivered.	20%	0%	10%	20%	60%	65%	70%	70%	50%	60%	70%	75%	80%	50%
Investment Objectiv	Increasingly compliant & delivering expected levels of service.	20%	0%	10%	20%	40%	65%	70%	60%	50%	40%	80%	85%	90%	40%
Investment Objectiv	Improved relationships with partners & stakeholders.	25%	0%	10%	30%	50%	70%	75%	65%	70%	70%	80%	85%	90%	60%
Strategic Alignment															
Three waters Reform Objectives			**No Change**	**No Change**	**Some improvement**	**Achieved**	**Achieved**	**Achieved**	**Achieved**	**Achieved**	**Achieved**	**Achieved**	**Achieved**	**Achieved**	**Some improvement**
Significantly improving safety and quality of drinking water			No Change	Some improvement	Some improvement	Achieved	Achieved	Exceeds	Achieved	Exceeds	Achieved	Achieved	Achieved	Achieved	Achieved
Ensuring all New Zealanders have equitable access			No Change	No Change	No Change	Some improvement	Some improvement	Some improvement	Some improvement	Some improvement	Some improvement	Some improvement	Some improvement	Some improvement	Some improvement
~~Improving resource coordination and unlocking strategic opertunities~~			No Change	No Change	No Change	No Change	No Change	No Change	No Change	No Change	No Change	No Change	No Change	No Change	No Change
~~increasing resilience of three waters service provision~~			No Change	No Change	No Change	No Change	No Change	No Change	No Change	No Change	No Change	No Change	No Change	No Change	No Change
Moving three waters services to a more financially sustainable footing			No Change	Negative improvement	Some improvement	Achieved	Achieved	Achieved	Achieved	Achieved	Achieved	Achieved	Achieved	Achieved	Some improvement
Improving transparency and accountability in cost and delivery of three waters services			No Change	No Change	Some improvement	Achieved	Achieved	Achieved	Achieved	Achieved	Achieved	Achieved	Achieved	Achieved	Some improvement
Taumata Arowai - Objectives			**Negative improvement**	**No Change**	**Some improvement**	**Some improvement**	**Some improvement**	**Achieved**	**Achieved**	**Achieved**	**Achieved**	**Achieved**	**Achieved**	**Achieved**	**Achieved**
Protect and promote safe drinking water and related public health outcomes			No Change	No Change	Some improvement	Some improvement	Some improvement	Some improvement	Some improvement	Some improvement	Some improvement	Some improvement	Some improvement	Some improvement	Some improvement
Build and maintain capability among drinking water suppliers and across the wider industry			Negative improvement	Negative improvement	Negative improvement	Some improvement	Some improvement	Achieved	Achieved	Some improvement	Achieved	Achieved	Achieved	Achieved	Achieved
Give effect to Te Mana o te Wai, to the extent that Te Mana o te Wai applies to the functions and duties of Taumata Arowai			Negative improvement	No Change	Some improvement	Some improvement	Some improvement	Some improvement	Some improvement	Some improvement	Some improvement	Some improvement	Some improvement	Some improvement	Some improvement
Provide oversight of environmental performance of wastewater and stormwater networks			Negative improvement	No Change	No Change	Some improvement	Some improvement	Achieved	Achieved	Achieved	Achieved	Achieved	Achieved	Achieved	Achieved
Promote public understanding of the environmental performance of wastewater and storm-water networks.			Negative improvement	Some improvement	Achieved	Achieved	Achieved	Achieved	Achieved	Achieved	Achieved	Achieved	Achieved	Achieved	Achieved
Design Features - Three Waters Reform			**Negative improvement**	**No Change**	**Some improvement**	**Achieved**	**Achieved**	**Achieved**	**Achieved**	**Achieved**	**Achieved**	**Achieved**	**Achieved**	**Achieved**	**Achieved**
Water service delivery entities that are: -of significnat scale -asset-owning entities -structured as statutory entities			Negative improvement	Negative improvement	Negative improvement	No Change	No Change	Some improvement	Some improvement	Some improvement	Achieved	Exceeds	Exceeds	Exceeds	Some improvement
Delivery of drinking water and wastewater services as a priority			Negative improvement	No Change	Some improvement	Achieved	Achieved	Achieved	Achieved	Achieved	Achieved	Achieved	Achieved	Achieved	Achieved
Publicly owned entities			Negative improvement	Negative improvement	Some improvement	Achieved	Achieved	Achieved	Achieved	Achieved	Achieved	Achieved	Achieved	Achieved	Achieved
Mechanism for enabling iwi / Maori and communities			Negative improvement	Some improvement	Some improvement	Achieved	Achieved	Achieved	Achieved	Achieved	Achieved	Achieved	Achieved	Achieved	Achieved
Business Needs			**Neutral**	**Neutral**	**Slight postive**	**Slight postive**	**Slight postive**	**Moderate to large positive**	**Moderate to large positive**	**Slight postive**	**Moderate to large positive**	**Slight negative**	**Slight negative**	**Slight postive**	**Moderate to large positive**
Local Influence / input			Neutral	Neutral	Slight postive	Slight postive	Slight postive	Moderate to large positive	Moderate to large positive	Slight postive	Moderate to large positive	Slight negative	Slight negative	Slight postive	Moderate to large positive
Representative goverance			Neutral	Neutral	Neutral	Slight postive	Slight postive	Moderate to large positive	Moderate to large positive	Slight postive	Slight postive	Moderate to large negative	Slight negative	Neutral	Slight postive
Dis Benefits			**Neutral**	**Neutral**	**Neutral**	**Neutral**	**Neutral**	**Neutral**	**Slight negative**	**Neutral**	**Slight negative**	**Moderate to large negative**	**Slight negative**	**Slight negative**	**Slight negative**
Stranded assets and systems in Council			Neutral	Neutral	Slight negative	Slight negative	Slight negative	Slight negative	Moderate to large negative	Slight negative	Moderate to large negative	Moderate to large negative	Slight negative	Moderate to large negative	Moderate to large negative
Spatial Planning / Integrated land use planning			Neutral	Neutral	Slight postive	Slight postive	Slight postive	Slight postive	Moderate to large positive	Slight postive	Moderate to large positive	Slight negative	Neutral	Moderate to large positive	Moderate to large positive
Stranded overheads and administration in Council			Neutral	Neutral	Slight negative	Slight negative	Slight negative	Slight negative	Moderate to large negative	Slight negative	Moderate to large negative	Moderate to large negative	Moderate to large negative	Moderate to large negative	Moderate to large negative
Risks															
Technical			Low	Low	Medium	Medium	High	High	High	High	High	Low	Low	Low	Low
Operational			Medium	Medium	Medium	Medium	High	High	High	Medium	Medium	Low	Low	Low	Low
Financial			High	High	High	Medium	Medium	Medium	Medium	Medium	Medium	Low	Low	Low	Low
Stakeholder/Political/Public			High	High	High	Medium	Medium	Medium	Medium	Medium	Medium	Medium	Medium	Medium	Medium
Environmental			High	High	High	Medium	Medium	Medium	Medium	Medium	Medium	Low	Low	Low	Low
Safety			High	High	High	Medium	Medium	Medium	Medium	Medium	Medium	Low	Low	Low	Low
Economic			High	High	High	Medium	Medium	Medium	Medium	Medium	Medium	Low	Low	Low	Low
Ranking:															
			13	**12**	**11**	**9**	**8**	**3**	**4**	**7**	**6**	**10**	**5**	**1**	**2**

Appendix D. Northland Options

Northland - Option 7	Multi-Regional Water CCO + Council services remain as they are
Definition  	Northland would combine with other regions (current unknown) to create a multi-regional CCO, which would own assets and be responsible for delivering all operational and capital three waters services for the multi-regional area. The CCO and the directors will be accountable for the performance of the water entity and recover costs from individual customers. The councils would define its expectation of the CCO, monitor performance and potentially have governance representation. It is currently unknown the level of influence Northland Councils will have. Mana Whenua would also potentially have governance representation and be involved in the co-design of the organisation. This model may provide cost savings and efficiencies of scale. However, it is likely the main office would be based outside the region.
Benefits over status quo	• Opportunity for development of a new structure that enables participation of Mana Whenua from the outset – co-governance and co-design. However, due to the large scale of a multi-regional water CCO, the level of influence is currently unknown. • Delivers cost savings for water through scale and capacity as well as controlling the revenue stream and investment decisions. • Multi-regionalising costs is likely to improve affordability for water. • The creation of an infrastructure CCO provides an opportunity for advancement and job enrichment. • Increases resilience of organisation through creating a greater breadth and depth of resources. • Strategic capability to be developed within the CCO for water.
Misalignment to national objectives	• Probable partners have significant issues which will likely be of higher priority for investment, i.e., Watercare's imminent problems. • Remaining council services are left for councils to individually resource. This will likely increase competition and pressures on existing resources.
Risks and disbenefits	• The model requires a high rate and level of change to be successful. • The development of co-governance and co-design will place additional pressure on Council and Mana Whenua resources to participate fully. • Remaining council resources will be under further pressure to deliver other services. • Stranded assets e.g., offices, overheads, administration. • Disaggregation of district strategic and spatial planning. • Resource management consenting, remaining with council, will require infrastructure knowledge.

Northland - Option 8	Multi-Regional Water CCO + Regional Infrastructure Management CCO
Definition  	Similarly, to option 7, Northland would combine with other regions to create a multi-regional CCO, which would be accountable for its performance, own assets and deliver three water services. In addition to this, the Northland Territorial Authorities would create a management CCO to operate all remaining infrastructure – transport, solid waste, parks and, if not included in the multi-regional CCO, stormwater. The management CCO would have a professional board who along with the CCO would be accountable for the performance of the CCO; however, the councils would remain responsible for funding decisions based on the investment recommendations of the management CCO. Mana Whenua would also potentially have governance representation and be involved in the co-design of the organisation.
Benefits over status quo	• Opportunity for development of a new structure that enables participation of Mana Whenua from the outset – co-governance and co-design. However, due to the large scale of a multi-regional water CCO, the level of influence is currently unknown. • Delivers cost savings for water through scale and capacity as well as controlling the revenue stream and investment decisions. • Multi-regionalising costs is likely to improve affordability for water. • The creation of an infrastructure CCO provides an opportunity for advancement and job enrichment. • Increases resilience of organisation through creating a greater breadth and depth of resources. • Strategic capability to be developed within the CCO for water. • The creation of a regional infrastructure management CCO will support the remaining infrastructure left with council reducing competition and pressure on resources.
Misalignment to national objectives	• Probable partners have significant issues which will likely be of higher priority for investment, i.e., Watercare's imminent problems. • Removing all infrastructure from councils will put additional pressure on overheads and stretch resources for remaining functions.
Risks and disbenefits	• Individual Territorial Authorities may no longer be viable organisations due to the removal of all infrastructure. • This model requires a high rate and level of change to be successful. • The development of co-governance and co-design in two organisations will place additional pressure on resources for Council and Mana Whenua to participate fully in both. • Stranded assets e.g., offices, overheads, administration.

Northland - Option 9	Multi-Regional Water CCO + Northland Combined Authority
Definition  	Similarly, to option 7, Northland would combine with other regions to create a multi-regional CCO, which along with the directors would be accountable for its performance, own assets and deliver operational and capital three water services. In addition to this, the four Northland councils would create a Combined Authority to deliver all other territorial authority and regional authority services. Mana Whenua, councils and the CCO who all have the same roles and responsibilities in regard to the multi-regional asset owning three waters CCO, as described in option 7.
Benefits over status quo	• Opportunity for development of a new structure that enables participation of Mana Whenua from the outset – co-governance and co-design. However, due to the large scale, the level of influence is currently unknown. • Delivers cost savings for water through scale and capacity as well as controlling the revenue stream and investment decisions. • Multi-regionalising costs is likely to improve affordability for water. • The creation of an infrastructure CCO provides an opportunity for advancement and job enrichment. • Increases resilience of organisation through creating a greater breadth and depth of resources. • Strategic capability to be developed within the CCO for water. • The creation of a Combined Authority supports the remaining functions in council, reducing competition and pressure on resources. • Enhances affordability for services other than water. • Improved affordability for non-water assets. • Reduced overheads and administration costs. • Streamlines of governance.
Misalignment to national objectives	• Probable partners have significant issues which will likely be of higher priority for investment, i.e., Watercare's imminent problems.
Risks and disbenefits	• This model requires a high rate and level of change to be successful. • The development of co-governance and co-design in two organisations will place additional pressure on Mana Whenua resources to participate fully.

Option 10	**Regional Water asset owning CCO + Northland Combined Authority –** Note: this option was assessed following the workshop.
Definition  	The four Northland councils would create a Combined Authority to deliver all territorial authority and regional authority services. In addition to this, a regional asset owning CCO would be formed to provide three water services to the region. The CCO and the directors will be accountable for the performance of the water entity. They would be responsible for delivering all operational and capital three waters services for Northland area. The CCO would also recover costs from individual customers. The councils would define its expectation of the CCO, monitor performance and potentially have governance representation. Mana Whenua would also potentially have governance representation and be involved in the co-design of the CCO.
Benefits over status quo	• Opportunity for development of new structures enables participation of Mana Whenua from the outset – co-governance and co-design. However, due to the large scale, the level of influence is currently unknown. • Delivers cost savings through scale and capacity as well as controlling the revenue stream and investment decisions – for water and other council services. • The creation of an infrastructure CCO provides an opportunity for advancement and job enrichment. • Increases resilience for both organisations through creating a greater breadth and depth of resources. • Strategic capability to be developed within the CCO for water. • The creation of a combined authority supports the remaining functions in council, reducing competition and pressure on resources. • Enhances affordability for services other than water. • Improved affordability for non-water assets. • Reduced overheads and administration costs. • Streamlines of governance.
Misalignment to national objectives	• Is not a multi-regional entity.
Risks and disbenefits	• This model requires a high rate and level of change to be successful. • The development of co-governance and co-design in two organisations will place additional pressure on Mana Whenua resources to participate fully.

Phase 2 Analysis
Whangarei District Council

Auckland / Northland Three Waters Reform
September 2021

DRAFT for discussion

pwc

PricewaterhouseCoopers
PwC Tower
15 Customs Street West
Private Bag 92162
Auckland 1010
New Zealand
T: +64 9 355 8000

September 2021

Auckland / Northland Three Waters Reform: Phase 2 Analysis

We refer to the contract for goods or services dated 28 May 2021 (the Contract), and provide our report in relation to the impact assessment of the options. This report has been prepared by PwC pursuant to Phase 2 of the Contract.

This Report should be considered only in its entirety.

This report was prepared solely to assist the councils in assessing the impact of the proposed Three Waters Reform. We consent to your providing copies of this Report to third parties only in its entirety and on the basis that, to the fullest extent permitted by Law, we accept no duty of care to any such party in connection with the provision of this Report and/or any related information or explanation (together the Information). Accordingly, regardless of the form of action, whether in contract, tort (including without limitation negligence or otherwise) and to the extent permitted by applicable Law, we accept no liability to any third party and disclaim all responsibility for the consequences of any third party acting or refraining to act in reliance on the information.

Notwithstanding the above, our consent to your distributing this Report to third parties is given solely on the basis that you agree that, in the event such release leads to our incurring any costs or obligations to such third parties, we will rely on the indemnities which you have provided to us.

In preparing this Report we obtained information from a variety of sources. While we have analysed financial information, we have not undertaken an audit or verified this information, and will not accept any responsibility for any errors contained in the information provided. Accordingly, we accept no responsibility and make no representations with respect to the accuracy of or completeness of any information provided to us, except where otherwise stated and no assurance is given. Further detail on our key terms of business are provided in the Appendix of this Report.

Yours faithfully,

PricewaterhouseCoopers

Contents

Section	Page
Executive Summary	4
Introduction	6
1) Assumptions	
Definitions – summary of inputs and assumptions within the document	8
Connected households – Council – council connected households by activity type	9
Connected households – Study area – total forecast connected households across the study area by activity type	10
Operating expenditure – Council – by activity type over the LTP period	11
Operating expenditure – Study area – total forecast operating expenditure and potential efficiencies	12
Capital expenditure – Council – comparison of status-quo capex and capex required to meet proposed regulation	13
Capital expenditure – Study area – comparison of status-quo capex and the increase to meet regulations	14
Operating revenue – Council – council three waters operating revenue by activity type	15
Operating revenue – Study area – total operating revenue across the study area	16
Debt – Council – council debt split by three-waters and non-three waters	17
Debt – Study area – total three waters and non-three waters debt across the study area	18
Debt to revenue – Council – status-quo indicative comparison of total council and three waters debt to revenue	19
Three waters sources and uses – split of funding applications and funding applications as per LTP	20
2) Scenarios	
Scenario summary – summary of each scenarios analysed	22
Approach – high level assumptions and methodology	23
Status-quo – summary of average cost per household under status quo	24
Regulated status-quo – average cost per household and debt to revenue under Regulated status-quo	25
Regulated reform – Amalgamation (Entity A) – key metrics of Entity A under regulated reform scenario	26
Regulated reform – Amalgamation – average cost per household and debt to revenue under Regulated reform amalgamation scenario	27
Sensitivity analysis – 100% of WICS capex – impact if 100% of WICS capex is undertaken over the forecast period	28
Appendix	
Key terms of business and restrictions	30

Executive Summary

Introduction

Regardless of whether the councils participate in the reform, it is expected that they will need to meet enhanced levels of service in a post-reform, regulated environment.

This report compares status-quo (ie Long Term Plan (LTP)) forecasts against the potential impact of proposed three waters economic regulation under two alternative scenarios. The analysis has been undertaken over the current LTP period (ie FY22 to FY31).

The scenarios that have been analysed are:

A. **Status-quo:** forecasts under the current LTP;
B. **Regulated status-quo:** if Whangarei District Council (WDC) remains responsible for three waters delivery in a regulated environment; and
C. **Regulated reform amalgamation**: if a new regional entity takes responsibility for three waters delivery across the Auckland and Northland regions.

Limitations of this analysis

The analysis in this report is highly dependent on the input assumptions, under both the status-quo and regulated scenarios, as set out in Section 1. Key input assumptions include:

- **forecast capital expenditure (over and above existing LTP forecasts) required to meet regulatory requirements;**
- **forecast revenue and expenditure;**
- **forecast debt and reserves; and**
- **no change to the refinery water usage.**

Changes to these assumptions will impact the scenarios tested and the relative benefits (or disbenefits) of reform. In particular, the required level of increase in capital expenditure under a regulated environment is likely to have a material impact on the results.

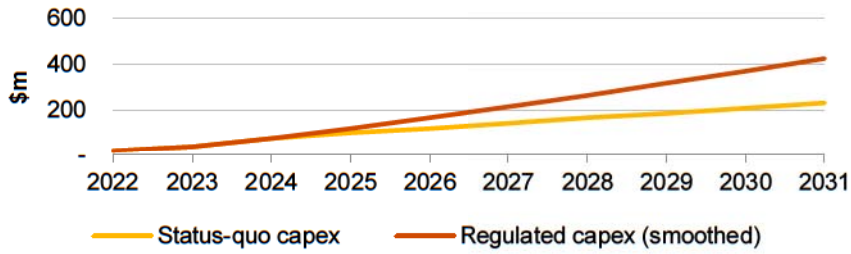
Additionally, this analysis is limited to the LTP period (FY22 to FY31) and is influenced by the use of reserves. Assuming regulated capex levels are maintained post FY31, there is likely to be an increasing financial burden on WDC and corresponding cost to households.

Forecast capital expenditure

Under a regulated environment, the increase in capex assumed to be required to meet regulatory requirements is expected to be significant.

As agreed with WDC, the analysis in this report is based on an increase of $193m over status-quo forecasts (between 2022 and 2031). This is equivalent to **50%** of the capex assumed to be required by WICS under a regulated environment as shown in the table and graph below. **Changing this assumption has a material impact on this analysis, as outlined on page 5 and page 28.**

Cumulative capex ($ nominal)



Whangarei capital costs (FY22 – FY31, $ nominal)			
Status-quo	**Regulated**	Increase over status-quo	Regulated as a % of WICS[1]
$231m	$424m	+85%	50%*

***The weighted average 'Regulated as a % of WICS' across all Entity A councils is 93%.**

Forecast operating efficiencies

The impact of amalgamation (ie economies of scale) and regulation are expected to yield operating efficiencies in the new water entity, compared to the status-quo. Operating efficiencies of 1.5% per year over the forecast period (i.e. 1.5% in FY25 to 10.5% in FY31) have been assumed in the regulated reform amalgamation scenario. The 1.5% is an indicative amount based on efficiencies expected in WICS analysis. No capital expenditure efficiencies have been assumed.

1. WICS capex comparison excludes depreciation on new assets

Executive Summary

Note: Average cost per household is not the actual cost, it is an average and could vary (eg between schemes, districts, regions).

Scenario B: Regulated status quo

Without reform, WDC is expected to need to raise more revenue, and/or increase debt, to fund the regulated level of capex (over and above current LTP forecasts). However, WDC are forecasting a large pool of three waters reserves to be accumulated over the LTP period, which are assumed to be used to fund the additional regulated capital expenditure.

There is likely to be a **small increase** to the required average **cost per household** and **council debt** to fund the additional $193m of capex, assuming all reserves are used for this purpose. **This assumes those reserves are not required to fund other three waters investment.**

The likely range of outcomes is shown as the pink shaded areas in the graphs opposite.

Scenario C: Regulated reform

Under reform, the new Entity A will be able to raise debt to fund the net increase in capex required. It is also assumed that reform will enable operating cost savings to be achieved that would not be realised under the status-quo.

The **average cost per household** is forecast to be **higher** than the status-quo, and **slightly above** the estimated range if council were to undertake the reform itself. Noting that all reserves are assumed to be spent under this scenario and the regulated capex is 50% of WICS (and the limitations of those assumptions).

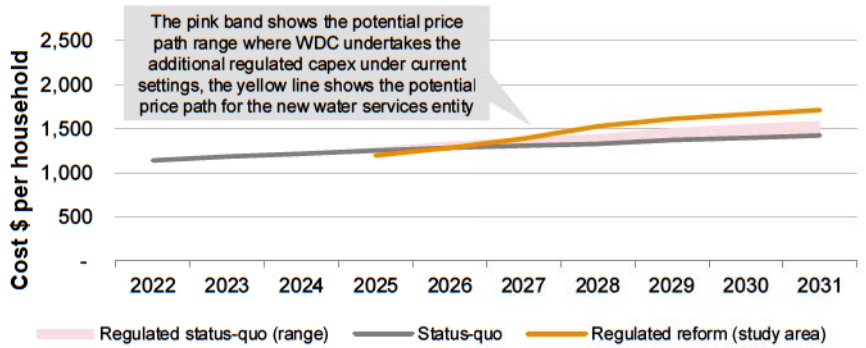
'No worse off' and 'Better off' funding

Council debt to revenue with the additional 'No worse off' and 'Better off' funding (yellow dashed line) is expected to leave the council in a similar debt to revenue position at the point of reform.

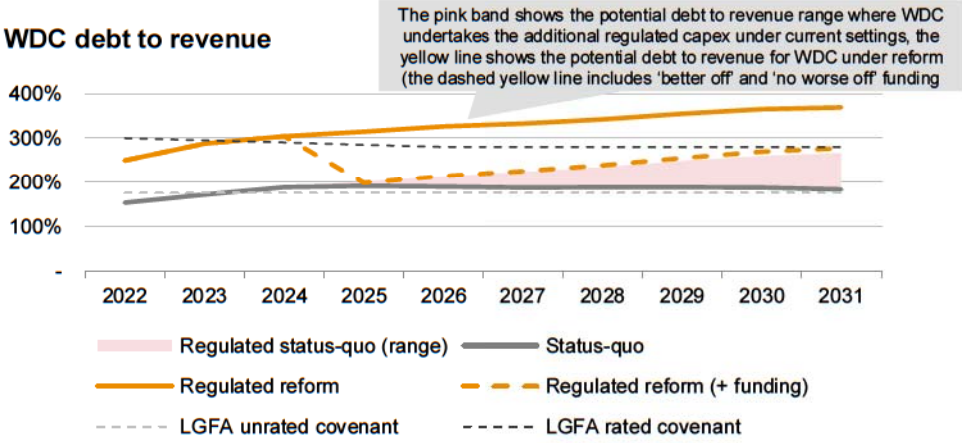
Scenario analysis: 100% of WICS capex[2]

A scenario assuming that the same level of capex as WICS over the forecast period has been included. The scenario will see a significant increase in average cost per household for Whangarei, well above the increase seen under the regulated reform (noting this is an average over the study area).

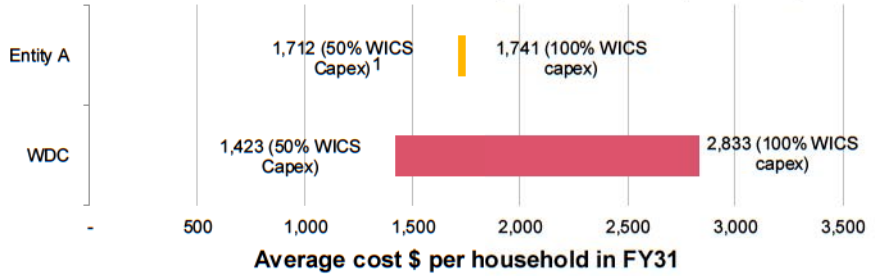
Average cost per household ($ per household, nominal)



WDC debt to revenue



Scenario analysis – 100% of WICS capex
Average cost per household in FY31 ($ per household, nominal)



1. Entity A '50% WICS Capex' scenario analysis includes capex for Whangarei equal to 50% of WICS. This percentage varies across each council, with the weighted average across all councils being ~93% of total WICS capex (excluding depreciation on new assets)
2. WICS capex excludes depreciation on new assets

Introduction

Purpose

- Phase 2 of the scope of work was to utilise the RFI data and other information to develop preliminary Constrained (ie status-quo) and Regulated Asset Management Plans (AMPs) covering future capital and operational expenditure parameters.
- **This paper includes the Phase 2 financial analysis of three waters service delivery in the Whangarei district only. The purpose of the analysis is to assess the operational and financial impact of the three waters reform programme.**
- This paper summarises the base level assumptions around three waters activity for WDC. These assumptions are largely informed by the Department of Internal Affairs (DIA) Request for Information (RFI) data as well as other information (including recent Long Term Plans (LTPs)).
- The Regulated capital expenditure programme is assumed to be the capital expenditure required for each council to achieve the expected requirements in an economically regulated (ie post three waters reform) environment.
- Three scenarios have been analysed:
  - **A. Status-quo:** forecasts under current LTPs
  - **B. Regulated status-quo:** assesses the financial impact if each council were to undertake the Regulated capital expenditure programme under current settings (ie three waters services being delivered by councils)
  - **C. Regulated reform amalgamation**: assesses the financial impact of three waters activities being delivered by a structurally separate amalgamated water entity (ie Entity A).

Important notes

- **Purpose of the work:** As noted above, the purpose of the work is to provide preliminary financial analysis of three waters services delivery within the region post three waters reform.
- **Source data:** A range of data was submitted by councils. Data received from councils has not been reviewed for accuracy, has been taken as being correct and has not been reconciled to other data provided by the councils. We have not sought to reconcile this and instead noted the source of the data used.
- **Draft status of data:** Much of the financial information is derived from RFI spreadsheets, which may not be approved by Council for implementation. As such, the analysis should be considered directional in nature. It provides a high level overview of the study area and a basis for indicative impact analysis to be undertaken.
- **Desktop analysis:** the work has been desktop in nature with limited interaction with councils. As such, data presented reflects the analysis undertaken and may not reflect underlying reasons or context for the findings.
- **Applicability of analysis**: Certain metrics may be more or less relevant to individual councils, analysis has been undertaken consistently to enable comparison across the study area.
- **GST:** all figures are presented exclusive of GST, unless otherwise stated.
- **Flood protection and control:** all analysis excludes flood protection and control.

1 Assumptions

Definitions

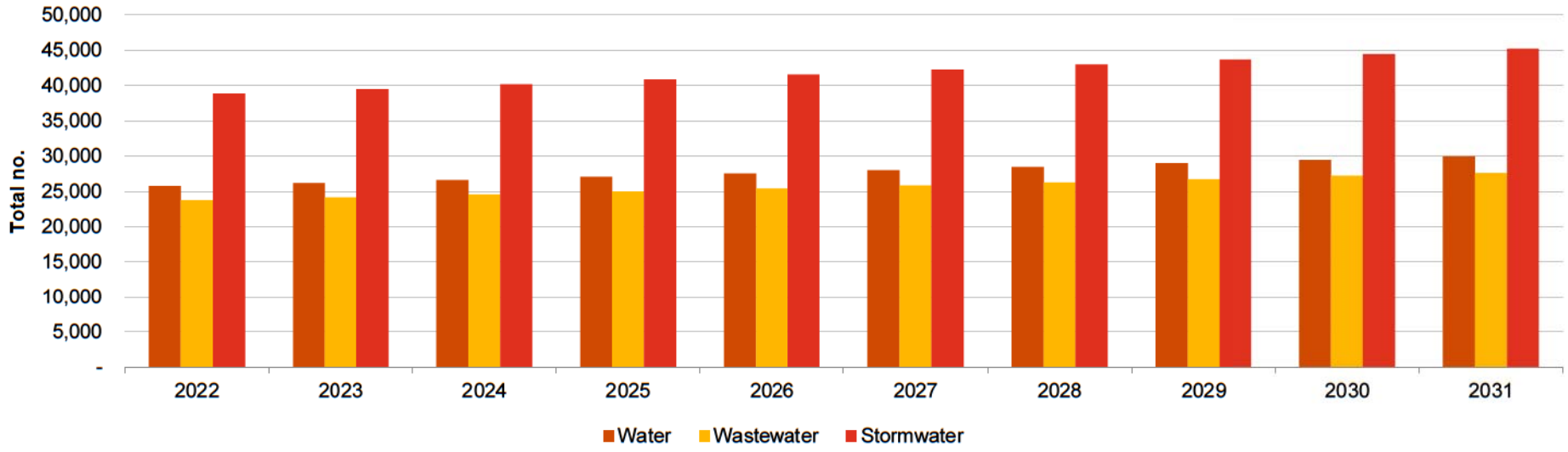
The analysis is based on the following inputs:

Definition	Explanation	Source
Connected households	The number of households receiving the three waters service	**DIA RFI:** FY22 starting households and growth in households from DIA RFI
Operating expenditure	Total operating expenditure (excluding finance charges) for the three waters service	**LTP:** Funding Impact Statements
Capital expenditure: status-quo	Total capital expenditure (including level of service, renewals and growth)	**LTP:** Funding Impact Statements
Capital expenditure: regulated	Total capital expenditure required to achieve the expected requirements in an economically regulated (ie post three waters reform) environment.	Total equal to 50% of WICS capex over the forecast period. Allocation across three waters activities in line with status quo capital expenditure.
Three waters operating revenue	Total operating revenue for the three waters service	**LTP:** Funding Impact Statements
Total council operating revenue	Total operating revenue for council	**LTP:** Funding Impact Statements
Household revenue	Approximate three waters revenue collected from households in the region	**DIA RFI:** 70% of Primary Revenue provided in the RFI. Secondary Revenue was excluded as this was typically raised from non-household sources. With 70% being the approximate average of household revenue as a proportion of total primary revenue for councils in the Auckland / Northland region
Average cost per household	Average cost per household is an average measure and does not represent the actual cost to households but is an approximate average for the region.	**Household revenue** divided by **connected households**
Three waters debt	External debt or internal loans allocated to three waters services	As per profile provided by council
Total council debt	Total council external debt	**LTP:** Gross debt
Three waters debt to revenue	An indicative measure to assess council borrowing constraints, noting that the calculation does not include adjustments allowable under LGFA covenants	**(Three waters debt minus reserves)** divided by **three waters operating revenue**
Total council debt to revenue	As above	**(Total council debt minus reserves)** divided by **total council operating revenue**

Connected households – Whangarei

Connected households are forecast to increase at approximately 1.7% per annum. Compared to the wider study area Whangarei has a noticeably higher level of stormwater connections compared to water and wastewater.

Base connected households (total no.)



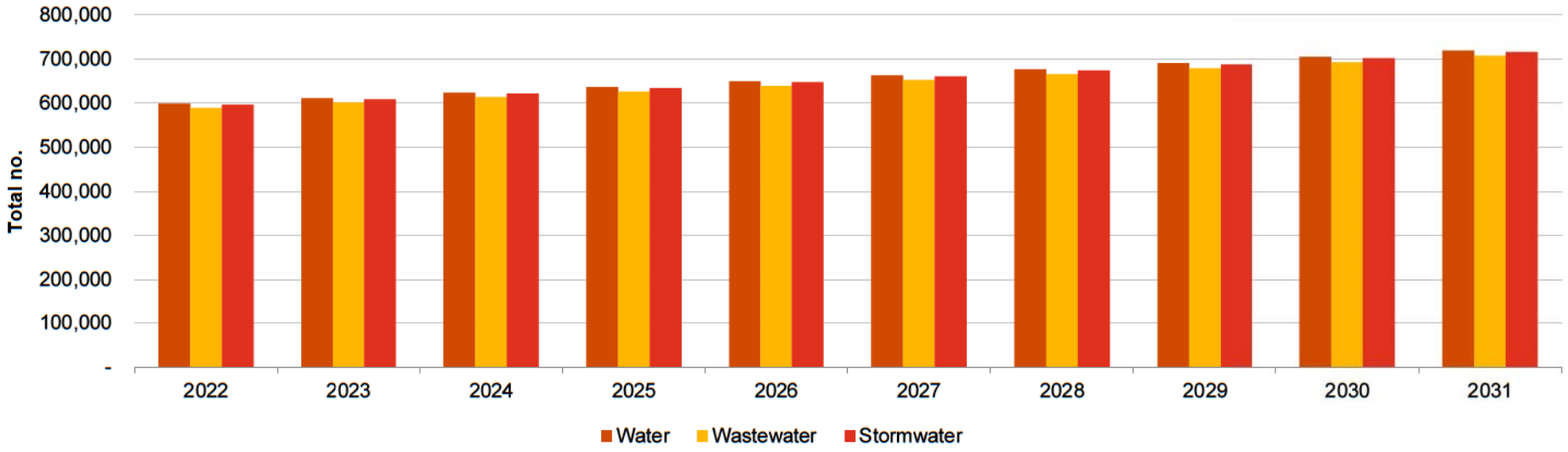
Source: RFI

No.	2022	2023	2024	2025	2026	2027	2028	2029	2030	2031
Water	25,741	26,179	26,624	27,077	27,537	28,005	28,481	28,965	29,458	29,959
Wastewater	23,749	24,153	24,564	24,981	25,406	25,838	26,277	26,724	27,178	27,640
Stormwater	38,845	39,505	40,177	40,860	41,554	42,261	42,979	43,710	44,453	45,209

Connected households – Study area

The number of connected households across the study area is forecast to grow at a approximately 2.1% per annum.

Base connected households (total no.)



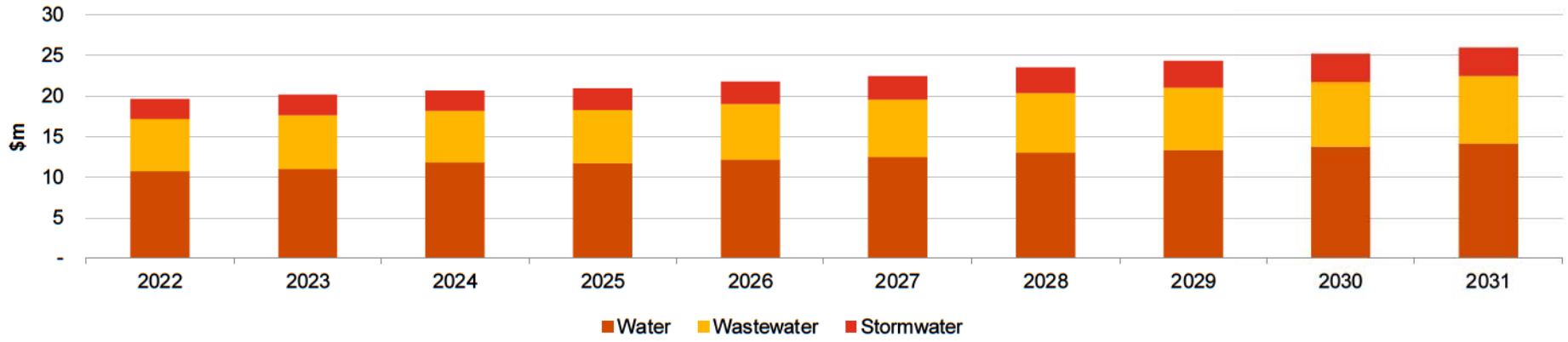
Source: RFI

No.	2022	2023	2024	2025	2026	2027	2028	2029	2030	2031
Water	556,543	568,026	579,747	591,711	603,923	616,388	629,112	642,100	655,358	668,890
Wastewater	548,183	559,470	570,991	582,750	594,752	607,004	619,509	632,273	645,301	658,600
Stormwater	539,617	550,635	561,881	573,358	585,071	597,026	609,226	621,678	634,386	647,355

Operating expenditure – Whangarei

Opex is forecast to increase by 45% over the period to 2031. Compared to the wider study area Whangarei demonstrated a higher proportion of water opex compared to other activities, representing 55% of total three waters opex.

Base operating costs ($m, nominal)



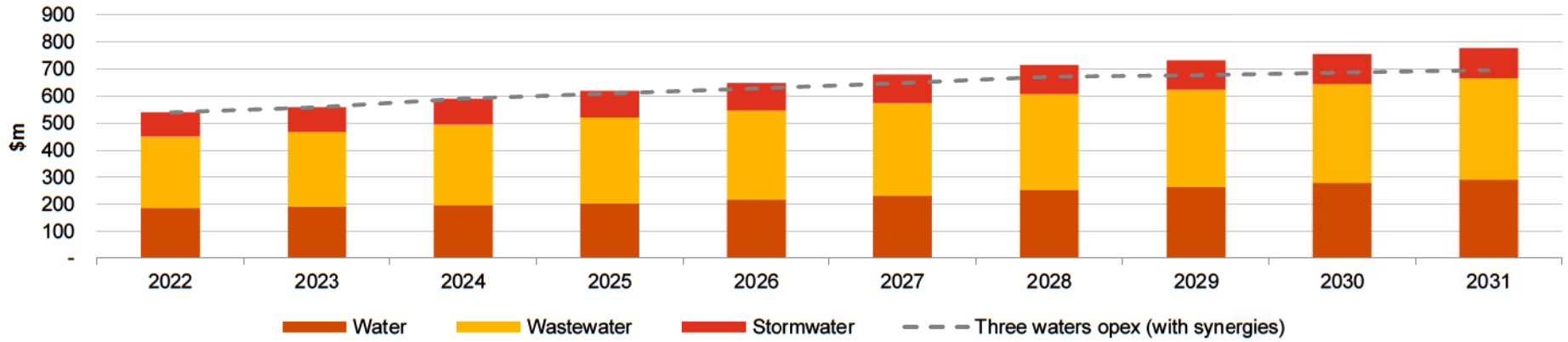
Source: LTP

NZ$m	2022	2023	2024	2025	2026	2027	2028	2029	2030	2031
Water	11	11	12	12	12	12	13	13	14	14
Wastewater	6	7	6	7	7	7	7	8	8	8
Stormwater	2	2	2	3	3	3	3	3	3	4
Total	**20**	**20**	**21**	**21**	**22**	**22**	**24**	**24**	**25**	**26**

Operating expenditure – Study area

Study area three waters opex is forecast to increase by 45% over the period to 2031. Once consolidated the entity is expected to realise some operating efficiencies which have been assumed at 1.5%[1] p.a. from 2025.

Base operating expenditure (including potential efficiencies)



Source: LTP

NZ$m	2022	2023	2024	2025	2026	2027	2028	2029	2030	2031
Water	187	192	197	204	219	232	253	264	279	292
Wastewater	265	277	298	317	330	343	354	360	367	374
Stormwater	89	90	95	98	100	104	107	107	109	111
Total	**539**	**559**	**590**	**620**	**650**	**681**	**716**	**733**	**757**	**778**
Efficiencies	-	-	-	*1.5%*	*3.0%*	*4.5%*	*6.0%*	*7.5%*	*9.0%*	*10.5%*
Total	**539**	**559**	**590**	**611**	**631**	**650**	**673**	**678**	**688**	**696**

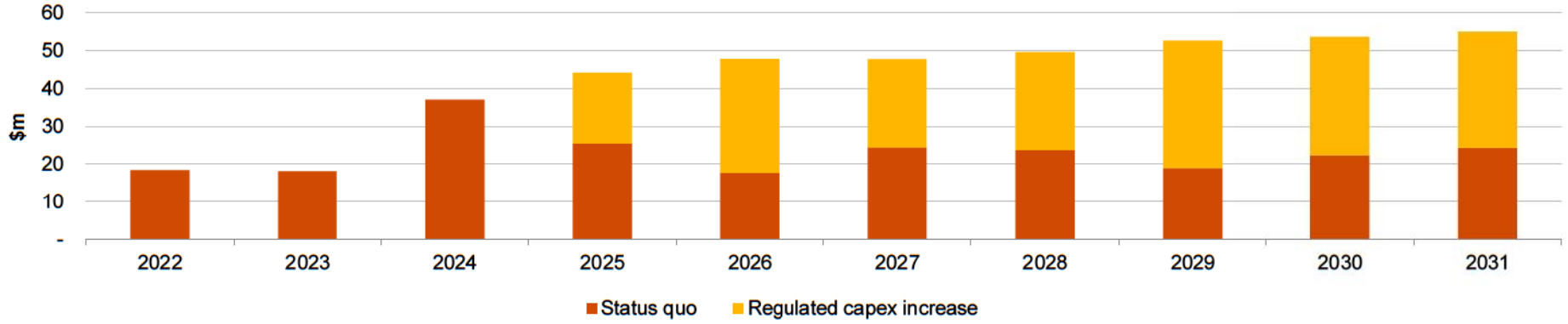
1. 1.5% in 2025 growing to 10.5% in 203. 1.5%, is an indicative amount based on efficiencies expected in WICS analysis, refer to page 22 for more details

Capital expenditure[1] – Whangarei[2]

WDC regulated capex increase over the forecast period primarily relates to increases in renewals and level of service capex spending.

Status-quo	Regulated	Increase over status-quo	Regulated as a % of WICS[3]
$231m	**$424m**	+85%	50%

Capital expenditure (p.a.)



Source: LTP, RFI

	NZ$m	2022	2023	2024	2025	2026	2027	2028	2029	2030	2031
Status-quo	Renewals	8	6	9	9	9	12	16	12	12	13
	LoS	5	6	12	10	5	8	5	4	6	6
	Growth	5	6	16	7	4	4	3	2	4	5
	Total	**18**	**18**	**37**	**25**	**18**	**24**	**24**	**19**	**22**	**24**
Regulated	Renewals	8	6	9	19	27	26	31	32	31	31
	LoS	5	6	12	16	15	16	14	16	17	17
	Growth	5	6	16	9	6	6	5	5	6	7
	Total	**18**	**18**	**37**	**44**	**48**	**48**	**50**	**53**	**54**	**55**

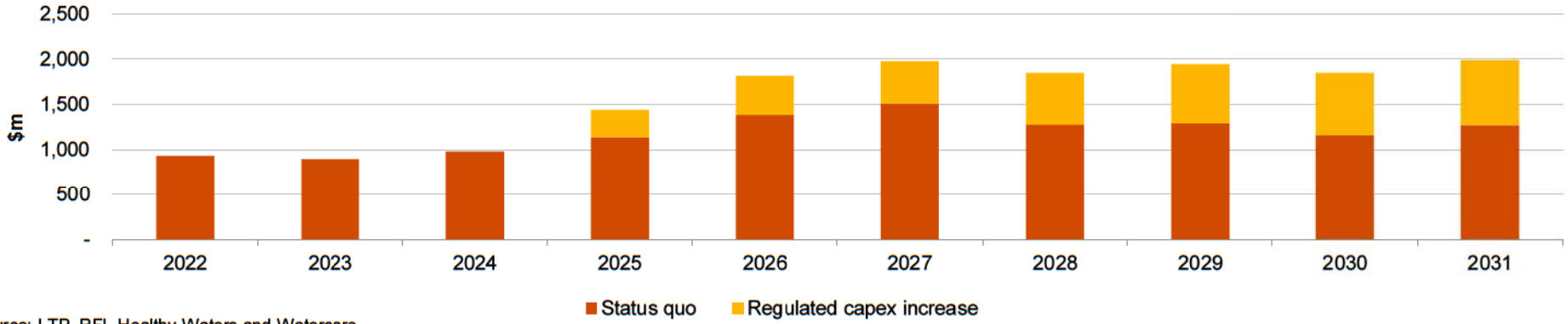
1. Regulated capex constrained to status-quo over FY22-FY24 to reflect the timing of reform with entities not expected to be established until 2024
2. Regulated capex for Whangarei has been estimated based on 50% of WICS capex (excl. depreciation on new assets)
3. WICS capex comparison excludes depreciation on new assets

Capital expenditure – Study area

Capex increases assumed to be required to meet regulatory requirements have been delayed to begin in FY25[1], with any increase in FY22-FY24 allocated proportionally over subsequent years.

Status-quo	Regulated	Increase over status-quo	Regulated as a % of WICS
$11,834m	**$15,674m**	+32%	-

Capital expenditure (p.a.)



Source: LTP, RFI, Healthy Waters and Watercare

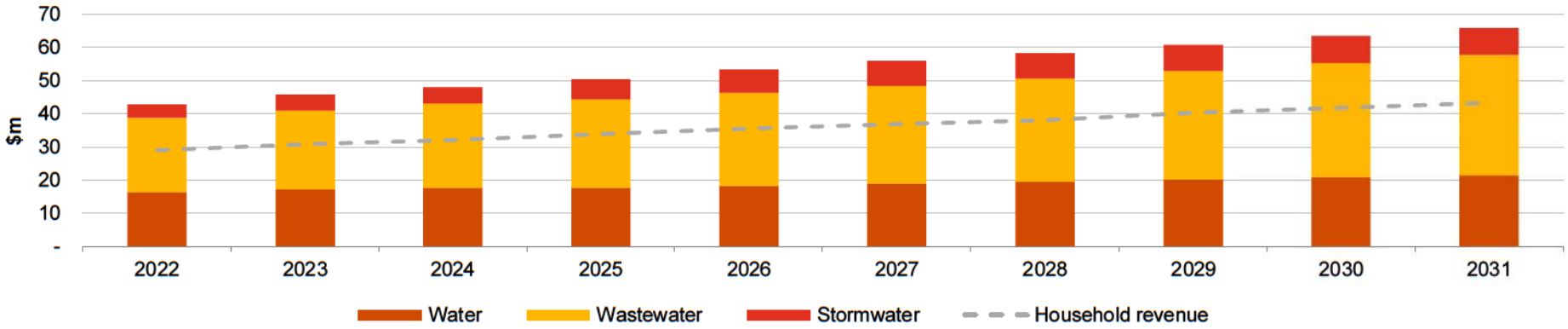
	NZ$m	2022	2023	2024	2025	2026	2027	2028	2029	2030	2031
Status-quo	Renewals	376	308	363	454	611	710	530	618	490	550
	LoS	172	203	193	195	206	273	212	159	182	146
	Growth	384	384	422	489	568	527	534	513	487	574
	Total	**932**	**895**	**978**	**1,138**	**1,386**	**1,510**	**1,275**	**1,291**	**1,159**	**1,270**
Regulated	Renewals	376	308	363	590	812	907	766	900	777	845
	LoS	172	203	193	282	329	416	391	360	396	371
	Growth	384	384	422	566	676	657	691	687	677	774
	Total	**932**	**895**	**978**	**1,437**	**1,817**	**1,979**	**1,848**	**1,946**	**1,850**	**1,990**

1. Regulated capex constrained to status-quo over FY22-FY24 to reflect the timing of reform with entities not expected to be established until 2024

Operating revenue[1] – Whangarei

Operating revenue is forecast to grow by 54% over the forecast period, with wastewater making up approximately 53% of revenue, water 35% and stormwater 12%.

Total operating revenue (base)



Source: LTP, RFI

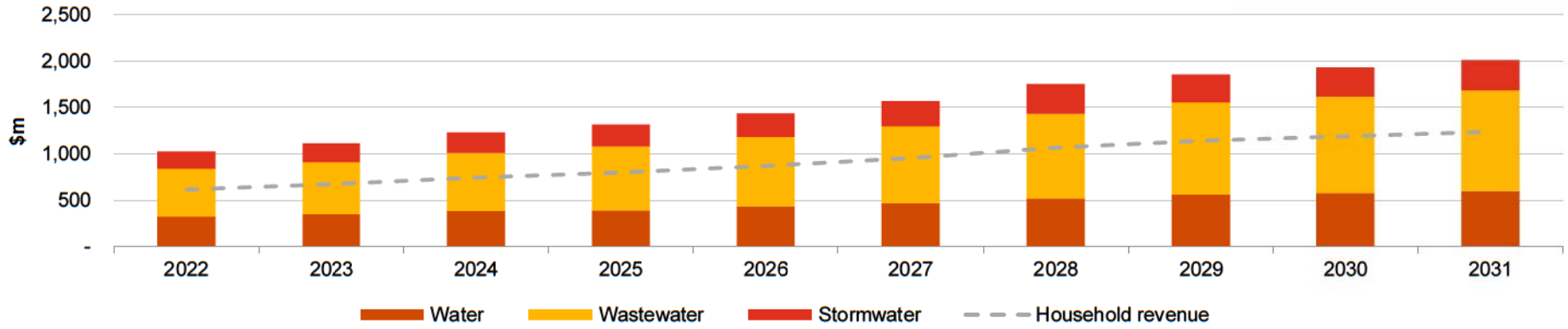
NZ$m	2022	2023	2024	2025	2026	2027	2028	2029	2030	2031
Water	16	17	18	18	18	19	20	20	21	21
Wastewater	22	24	25	27	28	30	31	33	34	36
Stormwater	4	5	5	6	7	7	8	8	8	8
Total	**43**	**46**	**48**	**50**	**53**	**56**	**58**	**61**	**63**	**66**
Household	29	31	32	34	36	37	38	40	42	43

1. Operating revenue is LTP forecasts, household revenue is 70% of RFI primary revenue

Operating revenue[1] – Study area

Study area operating revenue is forecast to grow by 96% over the forecast period, with wastewater making up approximately 53% of revenue, water 30% and stormwater 17%.

Total operating revenue (base)



Source: LTP, RFI

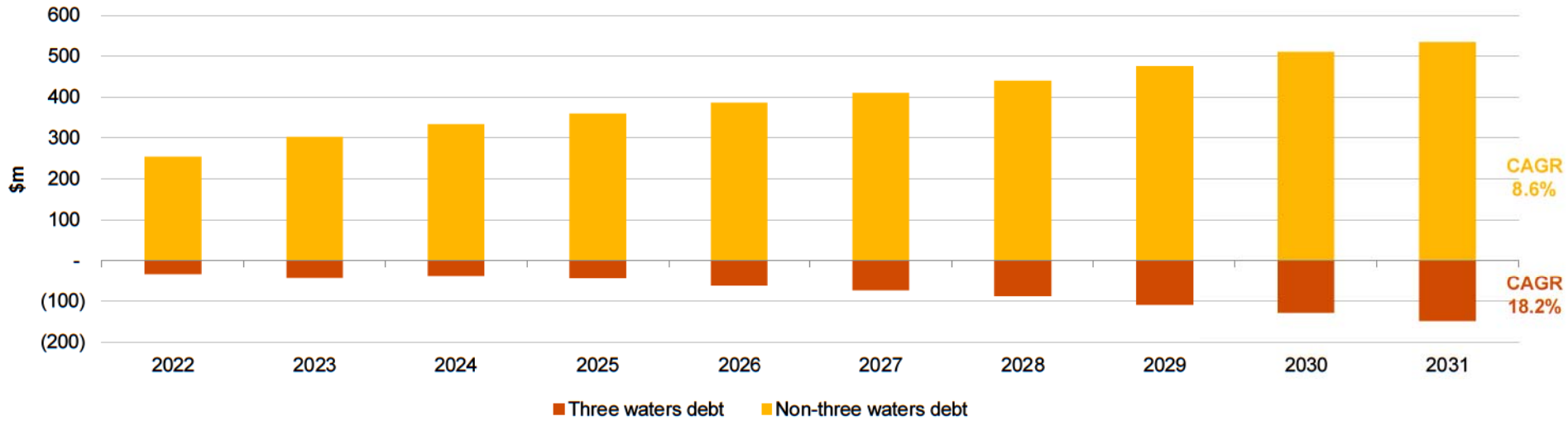
NZ$m	2022	2023	2024	2025	2026	2027	2028	2029	2030	2031
Water	324	349	383	391	434	472	520	561	578	601
Wastewater	514	561	628	691	752	827	913	997	1,039	1,086
Stormwater	187	204	219	236	250	269	319	300	315	327
Total	**1,025**	**1,115**	**1,230**	**1,318**	**1,436**	**1,569**	**1,753**	**1,858**	**1,932**	**2,013**
Household	614	673	745	799	871	954	1,067	1,140	1,188	1,238

1. Operating revenue is LTP forecasts, household revenue is 70% of RFI primary revenue

Debt – Whangarei

A large pool of three waters reserves are accumulated over the LTP period, offsetting increases in non-three waters debt.

Total council debt



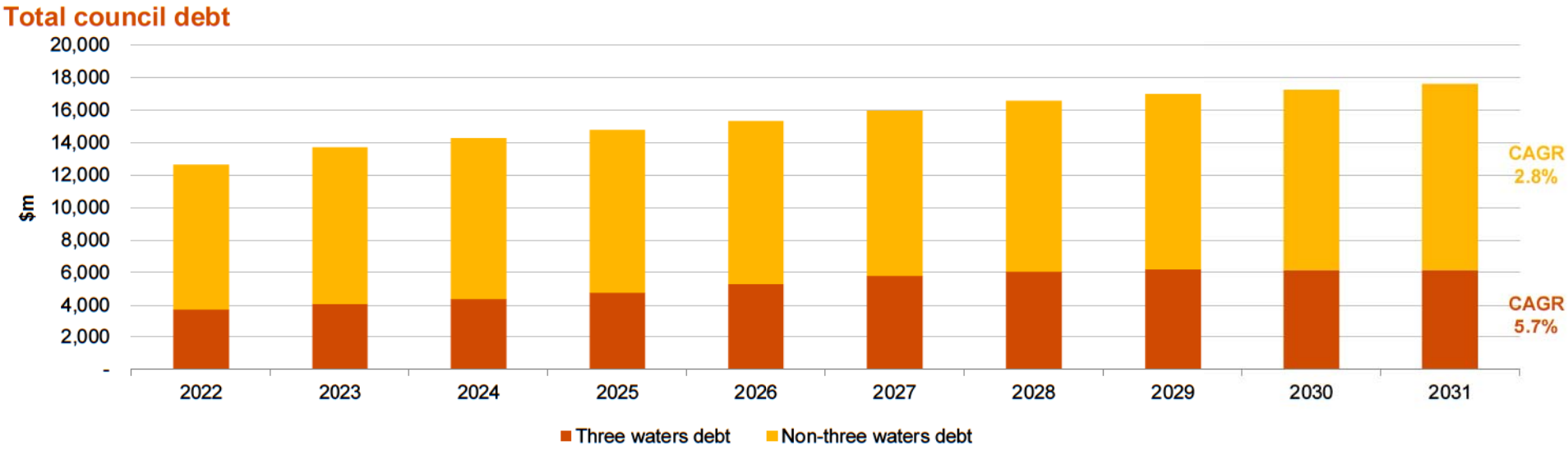
Source: RFI, LTP

NZ$m	2022	2023	2024	2025	2026	2027	2028	2029	2030	2031
Three waters	(33)	(43)	(37)	(44)	(61)	(74)	(88)	(109)	(129)	(148)
Total council	221	259	297	315	325	336	351	366	381	386

Source: RFI, LTP

Debt – Study area

Study area three waters debt is forecast to grow faster than non-three waters debt over the forecast period. The below excludes 'Better off' and 'No worse off' funding, which will be partly debt funded by the new water entity.



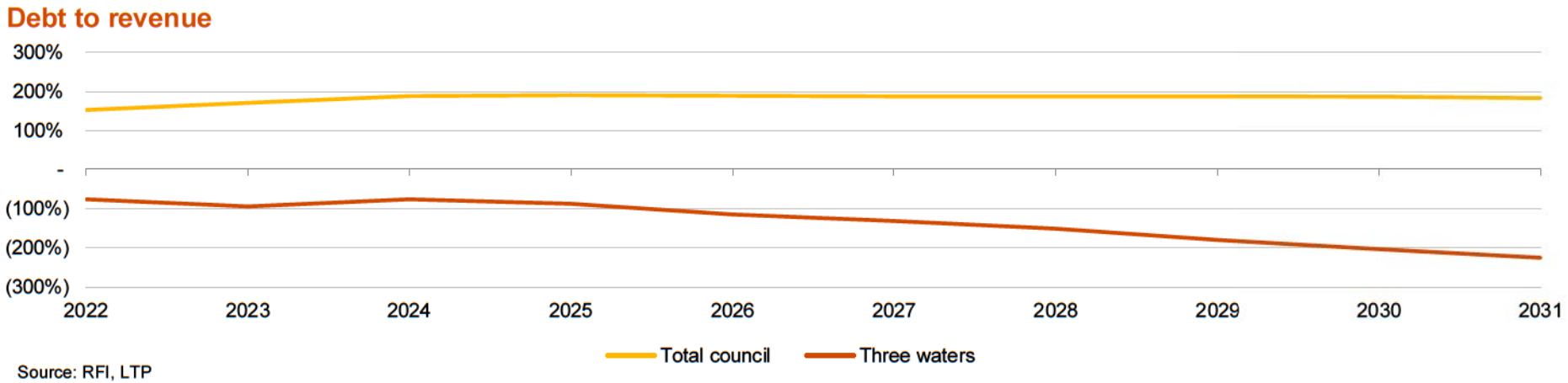
Source: RFI, LTP

NZ$m	2022	2023	2024	2025	2026	2027	2028	2029	2030	2031
Three waters	3,732	4,064	4,380	4,768	5,293	5,817	6,049	6,192	6,168	6,169
Total council	12,631	13,707	14,272	14,767	15,317	15,957	16,560	16,996	17,235	17,594

Debt to revenue – Whangarei

WDC three waters debt to revenue[1] is negative and significantly lower than total council debt to revenue. This is driven by increasing three waters reserves over the forecast period.

Three waters % of revenue (FY22 – FY31, % average over forecast)	Three waters % of debt (FY22 – FY31, % average over forecast)
31%	-23%



Source: RFI, LTP

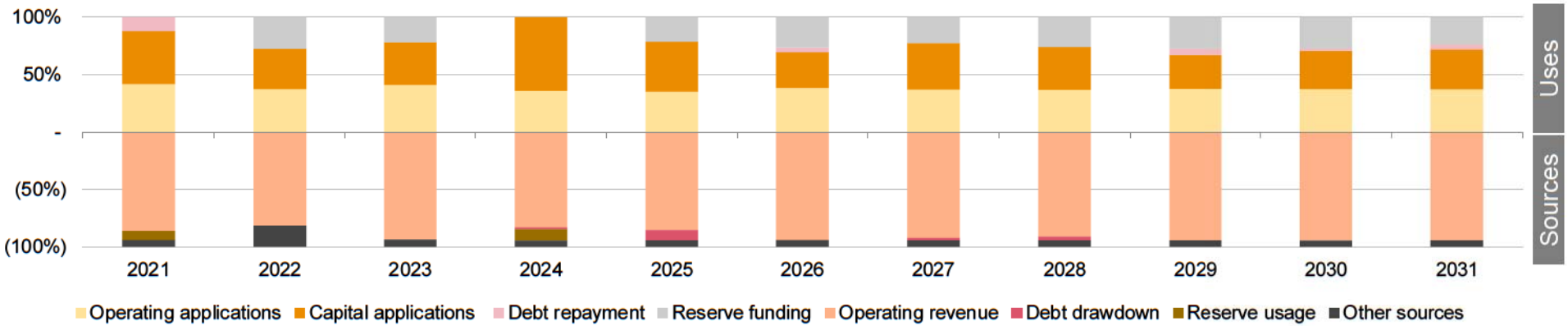
NZ$m	2022	2023	2024	2025	2026	2027	2028	2029	2030	2031
Three waters	(77%)	(95%)	(77%)	(88%)	(115%)	(132%)	(152%)	(180%)	(203%)	(225%)
Total council	153%	172%	188%	191%	189%	188%	188%	188%	187%	183%

1. Debt to revenue is an indicative measure and is based on operational revenue and gross debt. It does not include adjustments allowable under LGFA rules

Three waters sources and uses - Whangarei

Three waters[1] applications[2] are split between operating and capital applications, with primary sources within LTPs being operating revenue and debt.

Sources and uses (%)



Source: LTP

	NZ$m	2021	2022	2023	2024	2025	2026	2027	2028	2029	2030	2031
Uses	Operating applications	20	20	20	21	21	22	22	24	24	25	26
	Capital applications	22	18	18	37	25	18	24	24	19	22	24
	Debt repayment	6	-	-	-	-	2	-	-	4	1	3
	Reserve funding	-	14	11	-	13	15	14	17	18	18	17
	Total	**47**	**52**	**49**	**58**	**59**	**57**	**61**	**64**	**64**	**67**	**70**
Sources	Operating revenue	40	43	46	48	50	53	56	58	61	63	66
	Debt drawdown	-	-	-	1	5	-	1	2	-	-	-
	Reserve usage	4	-	-	6	-	-	-	-	-	-	-
	Other sources	3	10	3	3	3	3	3	4	4	4	4
	Total	**47**	**52**	**49**	**58**	**59**	**57**	**61**	**64**	**64**	**67**	**70**

DRAFT FOR DISCUSSION

1. Includes only Water, Wastewater and Stormwater as per current LTP funding impact statements
2. Reserves have been separated from capital applications within the charts

2 Scenarios

Scenario summary

Scenarios assessed include current forecasts (as per RFI and LTP) as well as the impact of proposed regulation if councils remain responsible for delivery, or if a new regional entity takes responsibility.

Scenario	Capex (nominal)	Delivery structure	Balance sheet separation	Three waters debt	Three waters revenue	Outcomes
A) Status-quo	LTP	Status-quo (Remains with each council)	No	As per RFI and profiles provided	Two different revenue measures are used depending on the key metric being assessed: **Debt to revenue:** As per LTP **Average cost per household:** Household revenue as per RFI	Levels of service assumed insufficient to meet regulatory requirements
B) Regulated status-quo	As per provided profiles	As above	As above	The below two methods provide a range to assess this scenario, with the likely outcome in between. **Debt funded:** Revenue is either held at 'status-quo' levels, with all capex funded by debt and all debt servicing costs capitalised; or, **Revenue funded:** Revenue is increased to fully fund additional renewals capex (by FY31) as well as debt servicing on LoS capex (LoS capex assumed to be debt funded and repaid over 10 years).		Increased levels of service, accelerated growth and renewals investment
C) Regulated reform - Amalgamation	As above	New entity responsible for Three Waters delivery across entire Auckland and Northland region	Yes (debt transfer based on existing allocation)	Debt based on initial transfer + increases depending on capex requirements. Renewals and LoS funded through debt with servicing met through additional revenue charged to users.	LTP + additional debt servicing costs - opex synergies - revenue savings passed to users	As above

Approach

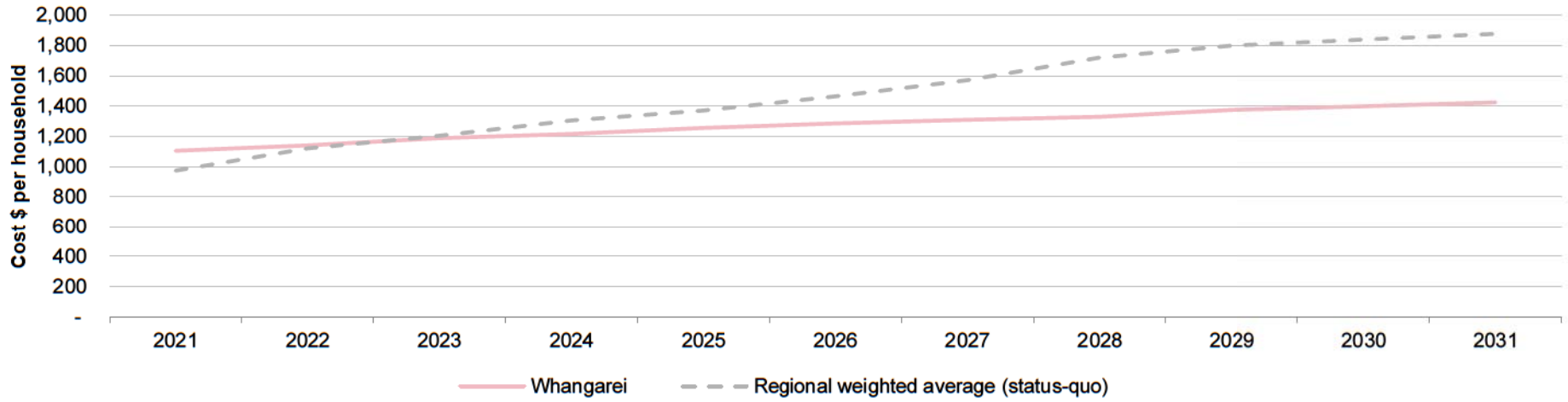
The analysis undertaken of each scenario makes the following assumptions:

Assumption	Description
Regulated capex	Regardless of whether the councils participate in the reform, it is expected that they will need to meet enhanced levels of service in a post-reform, regulated environment. The 'regulated' scenarios are assumed to be the minimum capex required to meet these enhanced levels.
Growth capex not funded through households	In all scenarios, additional growth capex is funded through debt, and repaid through Development Contributions (DCs) assuming a repayment period of 5 years (ie there is no additional growth capex cost to households).
Balance sheet separation	The **'regulated reform – Amalgamation'** scenario assumes balance sheet separation of three waters activities is achieved.
Status quo Funding assumption	**Status-quo** scenario is funded through existing revenue and debt forecasts.
Regulated status-quo funding assumption	Under the **'regulated status-quo'** scenario a range is provided with either: • all capex funded by debt and all debt servicing costs capitalised, or • revenue is increased to fully fund additional renewals capex (by FY31) as well as debt servicing on levels of service capex (levels of service capex assumed to be debt funded and repaid over 10 years).
Regulated reform – amalgamation funding assumption	Under the **'regulated reform – amalgamation'** scenario, levels of service and renewals capex is funded through debt, and repaid through user charges assuming a repayment period of 30 years.
Water Entity A debt to revenue	Maximum new entity debt to revenue ratio of 600% under the **'regulated reform – amalgamation'** scenario.
Opex synergies	Opex synergies of 1.5% per year are assumed over the forecast period (i.e. 1.5% in FY25 to 10.5% in FY31) in the 'regulated reform' scenarios only. The 1.5% is an indicative amount based on efficiencies expected in WICS analysis – with WICS estimating that Three Waters costs are 80% higher in Auckland compared to the equivalent level under Scottish Water operating model.

Status-quo average cost per household

While initially higher than the regional average, the status-quo regional average cost per household is expected to grow at a faster rate compared to Whangarei.

Status-quo average cost per household ($ per household, nominal)



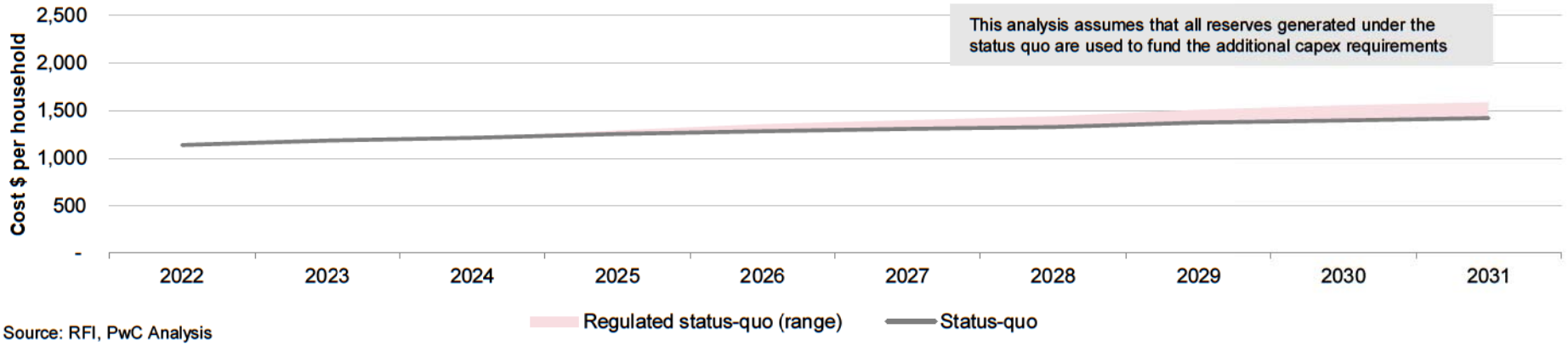
Source: RFI, LTP, PwC Analysis

NZ$	2021	2022	2023	2024	2025	2026	2027	2028	2029	2030	2031
Whangarei	1,104	1,139	1,187	1,215	1,254	1,285	1,309	1,328	1,374	1,398	1,423
Average	**972**	**1,119**	**1,202**	**1,304**	**1,370**	**1,463**	**1,570**	**1,720**	**1,800**	**1,839**	**1,877**

Regulated status-quo

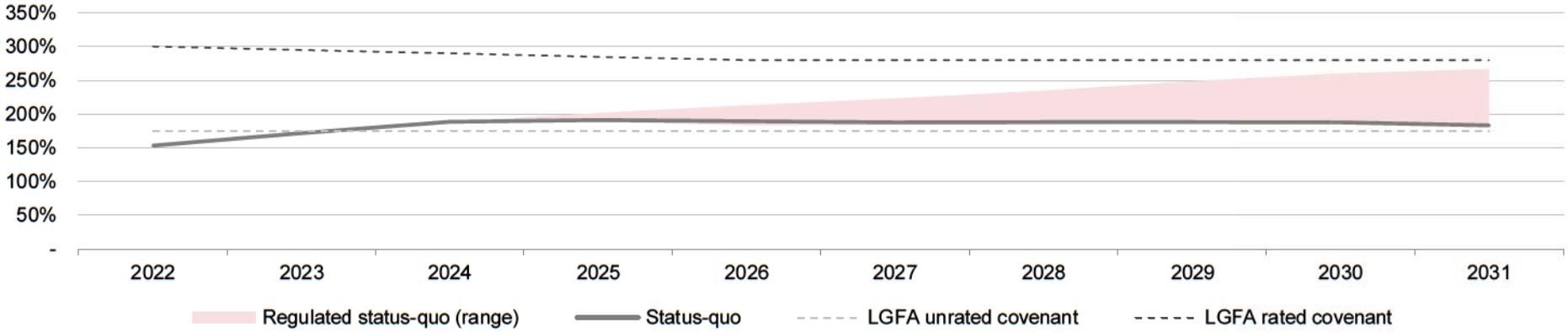
Without reform and based on the 50% of WICS capex assumption, there is likely to be a **small increase** to the required average **cost per household** and **council debt**, which is likely to push the council nearer to the LGFA rated covenant. WDC are forecasting a large pool of three waters reserves to be accumulated over the LTP period which is assumed to be used for fund additional capex requirements.

Average cost per household ($ per household, nominal)



Source: RFI, PwC Analysis

Whangarei District Council debt to revenue (%)

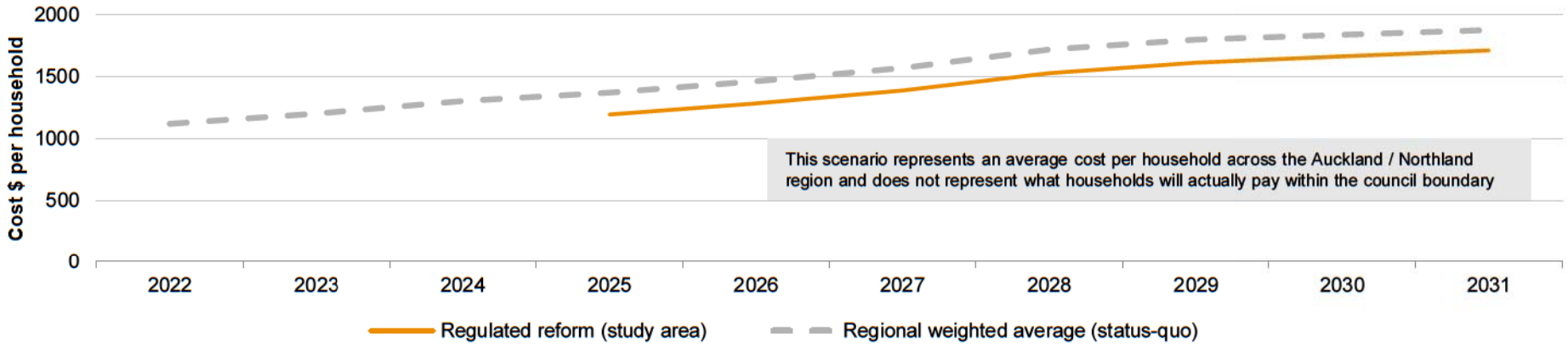


Source: RFI, PwC Analysis

Regulated reform – Amalgamation (Entity A)

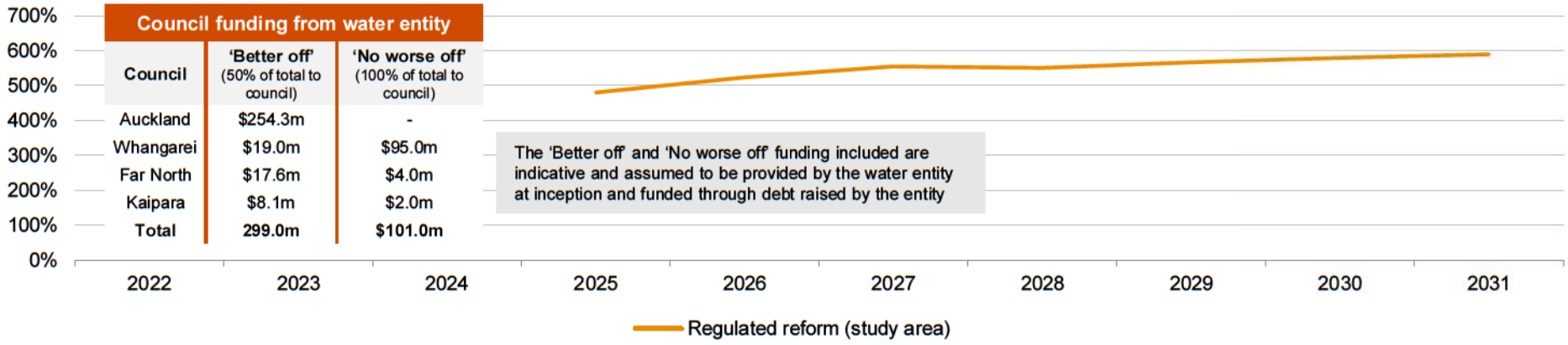
Post reform (with a single Entity A) average cost per household is forecast to be less than the regional status-quo weighted average (as per page 23), highlighting that the increased capex cost is offset by higher gearing and opex efficiencies.

Average cost per household ($ per household, nominal)



Source: RFI, PwC Analysis

Entity A debt to revenue (debt to revenue assumed to peak at 600%[1])



Council funding from water entity

Council	'Better off' (50% of total to council)	'No worse off' (100% of total to council)
Auckland	$254.3m	-
Whangarei	$19.0m	$95.0m
Far North	$17.6m	$4.0m
Kaipara	$8.1m	$2.0m
Total	**299.0m**	**$101.0m**

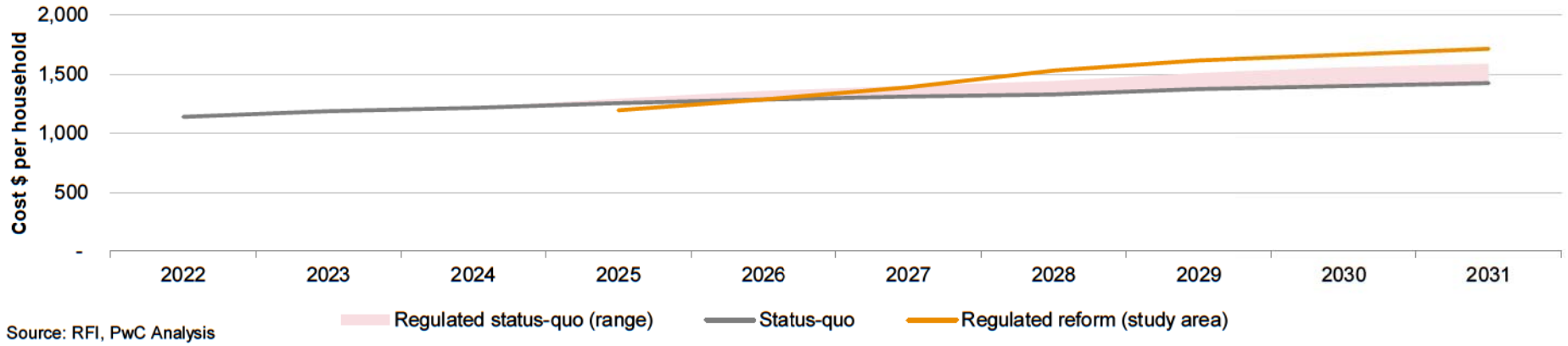
Source: LTP, RFI, PwC Analysis

1. Gearing ratio is a high level assumption based on comparison to international water utility peers, lower gearing may be required depending on the borrowing solution and credit rating outcome for the water entity.

Regulated reform[1] – Amalgamation

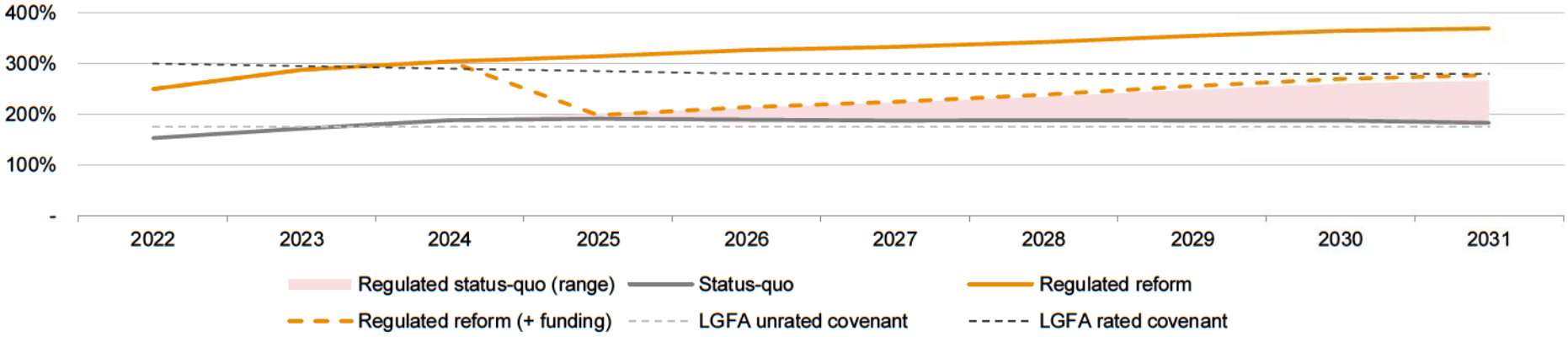
The average cost per household is forecast to be higher than the status-quo, and slightly above the estimated range if council were to undertake the reform itself. Debt to revenue with the additional 'No worse off' funding is expected to leave the council in a similar debt to revenue position at the point of reform.

Average cost per household ($ per household, nominal)



Source: RFI, PwC Analysis

Whangarei District Council debt to revenue (%)



Source: RFI, PwC Analysis

1. Regulated reform (+ funding) scenario assumes that 'Better off' and 'No worse off' funding is held by council and not spent

Sensitivity analysis – 100% of WICS capex

To achieve the 100% of the capex proposed by WICS there is likely to be a significant increase to household cost with the council likely to exceed its LGFA covenants.

Sensitivity summary

This scenario assumes a total of $848m of capex across the forecast period (FY22 – FY31), an increase of $617m over the status quo capex level. This increase will likely require a significant increase in revenue and/or debt, with Council likely to exceed its current LGFA covenant.

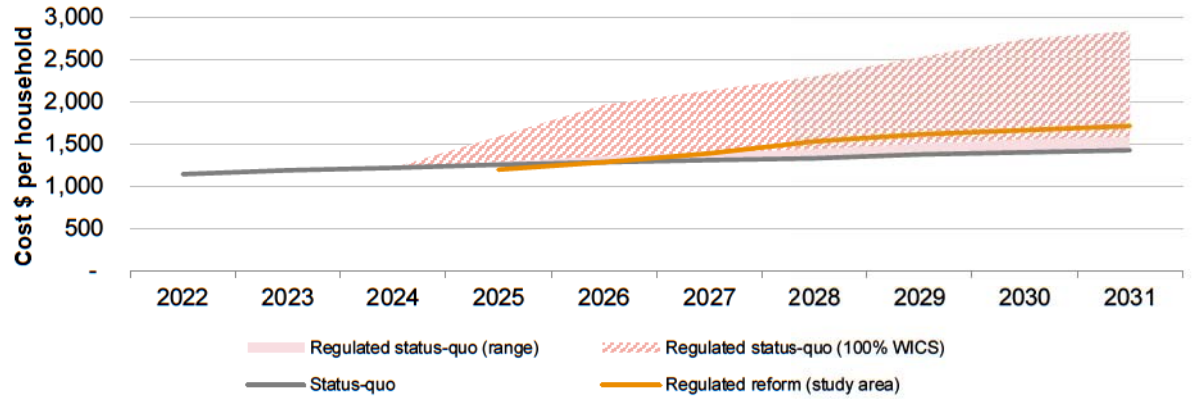
Increased costs

There is likely significant increase in cost per household, with no reserves generated to offset the cost. Under reform, average cost per household is now at the bottom of the regulated status-quo range

Significant debt burden

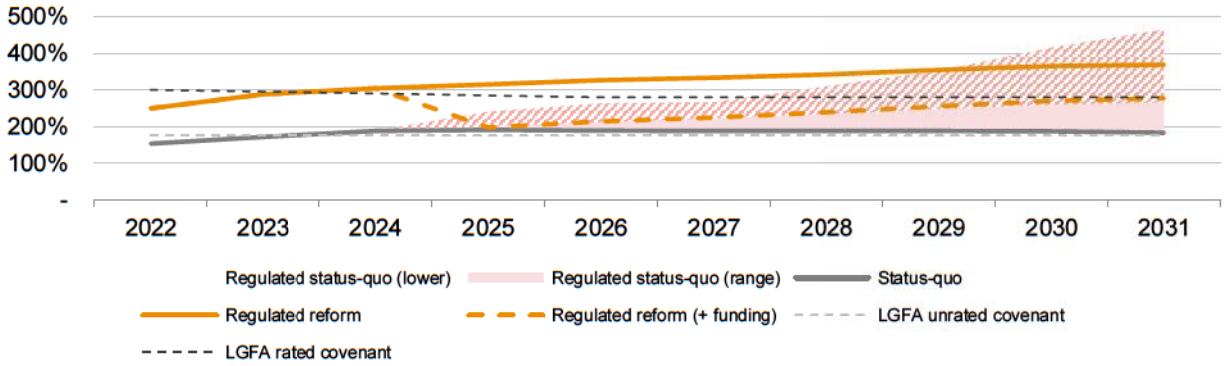
To achieve the additional capex the debt required is likely to push the Council to exceed its current LGFA covenants. Which is likely to place significant financial pressure on the council.

Average cost per household ($ per household, nominal)



Source: RFI, PwC Analysis

WDC debt to revenue



Source: RFI, PwC Analysis

A Appendix

Key terms of business and restrictions

This Report has been prepared solely for the purposes stated herein and should not be relied upon for any other purpose.

To the fullest extent permitted by law, PwC accepts no duty of care to any third party in connection with the provision of this Report and/or any related information or explanation (together, the "Information"). Accordingly, regardless of the form of action, whether in contract, tort (including without limitation, negligence) or otherwise, and to the extent permitted by applicable law, PwC accepts no liability of any kind to any third party and disclaims all responsibility for the consequences of any third party acting or refraining to act in reliance on the Information.

We have not independently verified the accuracy of information provided to us, and have not conducted any form of audit in respect of Council. Accordingly, we express no opinion on the reliability, accuracy, or completeness of the information provided to us and upon which we have relied.

The statements and opinions expressed herein have been made in good faith, and on the basis that all information relied upon is true and accurate in all material respects, and not misleading by reason of omission or otherwise.

The statements and opinions expressed in this report are based on information available as at the date of the report.

We reserve the right, but will be under no obligation, to review or amend our Report, if any additional information, which was in existence on the date of this report was not brought to our attention, or subsequently comes to light.

Certain numbers included in tables throughout this report have been rounded and therefore may not add exactly.

Reproduction of any information, data or material, including ratings ("Content") in any form is prohibited except with the prior written permission of the relevant Content Provider. Such party, its affiliates and suppliers ("Content Providers") do not guarantee the accuracy, adequacy, completeness, timeliness or availability of any Content and are not responsible for any errors or omissions (negligent or otherwise), regardless of the cause, or for the results obtained from the use of such Content. In no event shall Content Providers be liable for any damages, costs, expenses, legal fees, or losses (including lost income or lost profit and opportunity costs) in connection with any use of the Content. A reference to a particular investment or security, a rating or any observation concerning an investment that is part of the Content is not a recommendation to buy, sell or hold such investment or security, does not address the suitability of an investment or security and should not be relied on as investment advice.

This report is issued pursuant to the terms and conditions set out in our engagement letter dated 8 May 2020 and the Terms of Business attached thereto.

Thank you

pwc.co.nz

Quantifying Value of WDC Water Asset Revenues

Discussion Paper

By Stuart Henderson

23 September 2021

Introduction

This discussion paper seeks to quantify the opportunity costs associated with the reduction of debt capacity as a result of the proposed water reforms removing water revenues from Whangarei District Council (WDC) future revenues. WDC have indicated that the main impacts are:

- WDC lose a large amount of revenue, but no debt, meaning your borrowing capacity is significantly reduced
- WDC also lose the cashflow smoothing effect of Water and Wastewater rates (both are targeted rates) as you are building up reserves for both assets currently
- WDC will have to repay approximately $36 million of these reserves
- As assets are passed over, so is depreciation, maintenance and CapEx
- WDC don't pick up vested assets
- WDC have to repay Developer Contributions (DC's) collected but unspent
- There will be stranded overheads once the 3 Waters functions transfer

WDC have identified most of the above impacts and quantified them in their working model. To quantify the opportunity cost associated with the loss of revenues and impact on future debt capacity WDC can firstly establish a theoretical enterprise value associated with the forecast water revenue stream as provided by WDC's 2021 -2031 Long term Plan (LTP). The objective of determining the enterprise value is to establish a starting net present value of these cash flows in year 4 to enable WDC to intuitively compare to that of the 3 Waters entity receiving those cash flows and help quantify opportunity costs relating to the 3 Waters initiative.

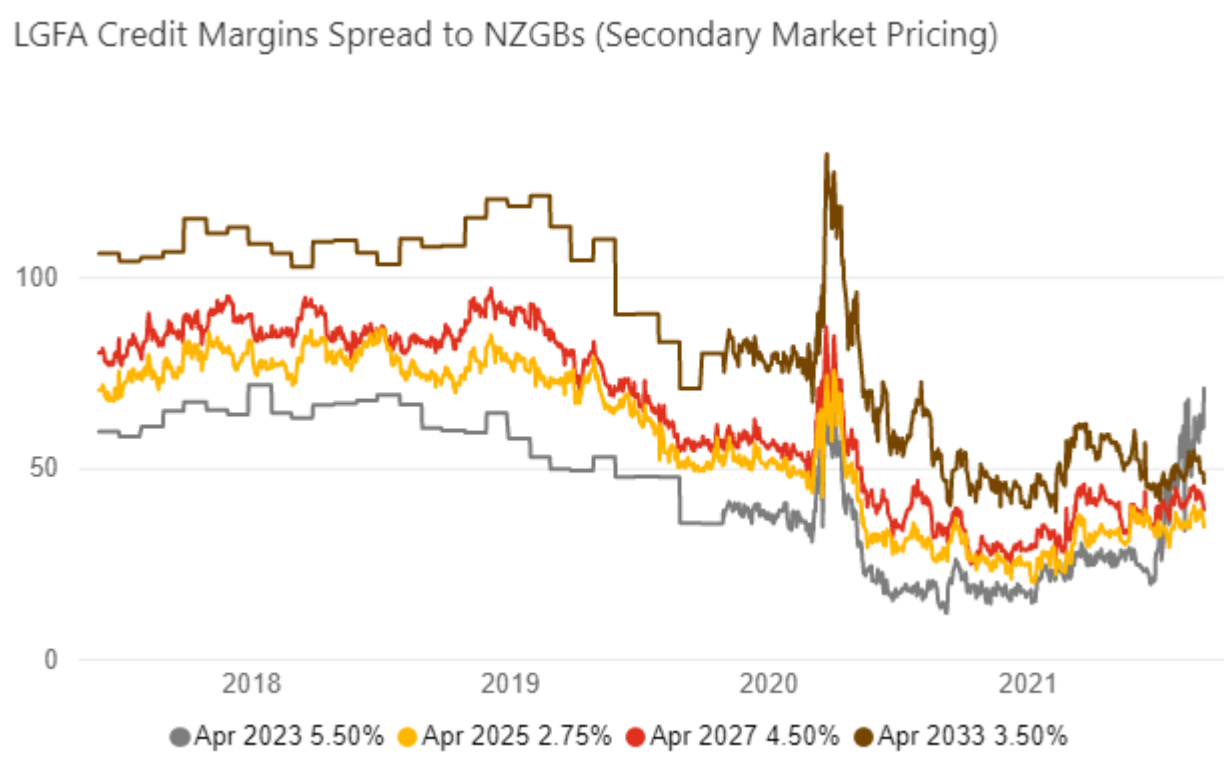
WDC cost of debt and 3 Waters cost of debt

WDC has a credit rating of AA+ from S&P Global Ratings which is one notch lower than the AAA rating provided to the New Zealand Government and LGFA for domestic long-term debt. The 3 Waters entities (4) are understood to be likely to have a standalone credit rating of A- based on the significant leverage of debt to revenue envisaged (approximately 6 x compared to the Local Government cap of 2.9x within the LGFA sourced funding program). It is further understood that the 3 Waters entities recent discussions with S&P Global indicate that the 3 Waters entities could be provided with a 5-notch credit rating uplift to AA+ being the same as WDC. This uplift will be the result of the government providing a liquidity standby facility and a perception that the entities will be supported by the New Zealand government indicatively "too big to fail". WDC currently fund through the LGFA at a margin of 0.15 % over the LGFA funding curve.

If the 3 Waters entities do achieve a credit rating uplift to AA+ it is highly probable that their funding costs will closely match that of WDC but will be higher than LGFA. It should be noted that the RBNZ currently provide Repo eligibility to LGFA long term bonds with a “haircut” of 5% as compared to Local Government Issuers with a credit rating range of AA- to AA+ having a long term “haircut” of 8%.

The following chart illustrates the margin differentiation between New Zealand Government (risk free) and LGFA (It also reflects other AAA Kauri issuers) emphasizing that not all AAA’s fund at the same price, especially when compared to New Zealand Government Bonds .

The purpose of the above summary supports the view that the projected cost of debt by the 3 Waters entities will, best-case, match that of WDC’s cost of debt through the LGFA. The key difference will be that 3 Waters can leverage WDC’s water assets (based on revenues) over twice that of WDC’s maximum capacity borrowing through the LGFA.



Enterprise Value of Water Revenues

The following summary spreadsheets illustrate the different enterprise values using a basic discounted cashflow model (DCF) based on WDC's water-based revenues contained within the 2021-2031 LTP. The first summary A) uses a discount rate based off Transpower's reported WACC of 4.57% in September 2019 to the Commerce Commission. Transpower is a good benchmark example of a 100% government owned essential infrastructure utility. Transpower has a AA credit rating and it's long term bonds are Repo eligible with the RBNZ with a "haircut" of 9% (Very close to WDC at 8%). Transpower also closely resemble 3 Waters in terms of gearing. It appears likely that 3 Waters cost of debt will be in the range of WDC (at best) and Transpower (at worst) .Transpower is comparatively highly geared (70%) and this debt leverage capacity impacts on their WACC as there is a significant weighting of debt not too dissimilar to the likely gearing of the 3 Water entities given their intention to increase the revenue to debt leverage level to approximately 6 x. Accordingly, the Transpower benchmark is a good proxy to reflect the enterprise value of WDC's water revenues from a 3 Waters perspective.

A:

1. Basic DCF Method	(1) Discount known free cash flows over forecast time horizon											
		Year 4	Year 5	Year 6	Year 7	Year 8	Year 9	Year 10				
Revenue net of reserves	0	48,845	51,434	52,073	54,018	55,764	57,566	59,698		**Discount Rate:***	4.57%	*WACC
Expenses	0	15,443	16,094	16,544	17,289	17,765	18,416	19,020	**(2) Determine Terminal Value**	**Terminal Growth Rate:***	2.00%	*Inflation
Net Water Revenue	**0**	**33,402**	**35,340**	**35,529**	**36,729**	**37,999**	**39,150**	**40,678**	**1,614,446**			
Discount Rate	*1.05*	*1.09*	*1.14*	*1.20*	*1.25*	*1.31*	*1.37*	*1.43*	*1.43*			
	0	30,546	30,906	29,714	29,375	29,062	28,634	28,451	1,129,189			
(3) Determine Year 4 Valuation	**1,335,878**											
Determine Current Valuation (Year 0)	**1,168,276**											
Basic Sense Check:												
Current Multiple:	35.0	times										
Terminal Multiple	39.7	times										

The above enterprise value using a **4.57**% WACC provides an enterprise value in year 4 at $1.168 billion against debt of $325 million. Please note that expenses are cash and exclude non-cash expenses such as depreciation. Revenue has treated reserves as pre-paid revenues and accordingly accumulated reserves of $36 million have been spread (approx. $5 million pa) over the valuation term and excluded from Revenue.

The following summary spreadsheet adjusts the WACC to reflect comparative changes to underlying cost of equity, interest rates and relevant credit spreads since September 2019. The new WACC is rounded to **4.2** %.

B:

1. Basic DCF Method	(1) Discount known free cash flows over forecast time horizon											
		Year 4	Year 5	Year 6	Year 7	Year 8	Year 9	Year 10				
Revenue net of reserves	0	48,845	51,434	52,073	54,018	55,764	57,566	59,698		**Discount Rate:***	4.20%	*WACC
Expenses	0	15,443	16,094	16,544	17,289	17,765	18,416	19,020	**(2) Determine Terminal Value**	**Terminal Growth Rate:***	2.00%	*Inflation
Net Water Revenue	**0**	**33,402**	**35,340**	**35,529**	**36,729**	**37,999**	**39,150**	**40,678**	**1,885,966**			
Discount Rate	*1.04*	*1.09*	*1.13*	*1.18*	*1.23*	*1.28*	*1.33*	*1.39*	*1.39*			
	0	30,763	31,236	30,138	29,900	29,687	29,353	29,269	1,357,039			
(3) Determine Year 4 Valuation	**1,567,387**											
Determine Current Valuation (Year 0)	**1,385,393**											
Basic Sense Check:												
Current Multiple:	41.5	times										
Terminal Multiple	46.4	times										

The above enterprise value using a 4.2% WACC provides an enterprise value in year 4 at $1.385 billion against debt of $325 million. This is a reasonable proxy for 3 Waters.

WDC has a different profile in terms of a tighter revenue gearing constraint and essentially has a higher WACC due to the 2.8 x revenue to debt cap. On a comparative basis this would increase the WACC to approximately **5.42** % as illustrated.

C:

1. Basic DCF Method	(1) Discount known free cash flows over forecast time horizon											
		Year 4	Year 5	Year 6	Year 7	Year 8	Year 9	Year 10				
Revenue net of reserves	0	48,845	51,434	52,073	54,018	55,764	57,566	59,698		Discount Rate:*	5.42%	*WACC
Expenses	0	15,443	16,094	16,544	17,289	17,765	18,416	19,020	(2) Determine Terminal Value	Terminal Growth Rate:*	2.00%	*Inflation
Net Water Revenue	**0**	**33,402**	**35,340**	**35,529**	**36,729**	**37,999**	**39,150**	**40,678**	**1,213,195**			
Discount Rate	*1.05*	*1.11*	*1.17*	*1.24*	*1.30*	*1.37*	*1.45*	*1.53*	*1.53*			
	0	30,056	30,164	28,767	28,210	27,685	27,056	26,667	795,328			
(3) Determine Year 4 Valuation	**993,933**											
Determine Current Valuation (Year 0)	**848,375**											
Basic Sense Check:												
Current Multiple:	25.4	times										
Terminal Multiple	29.8	times										

The above enterprise value using a 5.42% WACC provides an enterprise value in year 4 at $848 million against maximum debt of $152 million.

To complete the full picture in terms of quantifying the opportunity cost to WDC from the removal of water revenues and subsequent debt capacity constraint we need to model the current status quo in that WDC currently have no debt against the water-based revenues and accordingly the WACC will reflect the current market cost of equity for essential infrastructure (Utility) assets estimated at 7%.

D:

1. Basic DCF Method	(1) Discount known free cash flows over forecast time horizon											
		Year 4	Year 5	Year 6	Year 7	Year 8	Year 9	Year 10				
Revenue net of reserves	0	48,845	51,434	52,073	54,018	55,764	57,566	59,698		Discount Rate:*	7.00%	*WACC
Expenses	0	15,443	16,094	16,544	17,289	17,765	18,416	19,020	(2) Determine Terminal Value	Terminal Growth Rate:*	2.00%	*Inflation
Net Water Revenue	**0**	**33,402**	**35,340**	**35,529**	**36,729**	**37,999**	**39,150**	**40,678**	**829,825**			
Discount Rate	*1.07*	*1.14*	*1.23*	*1.31*	*1.40*	*1.50*	*1.61*	*1.72*	*1.72*			
	0	29,174	28,848	27,105	26,188	25,321	24,381	23,675	482,966			
(3) Determine Year 4 Valuation	**667,657**											
Determine Current Valuation (Year 0)	**545,007**											
Basic Sense Check:												
Current Multiple:	16.3	times										
Terminal Multiple	20.4	times										

The above enterprise value using a **7.0%** WACC provides an enterprise value in year 4 at $545 million against maximum debt of $152 million.

Assuming that Transpower is an acceptable counter factual in terms of establishing a meaningful comparative enterprise value, the above values allow WDC to approximate the opportunity cost to WDC in terms of measuring the value of the loss of debt capacity caused by the loss of future water revenues.

WDC direct opportunity cost = the difference between (Enterprise value C less debt) and (Enterprise value D less debt). C = ($848 million - $152 million = $698 million) and D = ($545 million - $0 million) =$545 million.

WDC direct opportunity cost = $698 million - $545 million = **$153** million.

If equity component of WACC is increased by 1% to 8% then the difference is reduced to **$105** million.

Conclusion

The above enterprise values reflect the differing gearing scenarios of the underlying water assets and their revenues. As a starting point the above year 4 enterprise values are conservative net present values of WDC's water asset revenues out to year ten (starting in 4 years) under differing WACC scenarios. In reality, the underlying assets have significantly longer lives and years 10-25 years of water asset revenues should be modelled.

WDC's "opportunity cost" from reduced debt capacity caused by the loss of water revenue is reflected in the difference between C and D as the enterprise values quantify the effective relationship between revenues and debt capacity. Depending on accepted views on WACC the opportunity cost to WDC sits somewhere between $105 million and $153 million.

RESOLUTION TO EXCLUDE THE PUBLIC

That the public be excluded from the following parts of proceedings of this meeting.

The general subject of each matter to be considered while the public is excluded, the reason for passing this resolution in relation to each matter, and the specific grounds under Section 48(1) of the Local Government Official Information and Meetings Act 1987 for the passing of this resolution are as follows:

1.	The making available of information would be likely to unreasonably prejudice the commercial position of persons who are the subject of the information. {Section 7(2)(c)}
2.	To enable the council (the committee) to carry on without prejudice or disadvantage commercial negotiations. {(Section 7(2)(i)}.
3.	To protect the privacy of natural persons. {Section 7(2)(a)}.
4.	Publicity prior to successful prosecution of the individuals named would be contrary to the laws of natural justice and may constitute contempt of court. {Section 48(1)(b)}.
5.	To protect information which is the subject to an obligation of confidence, the publication of such information would be likely to prejudice the supply of information from the same source and it is in the public interest that such information should continue to be supplied. {Section7(2)(c)(i)}.
6.	In order to maintain legal professional privilege. {Section 2(g)}.
7.	To enable the council to carry on without prejudice or disadvantage, negotiations {Section 7(2)(i)}.

Resolution to allow members of the public to remain

If the council/committee wishes members of the public to remain during discussion of confidential items the following additional recommendation will need to be passed:

Move/Second

"That _____ be permitted to remain at this meeting, after the public has been excluded, because of his/her/their knowledge of Item _____.

This knowledge, which will be of assistance in relation to the matter to be discussed, is relevant to that matter because _____.

Note:

Every resolution to exclude the public shall be put at a time when the meeting is open to the public.