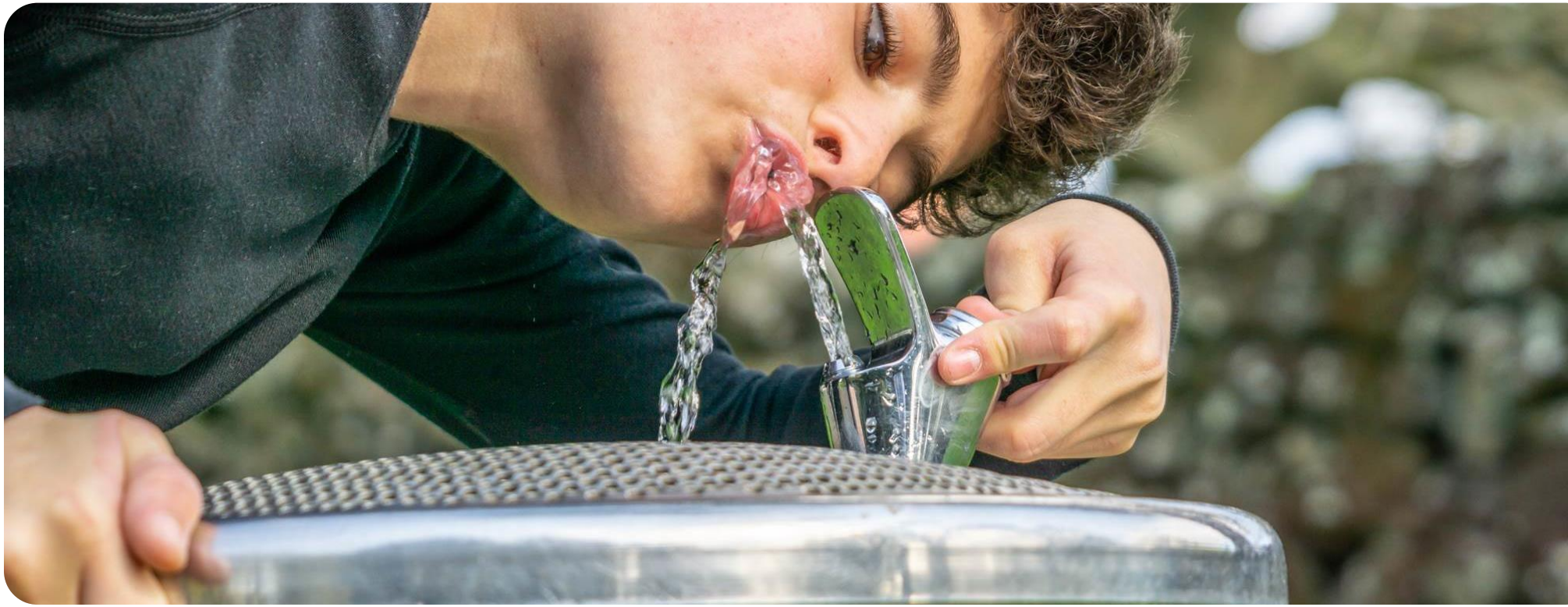

Current state review and high-level options assessment for water services delivery

Whakatāne District Council

Final Report

02 December 2024

Commercial in Confidence

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Introduction

Whakatāne District Council engaged MartinJenkins to undertake a review of its current water services delivery model and a high-level assessment of alternative options.

In line with the requirements for local authorities to prepare Water Services Delivery Plans, the Council wishes to understand whether it will be viable and sustainable for it to continue to deliver water services by itself into the future.

This assessment will inform Council's decision on whether to prepare its own Water Services Delivery Plan (and continue to deliver services on a standalone basis) or, alternatively, whether to work with neighbouring councils to explore joint service delivery arrangements.

Local Water Done Well will increase expectations on councils to demonstrate their delivery of water services is sustainable

The Government's Local Water Done Well policy means councils across New Zealand will need to assess whether their water services delivery arrangements are, and will continue to be, financially sustainable over the medium- to longer-term.

Councils will also need to consider whether existing service delivery arrangements will continue to meet community expectations regarding levels of service and affordability.

Future legislation is expected to require that councils demonstrate their water services can stand on their own two feet. This means that:

- rates and water charges are ring-fenced and only used to pay the costs of water services
- rates and water charges generate sufficient revenue to fully-fund operating, depreciation and financing costs over the medium-term
- investment to maintain and renew assets, meet regulatory requirements, and provide for growth can be funded and financed on a sustainable basis.

Assessing current service delivery arrangements and potential alternatives requires a holistic approach

We have undertaken a holistic, high-level assessment of the viability and sustainability of current service delivery arrangements, taking account of network performance, levels of service, asset condition, regulatory compliance, investment needs, financial projections, and affordability of water rates and charges.

We have then considered the main options available to Whakatāne District Council informed by the broader strategic context being faced by its community.

We have undertaken this assessment against the backdrop of cost pressures, population changes, impacts of climate change, and the Council's financial position and borrowing capacity. Councils also need to anticipate likely future requirements from economic regulation, including the additional compliance costs this is expected to bring.

This report presents the findings from our assessment and makes some suggestions regarding matters to further consider as part of preparing a Water Services Delivery Plan for Whakatāne District Council.

Overview of Council water services

Snapshot of water services

	Water supply	Wastewater	Stormwater
Contribution to local community outcomes	To provide safe, reliable and sustainable water supply to the district.	To provide services to collect, treat, and dispose of wastewater in a safe and sustainable way that protects public health and doesn't compromise ecosystems.	Protect people and property from flooding impacts and safeguard public health from the adverse effects of stormwater run-off.
Services	**13,056** drinking water connections	**12,143** wastewater connections	**10,650** stormwater connections
Assets	The Council has nine water supply schemes and owns, operates and maintains 11 treatment plants, 20 pump stations (includes groundwater bore pump sites), 23 reservoirs and 618km of pipes. There are 16 consents associated with the take and use of water.	The Council has six wastewater schemes and owns, operates and maintains six treatment plants, 55 pump stations, and 249 km of piped assets. There are 13 consents associated with the treatment of wastewater including the discharge of treated wastewater to land and water, and odour.	The Council manages nine stormwater schemes. The network includes 19 pump stations, 281km of streams, 1,560 manholes and 118km of piped assets. Council is in the process of applying for a comprehensive stormwater consent for its Whakatāne scheme and other areas in the district will follow.
Replacement asset value	**$209.3m**	**$115.9m**	**$129.5m**
Challenges	• Treatment upgrades to meet the requirements of the Drinking Water Quality Assurance Rules • Water source challenges including saline intrusion, farm runoff and potential cyanobacteria presence. • Potential for problems to develop in small community supplies present a risk to Council.	• Wastewater Treatment Plant upgrades to support re-consenting for four of six WWTPs - Whakatāne, Edgecumbe, Tāneatua, and Murupara. • Future regulatory framework uncertainty. • Impacts of geography and climate change on compliance (e.g. inflow and infiltration) and available wastewater discharge options. • Gaps in asset condition information (pump and plant).	• Potential climate change and sea level rise impacts on network. • Asset condition information is poor in comparison with water supply and wastewater.

Current service delivery model

Inhouse resources

Water services are primarily delivered by the Three Waters team located within the Council's Infrastructure Group.

The Three Waters Manager leads a team of approximately 35 staff delivering:

- Operations and maintenance
- Asset management
- Capital works delivery (project management)
- Administration support (trade waste and meter reading sit in this group).

Compliance monitoring and reporting, including managing resource consents, sits in the Development and Environment Group.

A number of other teams across the Council support the delivery of water services, including but not limited to finance (budgeting and financial reporting, rates, and procurement), information services (systems), and strategy (strategies, planning and reporting).

Outsourced delivery

The Council contracts delivery of capital projects.

Activity	Planning & Management	Operations & Maintenance	Capital Delivery
Water supply	Inhouse	Inhouse	Outsourced (Inhouse project management)
Wastewater	Inhouse	Inhouse	Outsourced (Inhouse project management)
Stormwater	Inhouse	Inhouse	Outsourced (Inhouse project management)

Progress over the last three years

- Significant improvement in understanding of asset condition.
- Increasing levels of coverage for water supply metering – 94% of connections across the district are metered, though not all have volumetric charging in place.
- Significant reduction in water loss from unmetered schemes, related to increased metering and leak detection.
- Early warning systems in place for watermain breaks (water pressure sensors) and wastewater overflows (manhole sensors).

Challenges

- Compliance challenges for drinking water and future wastewater consents – significant investment required.
- Workforce challenges; aging workforce and challenges to attract and retain.
- Funding and financing challenges and future affordability for ratepayers in the district.
- Geographically disparate communities – most schemes service small populations.
- Natural hazards/events and climate change effects with low lying settlements and high ground water.
- Balancing expectations for environmental outcomes with affordability.
- Potential future demand to service areas that are currently un-serviced.

Council water networks

Water supply

There are nine drinking water supply schemes across the district - Whakatāne/ Ōhope, Otumahi, Rangitāiki Plains, Tāneatua, Murupara, Matatā, Waimana, Rūātoki, and Te Mahoe).

The Council owns, operates and maintains 11 treatment plants, 20 pump stations (includes groundwater bore pump sites), 23 reservoirs and 618km of pipes. With large areas of the district being rural and, in some cases, isolated, many households have independent systems supplying their own needs.

Wastewater

Six wastewater schemes cover 1,690 hectares of land, providing wastewater services to the urban and residential areas of Whakatāne, Edgecumbe, Tāneatua, Ōhope, Te Mahoe, and Murupara.

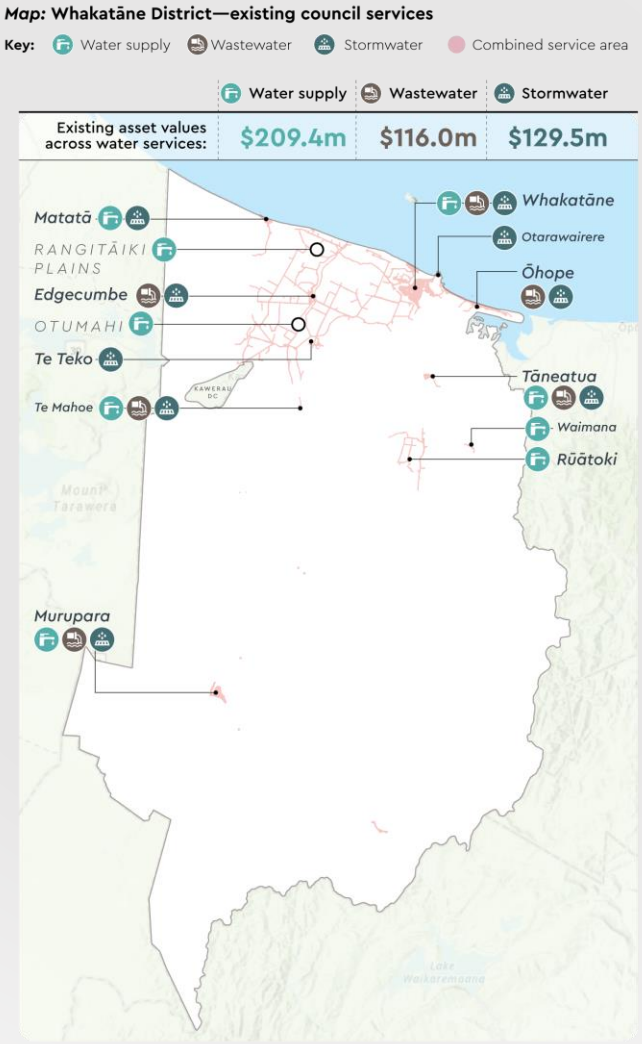
The Council owns, operates and maintains six treatment plants, 55 pump stations, and 249 km of piped assets.

Stormwater

The Council manages eight stormwater schemes which cover over 1,700 hectares of land and 78 percent of the population in the district.

The Council's stormwater network includes 19 pump stations, 281km of streams, 1,560 manholes and 118km of piped assets.

***Map:* Whakatāne District—existing council services**



Planned investment over the next 10 years:	Water supply	Wastewater	Stormwater
Total	$103.6m	$30.0m	$19.3m
What this planned investment looks like across key areas:			
Cross-district	$64.0m	$38.5m	$7.9m
Whakatāne-Ōhope	$9.1m	$9.0m	$9.2m
Otarawairere	N/A	N/A	$0
Te Mahoe	$0	$0	$0
Tāneatua	$0.4m	$0	$0
Rūātoki	$4.1m	N/A	N/A
Waimana	$0	N/A	N/A
Rangitāiki Plains	$10.1m	N/A	N/A
Otumahi-Edgecumbe	$7.2m	N/A	$2.3m
Te Teko	N/A	N/A	$0
Murupara	$8.7m	$0.3m	$0
Matatā	$0	$42.4m	$0

Asset condition

Water supply

Water supply assets are relatively younger than for wastewater and stormwater with peak installation during the 1990s.

There is good understanding of the condition of all water supply assets. Between 92 and 100% (by asset type) of the piped drinking water supply network has been assessed and around 11% percent falls into the poor or very poor category.

Nearly a third of the Council's reservoirs have been assessed as being in poor condition.

Wastewater

Wastewater assets are relatively older than both water supply and stormwater assets, with the peak decade for wastewater asset installation the 1960s.

There is good understanding of the condition of the piped wastewater network (between 95 and 100% assessed depending on type) but poor understanding for other types of wastewater assets including pumps and plants. Between 0 and 14% of piped assets falls into the poor or very poor category depending on the different asset types.

Treatment plants are variants of simple oxidation ponds, have not been condition assessed and are nearing the end of their consented lives. The exception to this is Te Mahoe, which has sand filters and a land application field.

It is worth noting that a not insignificant proportion of both wastewater and water supply pipes are older asbestos cement pipes (22% and 23% by value respectively). Asbestos cement pipes pose a resilience problem for Council as they become brittle with age and are prone to longitudinal cracking making repairs difficult.

Stormwater

While relatively young by New Zealand standards, portions of the network are now 'mature'. The 1970s was the decade with the greatest installation length.

There is relatively good understanding of the condition of above ground stormwater assets (e.g. pumps and floodgates) with over 70% been assessed but poor understanding for underground piped stormwater assets. Around 10% of assessed network have been categorised as either poor or very poor. Ongoing CCTV programmes will assist further verification of the condition of piped assets.

Stormwater drainage assets differ from drinking and wastewater assets in that they are predominately concrete. Concrete is generally robust with a long lifespan.

Water supply		% of asset value (cost)	Average age	Average life remaining
Linear	ACO	23%	53	13
	PVC/PE	46%	20	81
	Other	4%	35	43
Point and plant		28%	27	17

Wastewater		% of asset value (cost)	Average age	Average life remaining
Linear	ACO	22%	54	14
	PVC/PE	16%	27	77
	Other	17%	36	41
Point and plant		44%	27	26

Stormwater		% of asset value (cost)	Average age	Average life remaining
Linear	Concrete	70%	43	57
	Other	11%	35	46
Point and plant		19%	28	29

Asset maintenance and renewals

Renewals strategy

The Council's renewal approach aims to renew assets when they reach the end of their useful lives. Proactive renewal work is primarily targeted to those assets assessed as being in poor or very poor condition, but Council acknowledges renewal decision making isn't simple given the variety of factors that need to be weighed.

The Council is developing a renewals framework for piped assets based on international and local standards to support renewals decisions. The framework allows decision makers to weigh:

- the consequence and likelihood of failure – including social, environmental and economic impacts, and based on understanding of the condition and performance of the assets
- capacity requirements of the network – for future growth and current constraints
- opportunities for cost efficiency – for example, planned roading upgrades.

As part of setting the LTP, Council made decisions to defer investment including by reducing renewals of existing assets down to 70 percent of what the needs-based AMP recommends.

Renewals backlog

In recent years, water infrastructure renewals have fallen short of depreciation, indicating that asset age is increasing, potentially indicating a deterioration in asset condition that may impact on future levels of service.

Council analysis estimates a $96 million renewals backlog:

- Water supply – $55.8 million
- Wastewater – $36.7 million
- Stormwater – $3.3 million

These estimates are based on assets' theoretical end-of-life rather than actual asset performance.

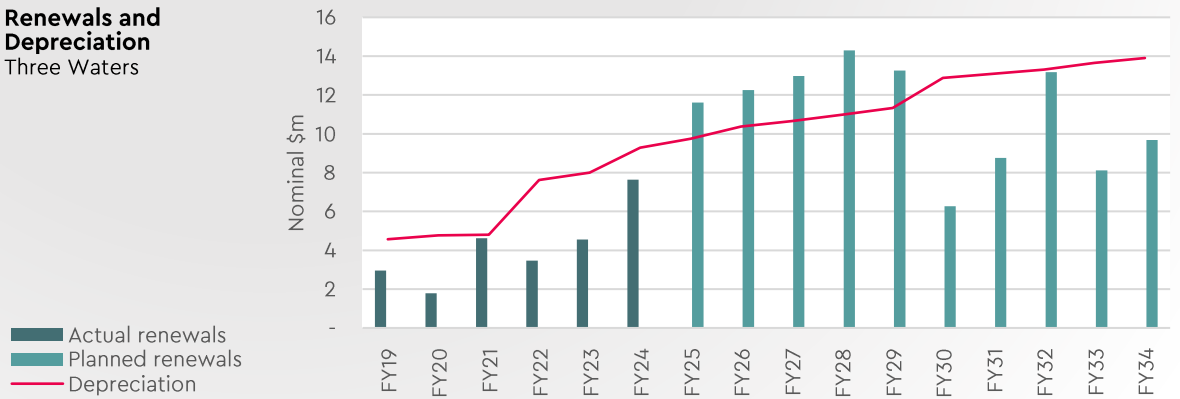
Renewals and depreciation

While renewals investment requirements are lumpy over time, reflecting the uneven pattern of historic development, over the longer-term renewals investment should come into line with the level of depreciation expense. We note that depreciation is based on asset replacement values that make no allowance for asset optimisation (e.g. relining pipes rather than full asset replacement).

The Council spent $25.0 million on three waters renewals over the last six years compared with depreciation expense of $39.0 million (renewals capex averaging of 64% depreciation).

Over the next ten years, the Council is planning to spend $110.3 million on renewals, or around 93% of the projected depreciation expense.

Renewals and Depreciation
Three Waters



Drinking water compliance

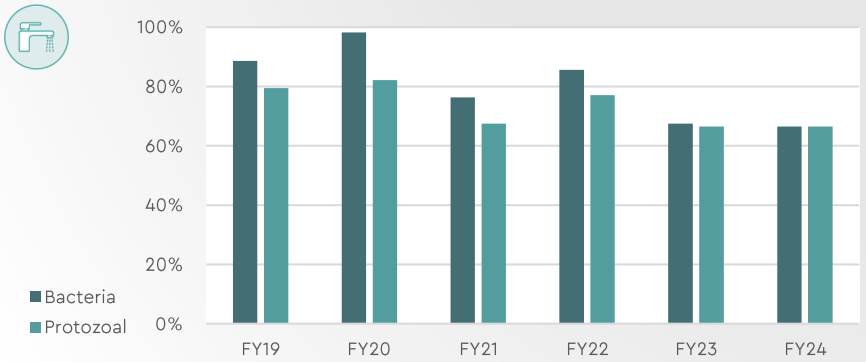
Consistent compliance with the DWQAR by scheme is low

Only one scheme, Whakatāne, is consistently compliant requirements for bacterial and protozoal treatment in the Drinking Water Quality Assurance Rules (DWQAR). This equates to 66% of the serviced population (due to the relative size of the different schemes).

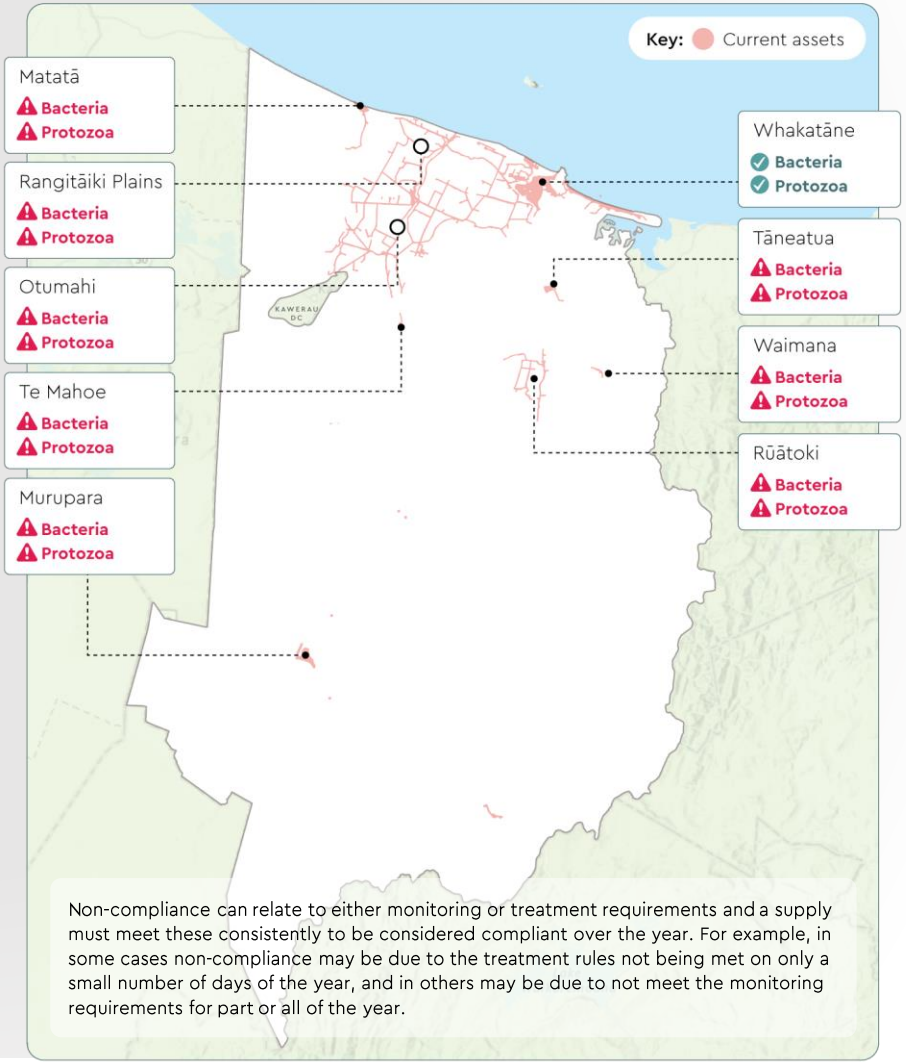
The two largest sources of risk to the community are the Rūātoki (water source) and Murupara (treatment) schemes. Council is investigating alternative water sources for the Rūātoki supply and consultation is underway with iwi and the community in Murupara regarding drinking water treatment options for the Murupara supply. Capital investment is shown in the early years of the LTP to address compliance issues for these schemes.

Other non-compliance is considered by the Council to be less critical as these are generally based around additional regulatory monitoring requirements, and ongoing Supervisory Control and Data Acquisition system upgrade. The Council has started to address these improvements and will continue based on availability of budgets.

Percentage of serviced population with compliant supply



Uses FY24 population data as basis for all calculations



Environmental compliance

Current consents

Whakatāne District Council currently has 16 consents for water take, 13 relating to wastewater and 46 for stormwater discharge. The stormwater discharge consents include some for temporary discharges associated with construction works. Fourteen of the consents are expired.

Water supply

Quantity of take is generally well within limits for all water take consents.

In FY24, a moderate non-compliance rating was issued due to take from the Waimana bore exceeding limits on two days, and failure to meet monitoring requirements led to non-compliance ratings for two months in a row at Johnson Road.

Wastewater

The Council has not received abatement or infringement notices nor enforcement orders nor conviction for its wastewater consents in FY24. However, there are instances where consent conditions have not been complied with from time to time.

In FY24, site audits led to a moderate non-compliance rating being issued for a Whakatāne WWTP outfall leakage incident, and moderate non-compliance ratings based on performance monitoring reports were issued for a flow meter issue at Murupara WWTP (since rectified) and exceedances in the daily effluent discharge volumes at Edgecumbe WWTP.

Stormwater

Expired consents primarily relate to stormwater and all are operating under a s124 exemption. The Council is working towards obtaining a comprehensive stormwater consent for its Whakatāne scheme and other areas will follow (a CSC for Ōhope is planned next).

The majority of stormwater consents do not require compliance monitoring and no non-compliance ratings were issued in FY24 for stormwater consents.

Future consents

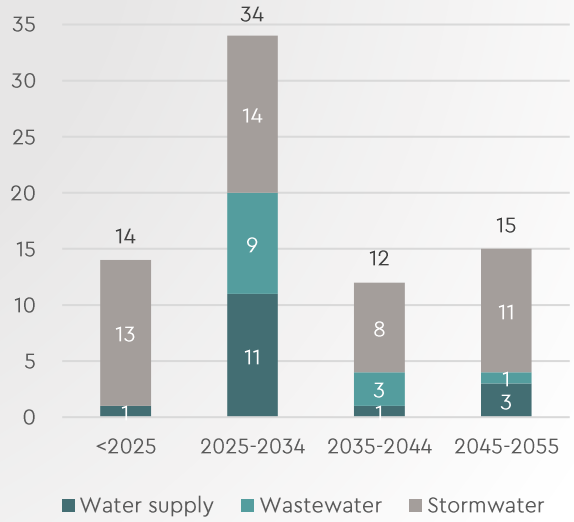
Looking ahead, a further 34 (45%) of consents will be expiring in the next decade. A significant number of consents expire on 1 October 2026, including consents associated with four wastewater treatment plants, eight water supply schemes and various stormwater discharges.

Council has developed a consent replacement strategy to address upcoming consent replacements for water supply and wastewater, and a project is underway to implement this strategy and manage the reconsenting process.

These consents were all granted before the introduction of the RMA in 1991 with compliance requirements set at a 'basic' level meaning that compliance is relatively easily achieved. Planning is happening in the context of uncertainty regarding future regulatory settings, including with the introduction of national wastewater environmental performance standards, but future consent conditions are expected to be more prescriptive and require significant upgrades to treatment plants to achieve compliance.

It is estimated that around $200 million will be required to upgrade facilities – nearly all of which relates to four WWTPs for Whakatāne, Edgecumbe, Tāneatua, and Murupara – with increased ongoing operational costs associated with more advanced infrastructure. The bulk of this cost is not provided for in the current LTP and is sitting in year 11 onwards of the AMP.

Expiry dates for resource consents
Three Waters



Service levels – customer complaints

Service levels are measured across each activity by recording the number of complaints per year alongside the time it takes for Council to respond and resolve service issues.

Customer complaints

Customer complaints are measured by the total number of complaints received per 1,000 connections. In FY22, Council consolidated its water supply and wastewater complaint reporting into single measures.

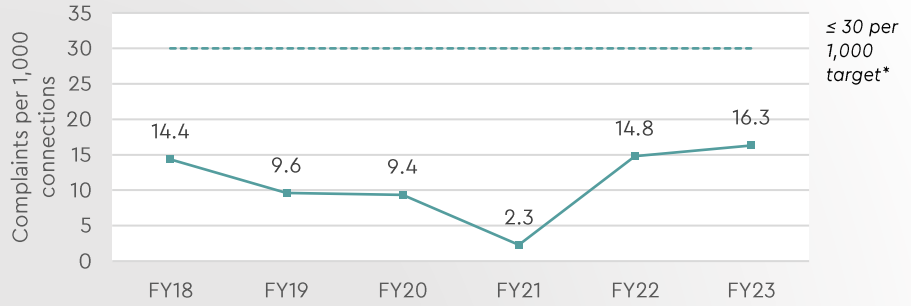
Water supply: The apparent increase in complaints in FY22 and 23 is largely attributable to changes in reporting methodology to better align with the DIA performance measure guidelines.

Wastewater: The high result in FY18 related to high number of complaints about system faults and blockages.

Stormwater: Complaints approached the target in FY22, attributed to a significant increase in rainfall in six of the months relative to the year before.

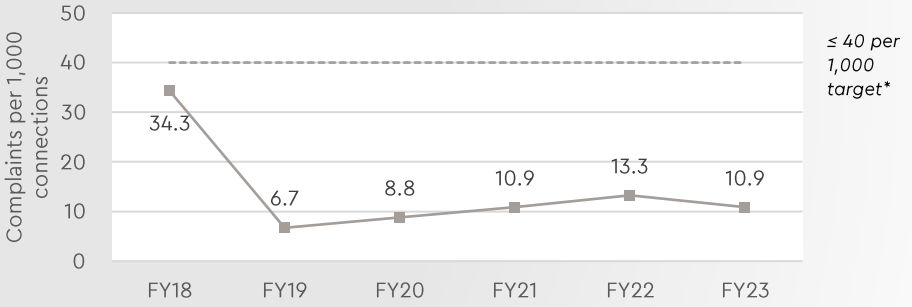
Water supply: Customer complaint rate vs target

Complaints received about drinking water clarity, taste, odour, pressure of flow, continuity of supply and the Council's response to any of these issues.



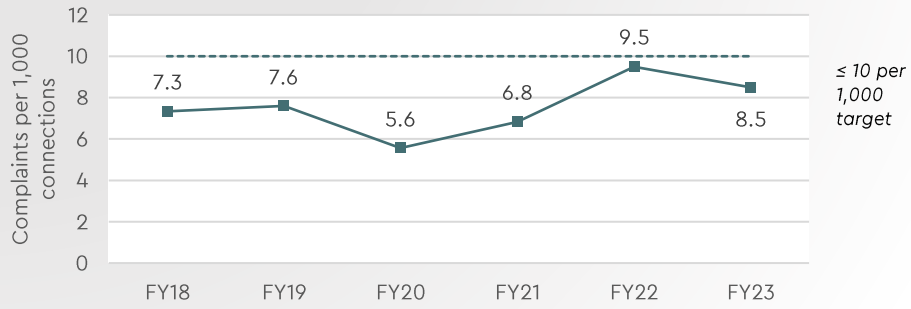
Wastewater: Customer complaint rate vs target

Complaints received about sewage odour, sewerage system faults, system blockages and the Council's response to any of these issues.



Stormwater: Customer complaint rate vs target

Complaints received about the performance of the stormwater system.



**Water supply and wastewater targets beginning FY22 (when reporting was consolidated) have been applied across all years but are not directly comparable.*

Service levels – customer resolution

Response times

Response times are measured by the time it takes for Council to respond, attend and resolve service issues.

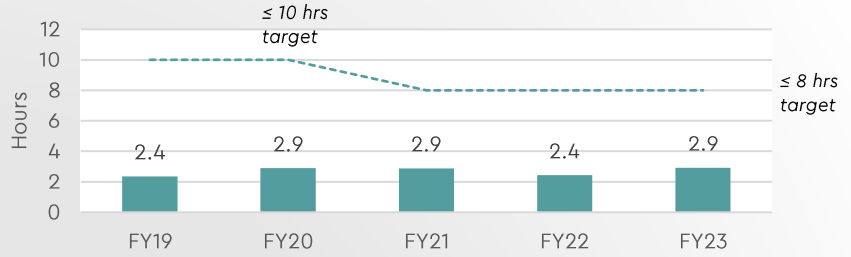
Water supply: Response times are measured for both urgent and non-urgent callouts. Resolution times for both urgent and non-urgent callouts have been relatively consistent over the last six years and are well within target times.

We note that the target response time for non-urgent callouts was revised downwards substantially in FY21 to a more realistic level than the previously high tolerance.

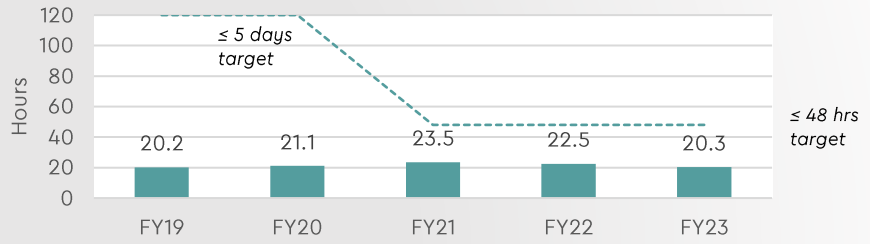
Wastewater: Wastewater resolution response times have fluctuated slightly over the past six years but are well within target times.

Stormwater: Stormwater attendance response times are only reported during flooding events, therefore the only data reported is for FY21.

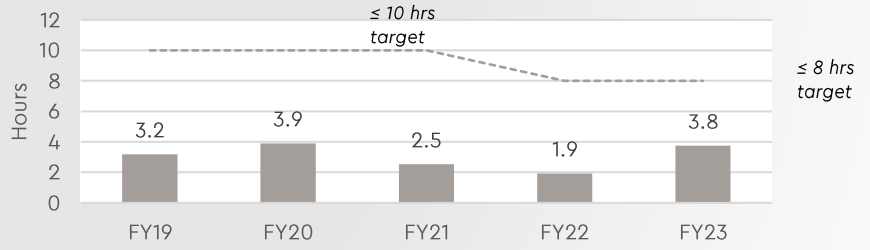
Water supply: Resolution response time against target (urgent)



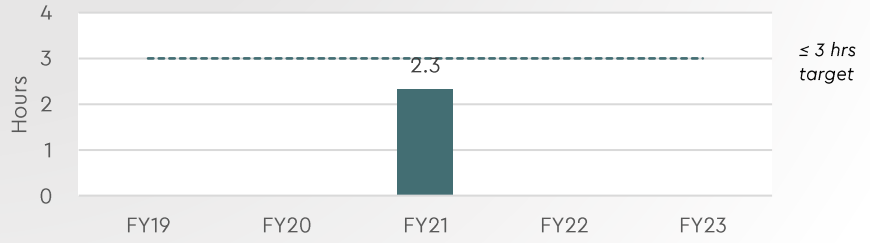
Water supply: Resolution response time against target (non-urgent



Wastewater: Resolution response time against target



Stormwater: Attendance response time against target



Network performance and usage – water supply

Across the district 94% of connections are now metered to support demand management, though not all are used for volumetric charging.

Water consumption

Water consumption for metered properties increased significantly in FY21 and has continued increasing. While 94% of connections are now metered, many do not have volumetric charging which could incentivise reduced consumption. Meters are installed on properties in both urban and rural area, and include high consumption industrial and farm connections.

Consumption for unmetered properties also jumped in FY21 with a slight decrease in the last two years. It is possible that lower rainfall in FY21 may have contributed to this pattern.

Water loss

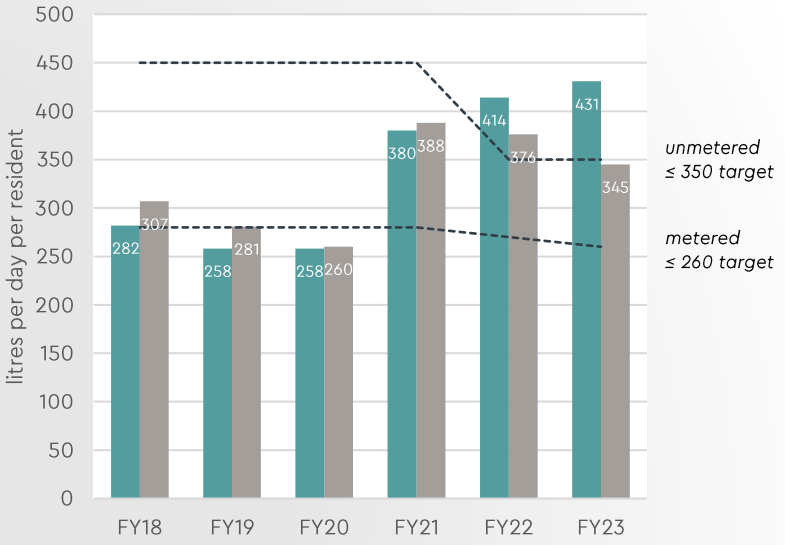
Water loss is the only network performance measure reported for water supply.

The pattern for metered versus unmetered properties is complex, as connections with meters where there is no volumetric charging are included in the 'unmetered' category for reporting purposes. For example, water loss from unmetered schemes has come down significantly over the last six years and this actually relates to increased leak detection through metering.

Water loss from metered schemes has generally been consistent and significantly lower than that from unmetered schemes. The high result in FY18 is likely because any water consumed by users of an unread meter calculated as 100% loss.

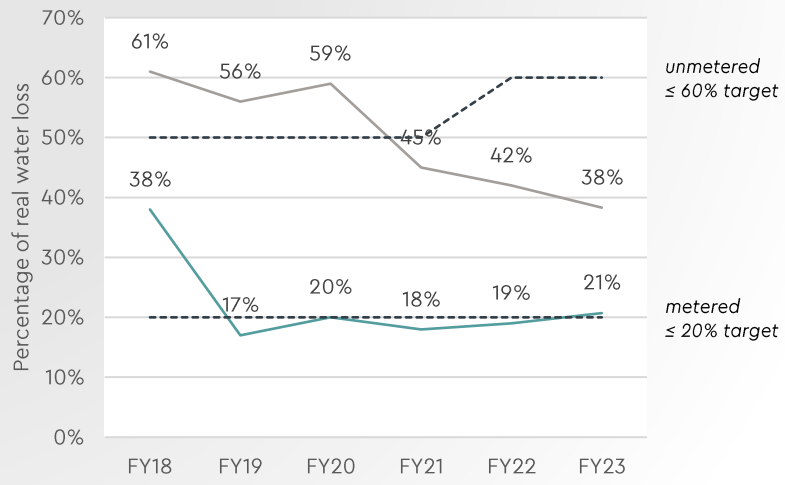
Water consumption

All metered connections are included in 'metered' for water consumption reporting purposes, regardless of charging mechanism



Water loss

Metered connections with no volumetric charging are included in 'unmetered' for water loss reporting purposes



Network performance – wastewater and stormwater

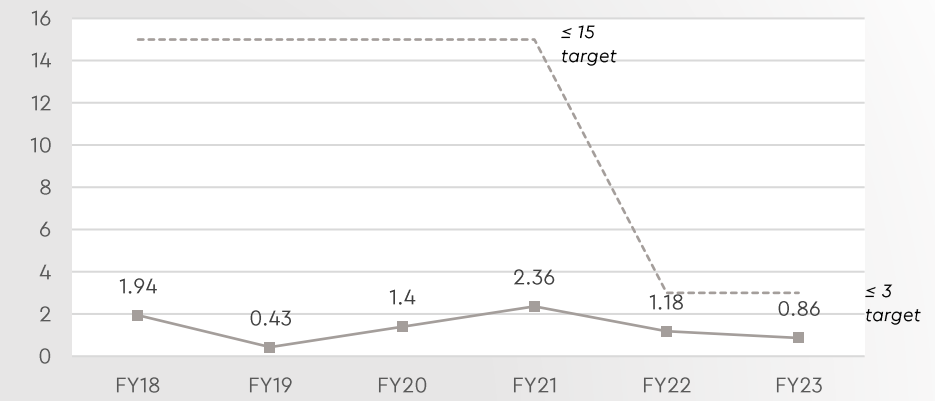
There are limited network performance measures for wastewater and stormwater.

Wastewater: Dry weather overflows are consistently within target levels.

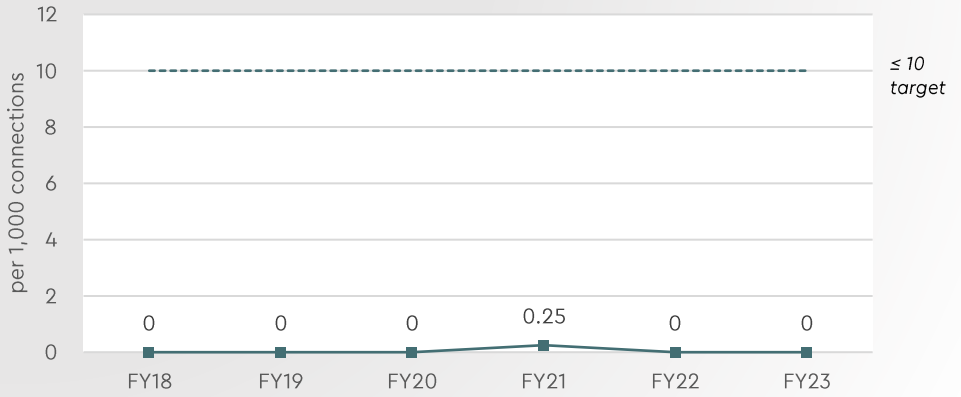
We note that the target level was revised downwards substantially in FY22 to a more realistic level than the previously high tolerance.

Stormwater: Habitable floors flooding occurred in FY21, but flooding levels were well within the Council's target range.

Wastewater: Dry weather overflows



Stormwater: Flooding (habitable floors)



Community supplies

Council is required to assess water services in its district, and to ensure safe drinking water is provided

Part 7 of the Local Government Act 2002 requires local authorities to undertake assessments of water services every three years. The first assessment is required by 1 July 2026.

Assessments are required to cover both Council and non-Council supplies (excluding domestic self-suppliers) and include (amongst other things) a description of the safety and quality of drinking water currently being supplied and identification and assessment of any public health risks.

Responsibilities if community supplies develop problems

If a private or community water supplier faces a significant problem with any of its drinking water services, and if required by Taumata Arowai, the Council must work with the supplier, the community, and Taumata Arowai to identify a solution to the problem.

The Council also has a statutory obligation to ensure that safe drinking water is provided to the affected consumers on a temporary or permanent basis, if the supplier is unable to continue to provide a service that meets the statutory requirements, or if an alternative solution is not readily available or cannot be agreed by the parties within a timeframe set by Taumata Arowai.

Community supplies present a risk to councils

Small and rural supplies represent a risk because they often have a combination of: unreliable water sources; basic treatment processes (e.g. filtration and chlorine dosing); lack of remote control and continuous monitoring; manually intensive operations and maintenance requirements; non-standardised plant and equipment (often installed on a DIY basis); potential for cross-connection to higher risk systems (e.g. dairy sheds) and insufficient backflow protection; minimal asset information or documentation; key person risks (e.g. knowledge of operations in a limited number of people); and mixed or unclear ownership and governance.

Around the country, small rural and community supplies are expected to face challenges upgrading infrastructure to meet regulatory requirements while remaining affordable for their communities. This could lead to increased pressure for councils to become more involved in finding sustainable solutions for those communities.

Little is known about these supplies in Whakatāne District

Most councils have limited visibility of the risks they are facing and no means of funding or resourcing investigations to better understand the supplies and associated risks.

Council-held information last updated in 2020 shows up to 24 private and community supplies in the district including a range of commercial premises, schools and community supplies. It also shows 64 marae in the district, but Council does not have information on the water source for most of these.

The last assessment of water supplies in Whakatāne District was undertaken in 2011 and concluded there was a lack of information on the sanitary status of small supplies in the District upon which to assess risk.

We understand Council officers plan to undertake work in 2025 to improve Council's understanding of community supplies and meet its obligations to complete an assessment of water services by 1 July 2026.

Risks and challenges over the next 10 years

- Consistent compliance with drinking water standards
- Resource consents expiry – upgrade requirements
- Uncertainty about future regulatory framework
- Impacts of geography, natural hazards & climate change
- Adequacy of asset maintenance and renewals
- Workforce challenges
- Funding, financing and affordability

Current state review framework

Key elements of Local Water Done Well

The Government's Local Water Done Well policy will significantly change the operating environment for water services in New Zealand.

New regulatory requirements, coupled with new structural and financing tools, is expected to lead to significant changes in service provision over time, including the adoption of new service delivery models.

WATER SERVICES PLANS

Plans will need to show how councils will meet water quality and infrastructure rules, while being financially sustainable

Plans need to include asset and financial information, investment required and proposed service delivery arrangements

FINANCIAL SUSTAINABILITY

Plans will need to show that:

- Water revenue is sufficient to cover maintenance, financing costs and depreciation
- Planned capital investment is sufficient to meet regulatory requirements and provide for growth
- Available financing does not constrain investment required to support service delivery

NEW STRUCTURAL AND FINANCING TOOLS

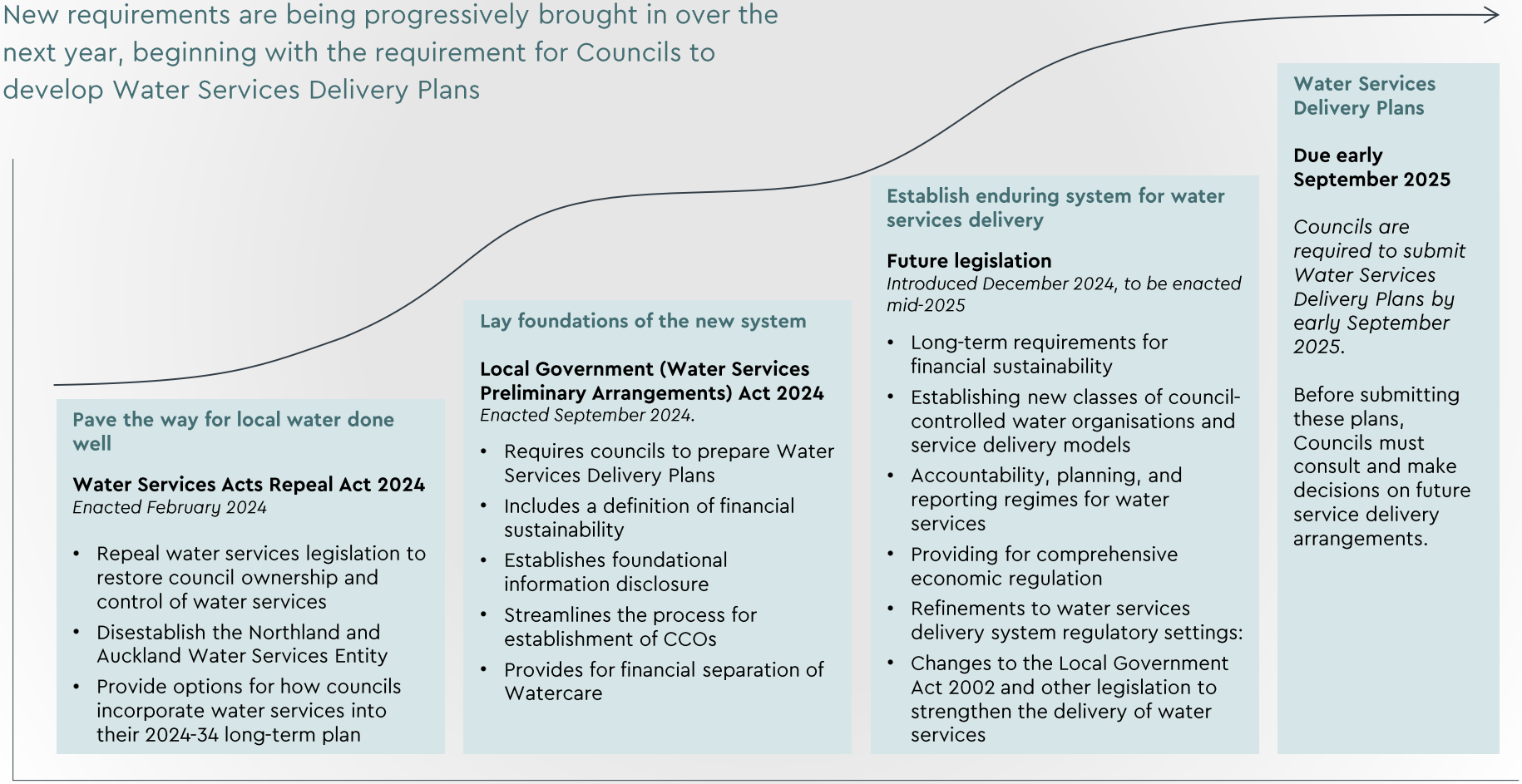
Future legislation, to be introduced in December 2024, will provide for a range of water services delivery models. In addition, LGFA and the Government have announced the intention to make lending facilities available to water CCOs.

NEW REGULATION

Legislation will set out long-term requirements for financial sustainability and provide for economic regulation. This will include requirements for councils to ring-fence their water services from other council activities and will include new information disclosure and reporting requirements.

Legislative timeline

New requirements are being progressively brought in over the next year, beginning with the requirement for Councils to develop Water Services Delivery Plans



Water Services Delivery Plans

Required content

Water services delivery plans will be required to include a description of:

- The current state of the water services network, including current levels of service, asset condition and lifespan, the asset management approach being used, and any issues, constraints or risks impacting on the delivery of water services
- The water infrastructure needed to meet regulatory requirements and provide for population growth
- The operational and capital expenditure required to delivery water services
- Financial projections including:
  - The operating costs and revenue required to delivery water services, including how that revenue will be separated from the territorial authority's other functions and activities
  - Projected capital expenditure on water infrastructure
  - Projected borrowing to finance the delivery of water services.
- The anticipated or proposed model for delivering water services, including what the local authority proposes to do to ensure water services delivery will be financially sustainable by 30 June 2028.

Planning horizon

Water services delivery plans will be required to cover a period of not less than ten financial years, starting with the FY25 financial year.

Local authorities are not restricted to covering only 10 years in their plan.

Many local authorities have submitted that a 30-year horizon is more appropriate for assessing sustainability of water services given the long-asset lives and investment cycles. Future regulatory requirements are expected to drive higher costs, with many of these costs likely to be faced beyond the current LTP period. It is therefore prudent to also viability and sustainability over both a 10 year and 30-year time horizon.

Assessing viability and sustainability

Two concepts in the Bill are central to the assessment of viability and sustainability:

- Ring-fencing
- Financial sustainability

The DIA guidance on these two elements is set out on the next two slides.

Ring-fencing

Taken directly from DIA 'Guidance for preparing Water Services Delivery Plans'

Plans must include information explaining how water services revenue will be ringfenced for water services.

In their Plans, councils must explain how revenue from, and delivery of, water services will be separated from councils' other functions and activities ('ring-fenced').

- Ringfencing is a critical requirement for revenue sufficiency and financial sustainability. It requires that:
  - Water revenues be spent on water services, and
  - Water services charges and expenses be transparent and accountable.
- To achieve these outcomes, we recommend Plans demonstrate how water services will be ringfenced from other activities. Councils could demonstrate this by ensuring:
  - Projected financial statements for water services are consistent and reconcilable;
  - Revenue (including rates and/or water charges) for water services are separately identifiable from other revenues;
  - Revenues generated for water services are spent on water services, not other council business;
  - Cash surpluses for water services are retained for future expenditure on water services; and
  - Internal borrowings are repayable and commercial arrangements enable water revenues be utilised for water services expenditure.

Financial sustainability

Taken directly from 'DIA Guidance for preparing Water Services Delivery Plans'

Plans must include a council self-assessment of the financial sustainability of their water services delivery.

The Financial Projections template assists councils to populate the financial performance measures in the Plan template, to address each of the above components.

Upon request, the Department can provide councils with a populated Financial Projections template based on their 2024-34 Long-Term Plan (LTP) information for water services.

- The Act defines 'financially sustainable', in relation to a council's delivery of water services, as:
  - The revenue applied to the council's delivery of those water services is sufficient to ensure the council's long-term investment in delivering water services; and
  - The council is financially able to meet all regulatory standards and requirements for the council's delivery of those water services.
- To assess whether a council's water services delivery is financially sustainable, the Plan templates ask councils to provide information about three components:
  - Revenue sufficiency – is there sufficient revenue to cover the costs (including servicing debt) of water services delivery?
  - Investment sufficiency – is the projected level of investment sufficient to meet regulatory requirements and provide for growth?
  - Financing sufficiency – are funding and finance arrangements sufficient to meet investment requirements?

How we approached the assessment

Operating context

- Good levels of water supply metering
- Significant wastewater upgrades needed to meet replacement consent requirements
- Low drinking water compliance – only one scheme fully compliant
- Significant investment in asset renewals, resilience and wastewater treatment plant upgrades were deferred beyond LTP period
- Geographically disparate communities – most schemes service small populations
- Climate change – low lying settlements and high ground water
- Mix of Council and community supplies, with pressure to extend service provision to currently unserved areas
- Affordability for ratepayers in the district
- Funding and financing challenges for current infrastructure strategy
- Complex rating system

Service levels

- Network performance
- DWS compliance
- RM consent compliance
- Customer service

Cost drivers

- Asset age and condition
- Improved levels of service
- Growth
- Asset revaluations
- Borrowing
- Operating costs

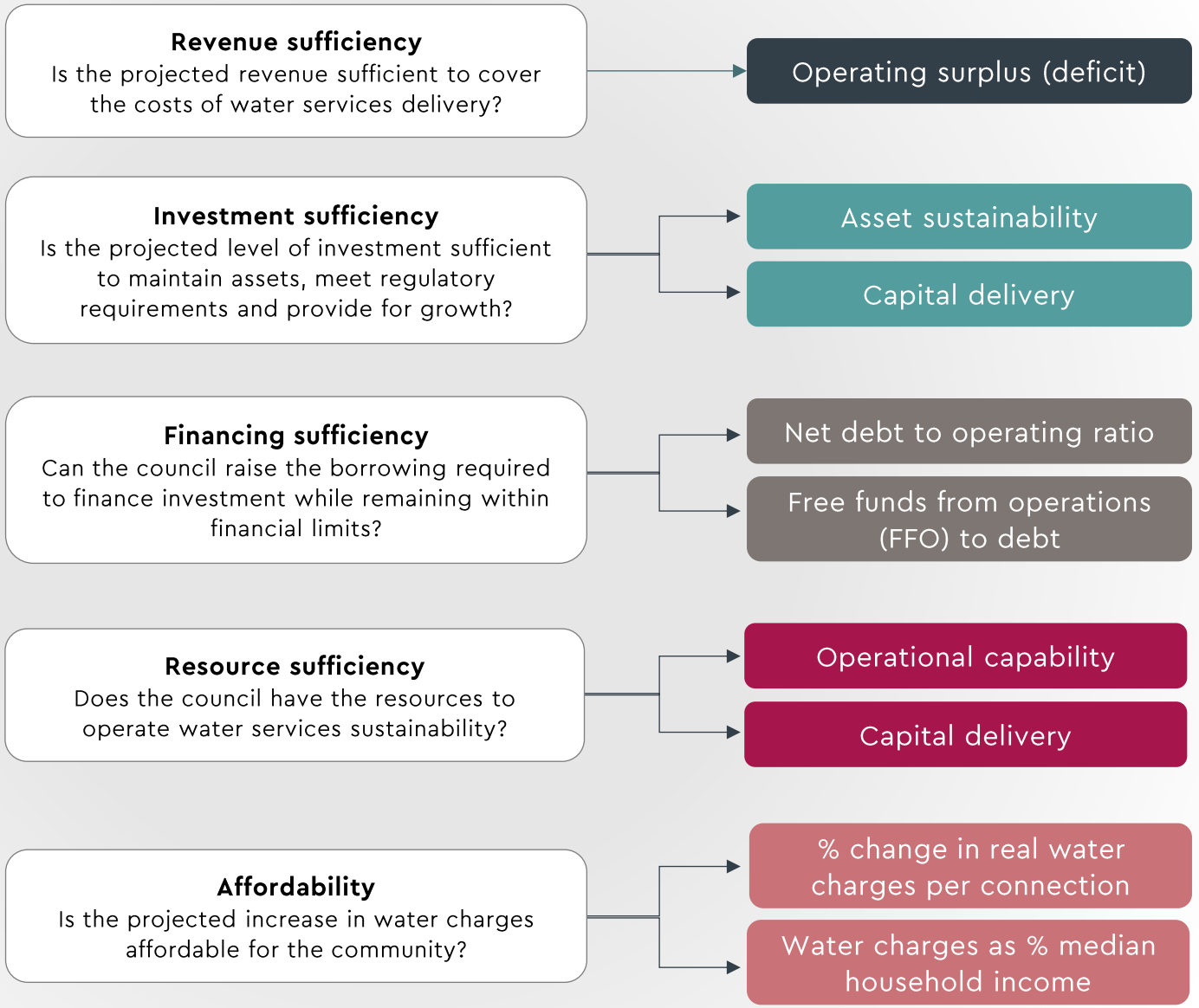
Financial projections

- Revenue and expenses
- Investment
- Borrowing
- Other capital funding

Viability and sustainability assessment

- Revenue sufficiency
- Investment sufficiency
- Financing sufficiency
- Resource sufficiency
- Affordability

Criteria for assessing viability and sustainability



Viability and sustainability measures

Operating surplus (deficit)	**Operating surplus (deficit)** measures the surplus (deficit) remaining after deducting all operating costs (including depreciation and interest) from operating revenues. Operating revenues include general and targeted rates, fees and charges but excludes sources of capital funding (e.g., financial and development contributions and any capital subsidies).
Asset sustainability	**Asset sustainability** measures the ratio of capital expenditure on renewals to depreciation, which indicates whether assets are being adequately maintained (when assessed over the long-term).
Capital delivery	**Capital delivery** is an historical measure of the gap between actual and planned capital expenditure, which is a proxy for whether future capital expenditure is likely to be delivered.
Net debt to operating ratio	**Net debt to operating revenue** measures the level of debt (net of any cash reserves) relative to operating revenue, which is an indication of the degree to which borrowing is supported by revenue over time. Local authority debt limits and financial covenants usually refer to this ratio.
Free funds from operations (FFO) to debt EBITDA to debt	**FFO to debt and EBITDA** (earnings before interest, taxes, depreciation, and amortization) **to debt are** two of the core financial ratios used by credit rating agencies when assessing the financial strength and credit quality of standalone water organisations.
Real charges per water connection	**Real charges per connection** indicates the extent to which water charges are required to increase over time to achieve revenue sufficiency, measured in today's dollars.
Water charge % median household income	**Charges as a percentage of median income** indicates the proportion of median household income required to pay for water charges, which can be assessed with reference to affordability benchmarks.

Ten-year outlook

Water supply services

Revenue sufficiency

Investment sufficiency

Financing sufficiency

Water supply operating expenditure

Last six years

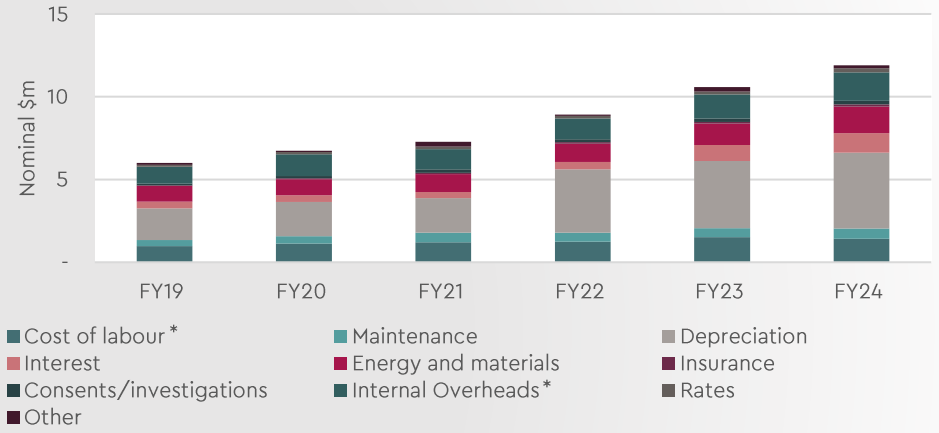
The cost of operating water supply services increased by 98% over the last six years – from $6.0 million to $11.9 million. Significant drivers of this included depreciation (+140%), overheads (+70%), interest (+190%), energy and materials (+72%), and labour costs (+47%).

The significant increase in depreciation reflected asset revaluations and investment, with higher asset replacement costs driving higher depreciation expense. Higher interest costs reflect higher borrowing and interest rates. Amongst other things, increases in overheads reflect inflationary costs and costs associated with increased FTE.

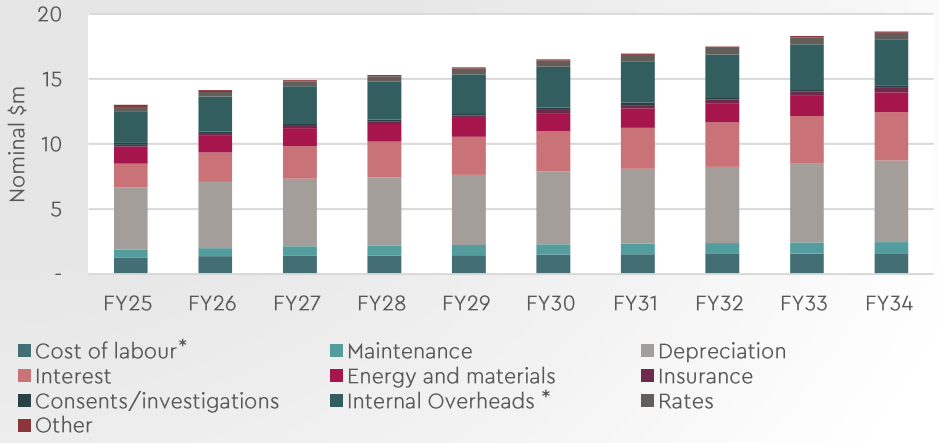
10-year outlook

Operating costs are projected to continue to increase by 4.6% per annum over the next ten years – from $11.9 million to $18.6 million. Significant drivers of this include depreciation expense (+3.1% p.a.), overheads (+7.4% p.a.), interest (12.3% p.a.), rates (+7.3% p.a.) and insurance (+11.2% p.a.).

Historic operating costs – Water supply



Projected operating costs - Water supply



** Council records costs for salaries, wages and casual staff for all water services under the stormwater activity group, with costs reallocated to water supply and wastewater activities through the internal overhead expense category. We have applied the council's cost allocation drivers to reallocate these costs between the internal overhead and labour cost expense categories.*

Water supply—capital expenditure

Investment sufficiency

Capital delivery

The Council has invested $33.5 million in water supply assets over the last six years compared with planned investment of $33.5 million (an overall delivery rate of 93%). Actual capex exceeded budget in FY21 and FY22 (due to the receipt of $4.3 million in 3 waters stimulus funding) and has been below budget in the last two years.

Capital expenditure plans

The Council is planning to invest $103.6 million in its water supply assets over the next ten years. This level of investment represents a significant increase on the average level of investment over the last six years in real terms. In today's dollars, investment averaged $6.5 million per annum over the last six years, compared with $9.2 million per annum planned for the next ten years (42% increase in average level of investment).

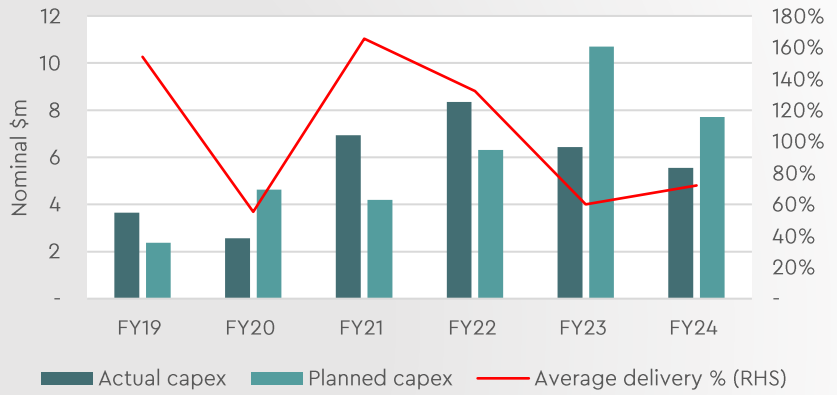
The capital profile shows a lumpy profile, with peaks of investment in FY25 (due to planned upgrades of Murupara and Rūātoki treatment plants and Otumahi water storage works) and FY32 (due to new water source and storage works). Overall, the Council is planning to invest $44 million over 10 years in level of service improvements and $8 million in growth-related capex.

Depreciation and renewals

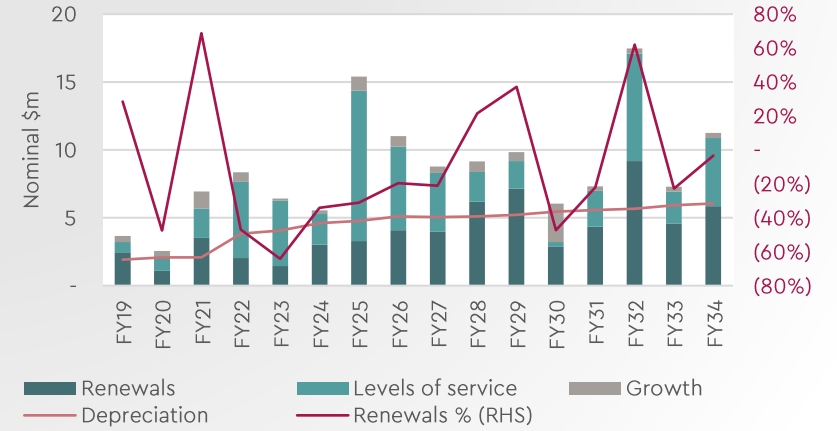
The Council spent $13.6 million on water supply renewals over the last six years compared with depreciation expense of $18.5 million (renewals % of 73%). Over the next ten years, the Council is planning to spend $51.5 million on renewals, or around 96% of the projected depreciation expense.

Council analysis shows a renewals backlog of $55.8 million in its water supply network, which will not be addressed in the current LTP period given the deferral of renewals investment.

Actual vs planned capex – Water supply



Capex and depreciation – Water supply



Water supply—revenues and operating balance

Revenue sufficiency

Revenues

Revenues for water supply are expected to increase by 142% over the next ten years – from $12.8 million to $20.5 million. This represents an increase of 88% over 10 years in today's dollars, or 6.5% per annum above the rate of inflation.

Water rates per connection are projected to increase from $722 in FY25 to around $1,407 per connection by FY34 ($1,143 in current prices). Water rates per connection are estimated to increase from 1.0% of the median household income in FY25 to 1.6% by FY34.

Operating surpluses (deficits)

Water supply services have operated at a deficit since FY21, with the deficit estimated to peak at $3.7 million (43% of revenue) in FY24. The Council plans to run deficits in FY25 and FY26 before running small surpluses from FY28-FY34. Over the full LTP period, the Council plans to run a cumulative operating surplus of $6.1 million, averaging 3.6% of operating revenue.

Revenue sufficiency

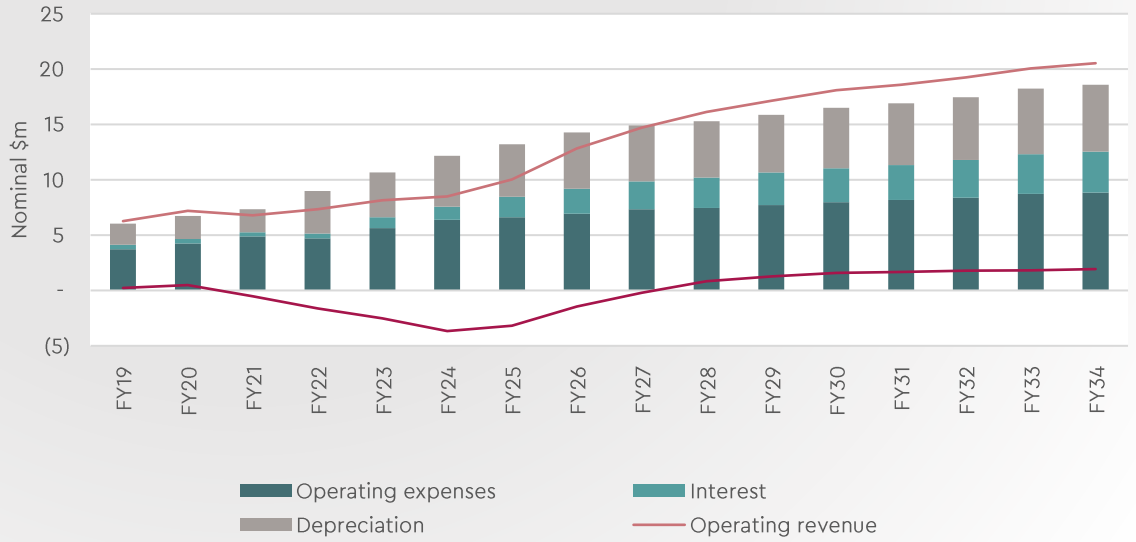
Revenue sufficiency requires that operating revenues are sufficient to meet the costs of operating water services and generate cash surpluses for investment or debt repayment. This includes that revenues recover the full cost of depreciation so that assets can be maintained into the future.

The Council's long-term plan financial projections are consistent with the expected future requirement for revenue sufficiency, provided that the provision for capital investment is sufficient to maintain assets, meet regulatory requirements, and provide for growth. However, as noted on the previous slide, this is unlikely to be the case.

The inclusion of additional investment to meet drinking water compliance requirements is expected to necessitate higher water rates than are forecast.

This conclusion is preliminary, based on our high-level assessment, and is subject to future requirements being confirmed following the passage of the Local Government (Water Services Preliminary Arrangements) Bill.

Revenues and expenses - Water supply



Water supply—borrowing and debt sustainability

Financing sufficiency

Borrowing

Water supply net borrowing increased by $12.7 million over the last five years, from $11.0 million in FY19 to $23.7 million in FY24. Net debt for water supply is expected to increase by $41.1 million over the next ten years, to around $64.8 million.

Net debt to revenue

Net debt to revenue increased from 176% in FY19 to 280% in FY24, driven by operating deficits and investment in water supply upgrade projects. Significant borrowing to fund further water supply upgrades in FY25 sees net debt to revenue reach 373% before declining to around 310% where it remains over the second half of the LTP period.

Water activities are typically operated with higher leverage than non-water council activities, due to their capital-intensive nature. **The proposed level of borrowing for water supply is within the normal bounds of what is expected and is not excessive by New Zealand local government standards.**

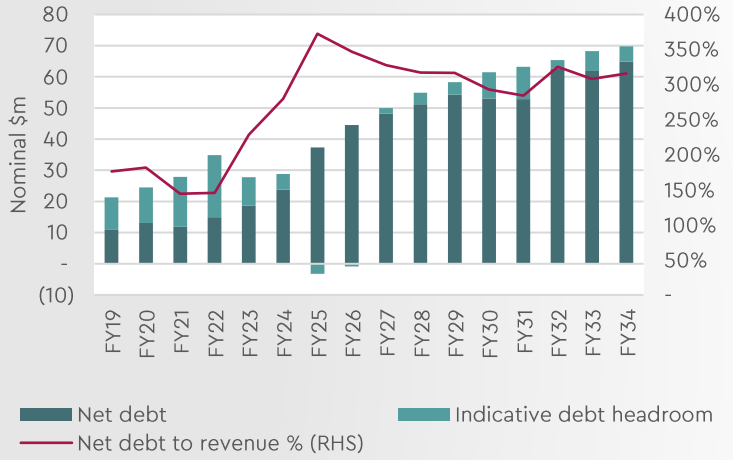
Debt sustainability

Funds from operations (FFO) to net debt improved from the low 20s in FY19 and FY20 to the mid-30s in FY22, before deteriorating to at or below 5% in FY24 and FY25. This represents a high-leveraged debt position, however this is relatively short-lived as FFO to net debt then improves to average 13% from FY27. This represents an aggressive level of leverage but is not atypical for water supply activities.

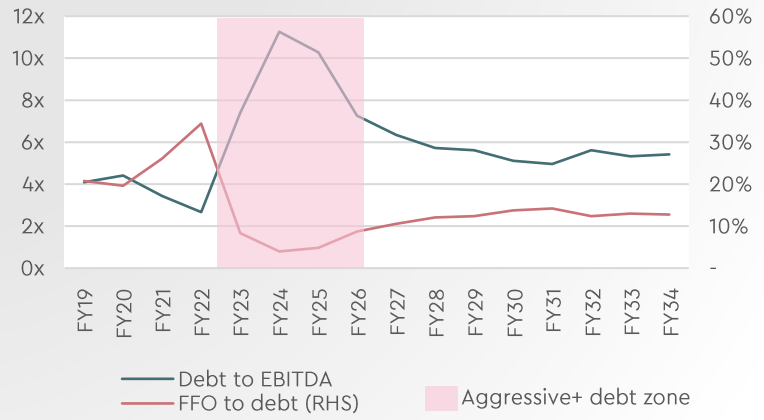
Debt to EBITDA broadly follows an inverse pattern, averaging between 2.7-4.4 over FY19-22, before increasing to 11.3 in FY24, before improving to average 5.5 over FY27-FY34. A range of 4-5 corresponds to an aggressive level of leverage, whereas a higher ratio (>5) corresponds to highly-leveraged level of debt.

Overall, the debt trajectory over the LTP period appears sustainable for water supply services on a standalone basis.

Net debt to revenue - Water supply



Debt sustainability - Water supply



Wastewater services

Revenue sufficiency

Investment sufficiency

Financing sufficiency

Wastewater operating expenditure

Last six years

The cost of operating wastewater services increased by 82% over the last six years – from $4.6 million to $8.3 million. Significant drivers of this included depreciation (+91%), overheads (+85%), labour costs (+46%), interest (+79%), and consents/investigations costs (+164%). The significant increase in 'other' costs in FY24 reflects a one-off write-off of work-in-progress related to work on wastewater for Matatā that began in 2013 but was discontinued (consent application and Environment Court costs).

The significant increase in depreciation reflected asset revaluations and investment, with higher asset replacement costs driving higher depreciation expense. Higher interest costs reflect higher borrowing and interest rates. Higher consents/investigations costs are driven by expiring resource consents. Amongst other things, increases in overheads reflect inflationary costs and costs associated with increased FTE.

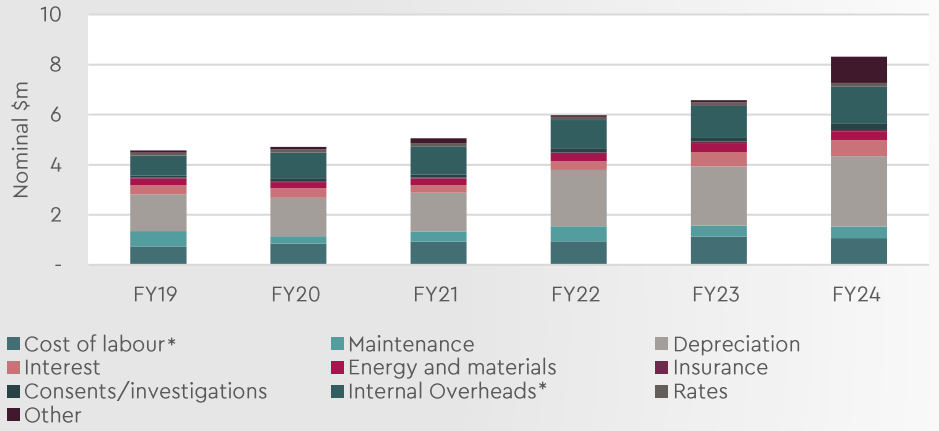
10-year outlook

Wastewater operating costs are projected to continue to increase by 5.5% per annum over the next ten years – from $8.3 million to $14.2 million. Significant drivers of this include depreciation expense (6.5% p.a.), interest expense (15.3% p.a.) overheads (4.5% p.a.), maintenance costs (9.0% p.a.), rates (+7.2% p.a.) and insurance (+12.0% p.a.).

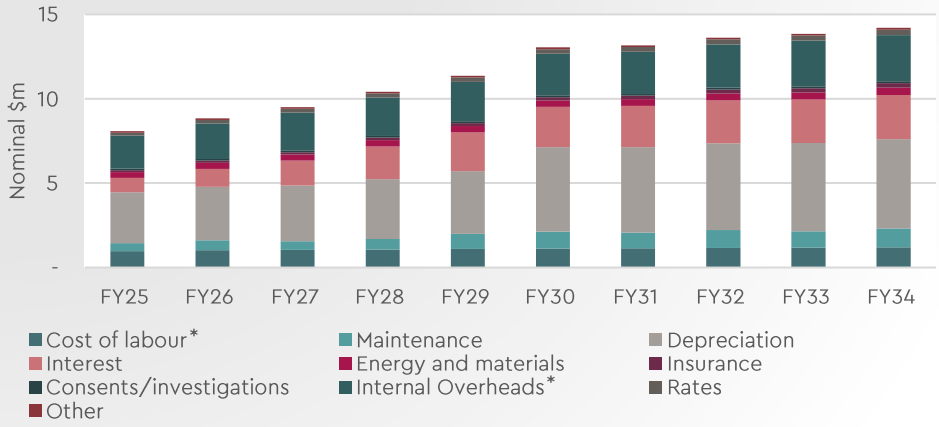
Higher maintenance costs reflect anticipated higher costs of maintaining upgraded wastewater treatment plants.

** Council records costs for salaries, wages and casual staff for all water services under the stormwater activity group, with costs reallocated to water supply and wastewater activities through the internal overhead expense category. We have applied the council's cost allocation drivers to reallocate these costs between the internal overhead and labour cost expense categories.*

Historic operating costs - Wastewater



Projected operating costs - Wastewater



Wastewater capital expenditure

Investment sufficiency

Capital delivery

The Council has invested $13.6 million in wastewater assets over the last six years compared with planned investment of $13.2 million (an overall delivery rate of 104%). Actual capex slightly exceeded budget in FY20-FY23. There was a step change in capex from FY22 (associated with the stimulus funding), with FY24 significantly higher than previous years despite being 20% under budget.

Capital expenditure plans

The Council is planning to invest $90.1 million in its wastewater assets over the next ten years. This level of investment represents a significant increase on the average level of investment over the last six years in real terms. In today's dollars, investment averaged $2.6 million per annum over the last six years, compared with $8.2 million per annum planned for the next ten years (220% increase in the average level of investment).

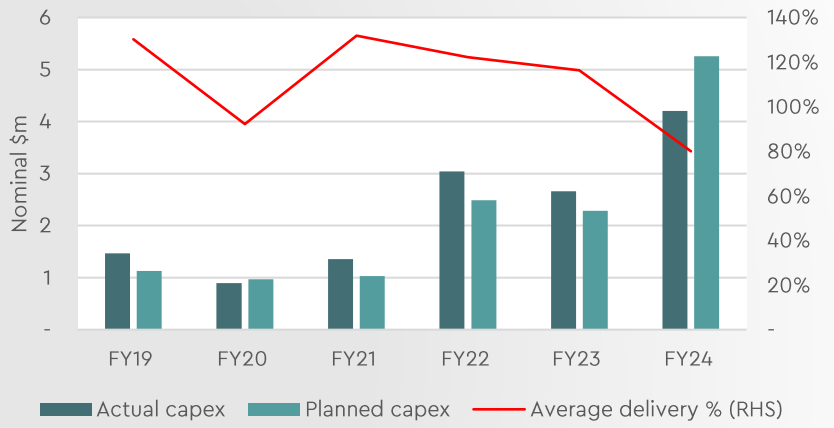
The capital profile shows a steeply rising investment profile, with $68.7 million (three-quarters of the total investment planned) occurring over four years from FY26-FY29. This reflects the significant investment planned in the Matatā Wastewater Scheme. However, we note there is no provision for investment in wastewater treatment plants facing expiring consents. Overall, the Council is planning to invest $44.7 million over 10 years in level of service improvements and $0.2 million in growth-related capex. Council has used a primary–driver approach to allocating capex which means some categories may be over or under stated.

Depreciation and renewals

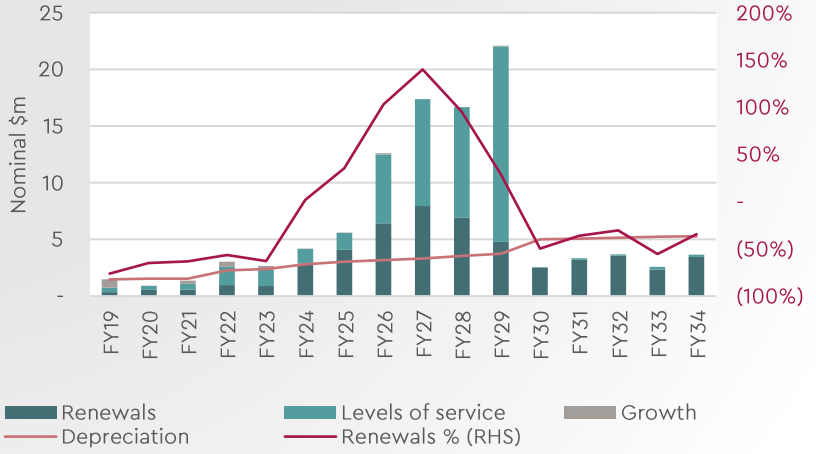
The Council spent $6.2 million on wastewater renewals over the last six years compared with depreciation expense of $12.0 million (renewals % of 52%). Over the next ten years, the Council is planning to spend $45.3 million on renewals, or around 107% of the projected depreciation expense.

Council analysis shows a renewals backlog of $36.7 million in its wastewater network which will not be addressed in this LTP period given the deferral of renewals investment.

Actual vs planned capex - Wastewater



Capex and depreciation - Wastewater



Wastewater revenues and operating balance

Revenue sufficiency

Revenues

Revenues for wastewater are expected to increase by 60% over the next ten years – from $6.8 million in FY24 to $10.9 million in FY34. This represents a real increase of 24%, or 2.2% per annum above the rate of inflation.

Wastewater charges per connection are projected to increase from $620 in FY24 to around $918 per connection by FY34 ($746 in current prices). Wastewater rates per connection are estimated to increase from 0.8% of the median household income in FY24 to 1.0% by FY34.

If wastewater revenues were increased to ensure sufficient revenue to meet total operating costs, wastewater charges per connection would be around $1,300 per connection by FY34.

Operating surpluses (deficits)

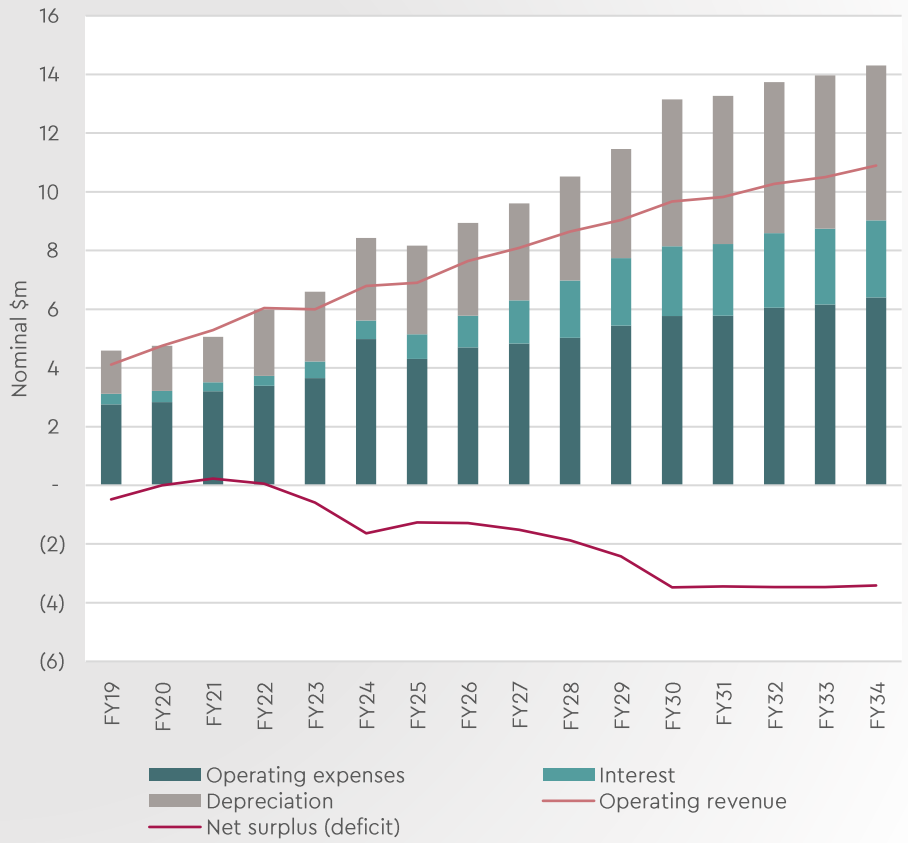
Wastewater services operated in financial balance from FY19 to FY22, but operated with significant deficits in FY23 and FY24. This is projected to continue for the duration of the LTP. In total, these deficits total $25.6 million over the 10-year period, or 28% of total cumulative wastewater revenue.

Revenue sufficiency

The Council's long-term plan financial projections for wastewater are not consistent with the requirement for revenue sufficiency under Local Water Done Well. This conclusion is preliminary, based on our high-level assessment, and is subject to future requirements being confirmed following the passage of the Local Government (Water Services Preliminary Arrangements) Bill.

In addition, the re-inclusion of deferred investment in wastewater treatment upgrades in the water services delivery plan capex projections would necessitate significant increases in wastewater rates in addition to those required to eliminate the LTP's projected operating deficits.

Revenues and expenses - Wastewater



Wastewater —borrowing and debt sustainability

Financing sufficiency

Borrowing

Net borrowing for wastewater increased by $5.5m million over the last five years, from $10.8 million in FY19 to $16.3 million in FY24. Net debt for wastewater is expected to increase by $54.5 million over the next ten years, to around $70.8 million.

Net debt to revenue

Net debt to revenue declined from increased from 262% in FY19 to 183% in FY22 before increasing to 240% in FY24. Significant borrowing over the next 7 years sees net debt to revenue reach 680% in FY28 before declining slightly to 650% by FY34.

Water activities are typically operated with higher leverage than non-water council activities, due to their capital-intensive nature. However, **the proposed level of borrowing for wastewater exceeds the normal bounds of what is expected and is considered excessive by New Zealand local government standards.**

This partly reflects our earlier observation that there is insufficient revenue being collected for wastewater services.

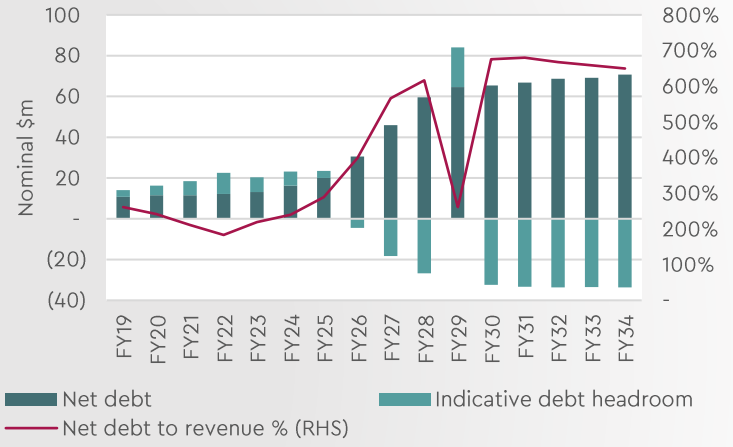
Debt sustainability

Funds from operations (FFO) to net debt improved from 12% in FY19 to 24% in FY22, before deteriorating to 7% in FY24. This already represents a highly-leveraged debt position, however FFO to net debt is projected to deteriorate further over the LTP period, averaging 3% for the last 5 years. This is expected to be well below the level at which LGFA would lend to a standalone water CCO.

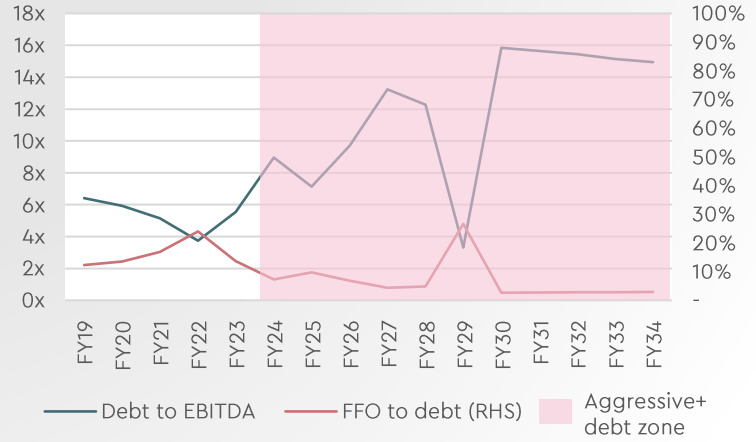
We note the downwards spike in net debt to revenue in FY29 reflects the anticipated receipt of $15.7 million in capital subsidies for the Matatā wastewater scheme. Reliance on this subsidy, which we understand is not confirmed, represents a material risk to the forecasts.

Overall, the debt trajectory over the LTP period appears unsustainable for wastewater services when assessed on a standalone basis.

Net debt to revenue - Wastewater



Debt sustainability - Wastewater



Stormwater services

Revenue sufficiency

Investment sufficiency

Financing sufficiency

Stormwater operating expenditure

Last six years

The cost of operating stormwater services increased by 49% over the last six years – from $6.0 million to $9.0 million. Significant drivers of this included depreciation (+59%), overheads (+50%), insurance (+185%), maintenance costs (+85%), and interest expense (+21%).

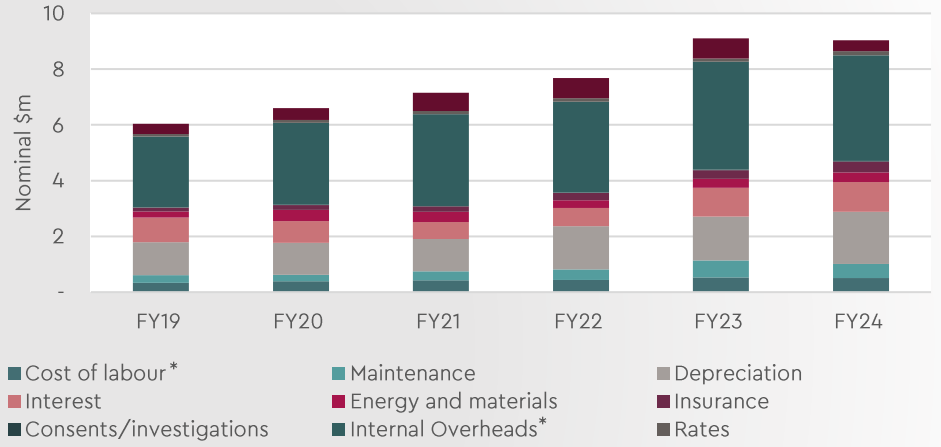
The increase in depreciation reflects asset revaluations and investment, resulting in higher asset replacement costs. The increase in maintenance costs is a result of increased requirements to maintain regulatory compliance. Amongst other things, increases in overheads reflect inflationary costs and costs associated with increased FTE.

10-year outlook

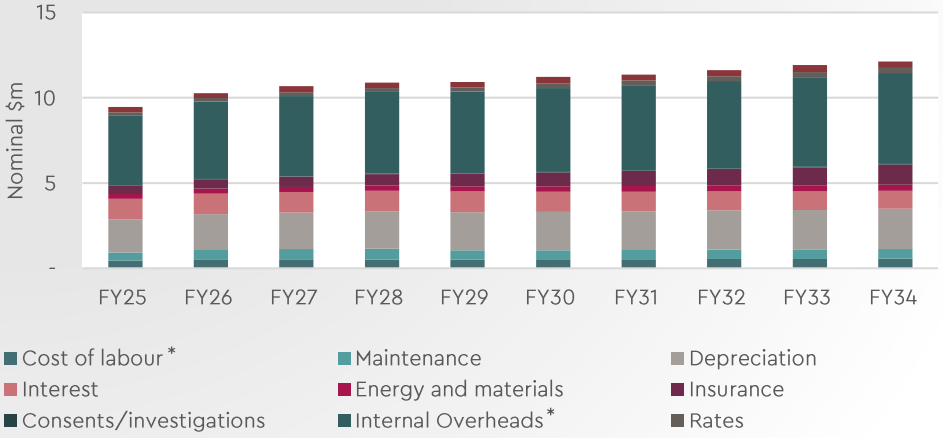
Stormwater operating costs are projected to continue to increase by 3.0% per annum over the next ten years – from $9.0 million to $12.1 million. Significant drivers of this include overheads (6.5% p.a.), insurance (11.6% p.a.), depreciation expense (2.3% p.a.), and rates (7.2% p.a.).

**Council records costs for salaries, wages and casual staff for all water services under the stormwater activity group, with costs reallocated to water supply and wastewater activities through the internal overhead expense category. We have applied the council's cost allocation drivers to reallocate these costs between the internal overhead and labour cost expense categories.*

Historic operating costs - Stormwater



Projected operating costs - Stormwater



Stormwater capital expenditure

Investment sufficiency

Capital delivery

The Council has invested $9.7 million in stormwater assets over the last six years compared with planned investment of $19.2 million (an overall delivery rate of 51%). The level of investment was significantly higher in FY23 and FY24 compared with previous years, notwithstanding that actual capex fell well short of what was planned.

Capital expenditure plans

The Council is planning to invest $19.3 million in its stormwater assets over the next ten years. This represents a similar level of investment to the average over the last six years in real terms. In today's dollars, investment averaged $1.8 million per annum over the last six years, compared with $1.8 million per annum planned for the next ten years (2% reduction).

The capital profile shows investment peaking in the current financial year (due to the investments in Whakatāne Pump Replacements and the Western Catchment upgrade) before investment flattens off at around $1.4 million per annum in today's dollars. Overall, the Council is planning to invest $5.6 million over 10 years in level of service improvements and $0.2 million in growth-related capex.

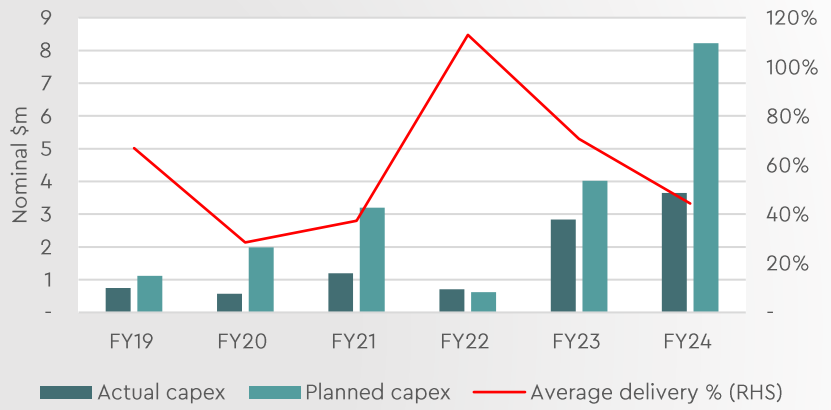
Depreciation and renewals

The Council spent $5.3 million on stormwater renewals over the last six years compared with depreciation expense of $8.5 million (a renewals % of 62%). Over the next ten years, the Council is planning to spend $13.6 million on renewals, or around 61% of the projected depreciation expense.

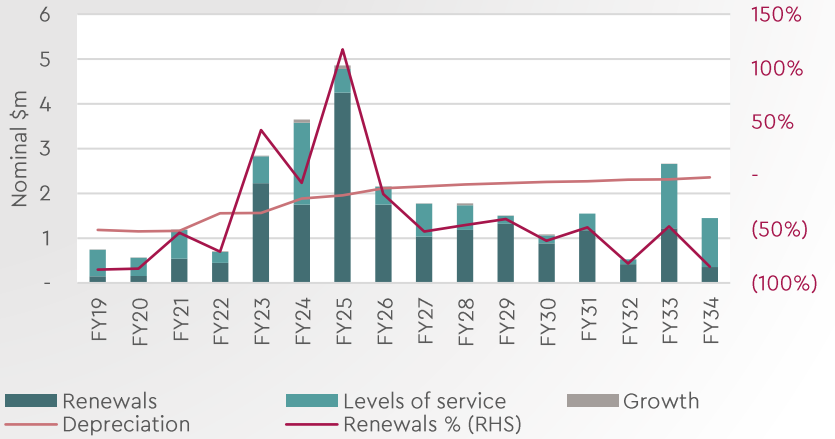
Council analysis shows as at FY23 it had a renewals backlog of $3.3 million in its wastewater network.

Given the level of renewals planned over the next ten years, the average age of assets is expected to increase.

Actual vs planned capex - Stormwater



Capex and depreciation - Stormwater



Stormwater revenues and operating balance

Revenue sufficiency

Revenues

Revenues for stormwater are expected to increase by 55% over the next ten years – from $8.2 million in FY24 to $12.8 million in FY34. This represents a real increase of 21%, or 1.9% per annum above the rate of inflation.

Stormwater rates per connection are projected to increase from $491 in FY24 to around $706 per connection by FY34 ($574 in current prices). The increase in stormwater rates is estimated to increase the costs of stormwater from 0.7% of the median household income in FY24 to 0.8% by FY34.

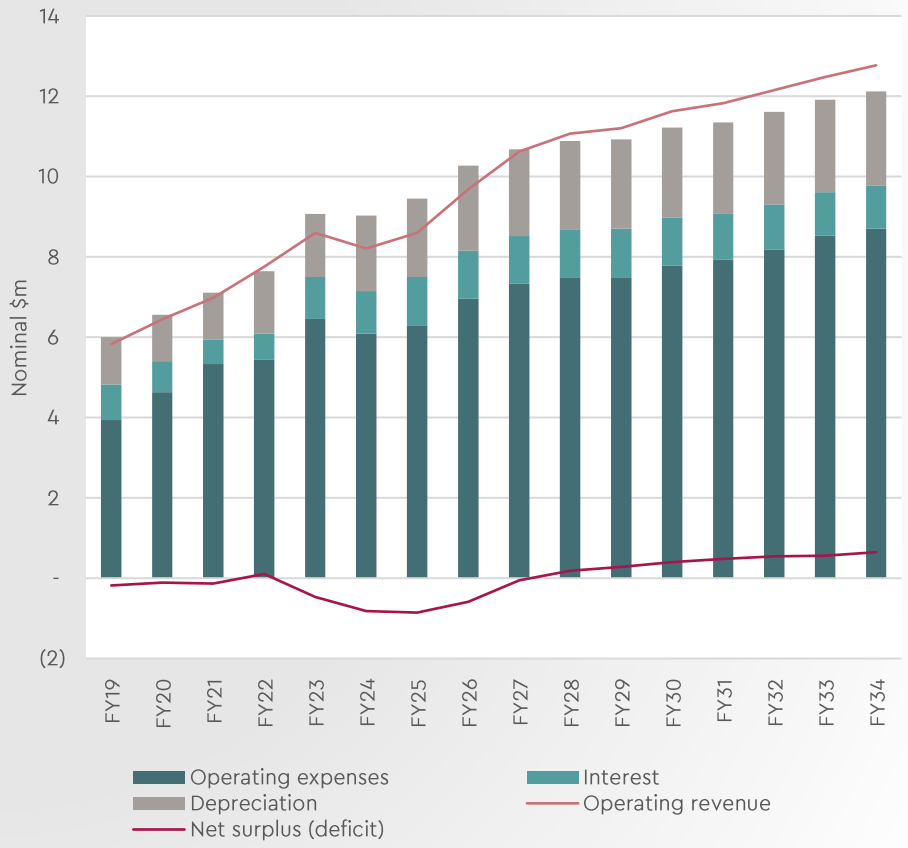
Operating surpluses (deficits)

Stormwater services operated in fiscal balance over FY19 – FY22 but have run deficits for the last two years. Looking forward, stormwater services is projected to operate deficits for the next two years before running small surpluses for the remainder of the forecast period. The cumulative surpluses over 10-years total $1.6 million (1.4% of operating revenue).

Revenue sufficiency

The Council's long-term plan financial projections are consistent with the expected future requirement for revenue sufficiency, provided that the provision for capital investment is sufficient to maintain assets, meet regulatory requirements, and provide for growth. This conclusion is preliminary, based on our high-level assessment, and is subject to future requirements being confirmed following the passage of the Local Government (Water Services Preliminary Arrangements) Bill.

Revenues and expenses - Stormwater



Stormwater borrowing and debt sustainability

Financing sufficiency

Borrowing

Stormwater net borrowing decreased by $3.2m million over the last five years, from $22.1 million in FY19 to $18.9 million in FY24. Net debt for stormwater is expected to increase to $23.4 million over the next two years, before declining to $14.4 million by FY34.

Net debt to revenue

Net debt to revenue decreased from 378% in FY19 to 230% in FY24. Significant borrowing in FY25 sees net debt to revenue reach 263% before declining steadily to reach 113% by FY34.

Water activities are typically operated with higher leverage than non-water council activities, due to their capital-intensive nature. **The proposed level of borrowing for stormwater is relatively conservative for water activities and is not excessive by New Zealand local government standards.**

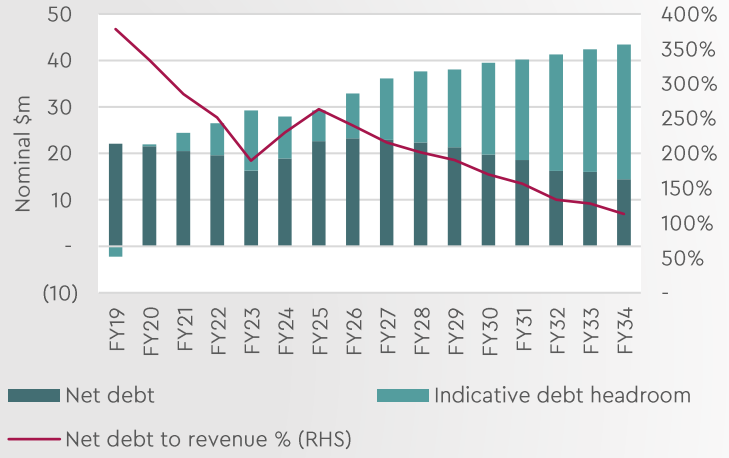
Debt sustainability

Funds from operations (FFO) to net debt improved from 5% in FY19 to 9% in FY22 before deteriorating to 5% in FY25. This represents a high-leveraged debt position, however this is relatively short-lived as FFO to net debt then steadily improves to reach 21% by FY34. This represents a significant but not aggressive level of leverage but is not atypical for stormwater activities.

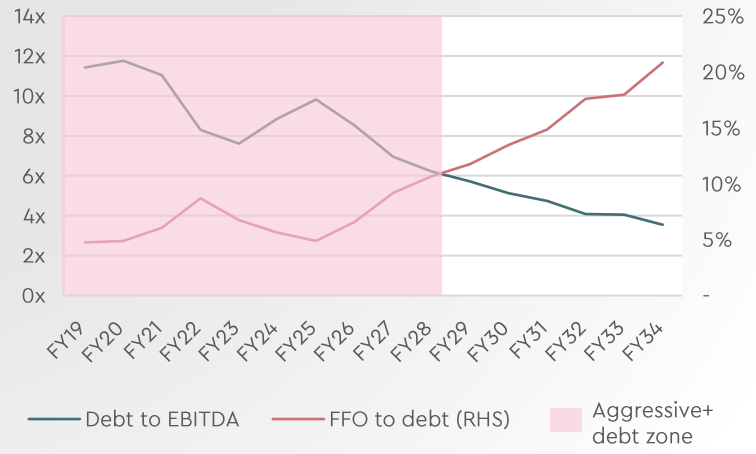
Debt to EBITDA broadly follows an inverse pattern, ranging between 7.6-9.8 over FY19-25, before steadily declining to 3.5 by FY34. Ratios above 5 represent a highly-leveraged debt position, whereas a level of 3.5-4.5 represents a significant but not aggressive level of debt.

Overall, the debt trajectory over the LTP period appears sustainable for stormwater services on a standalone basis, notwithstanding that it remains highly-leveraged in the near-term.

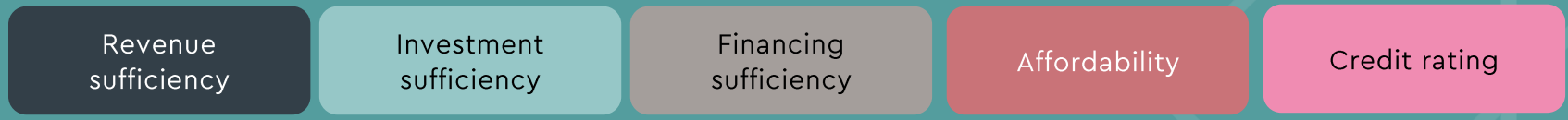
Net debt to revenue - Stormwater



Debt sustainability - Stormwater



Three waters services



Three waters operating expenditure

Last six years

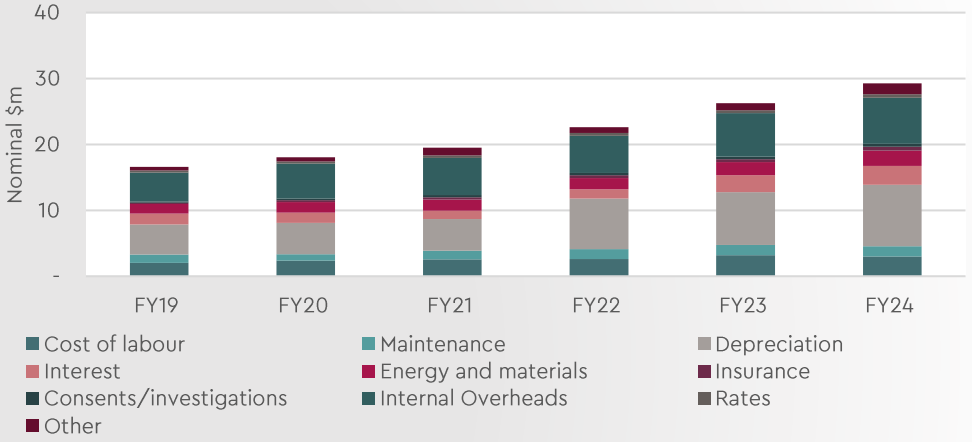
The cost of operating three waters services increased by 76% over the last six years – from $16.6 million to $29.3 million. Significant drivers of this included depreciation (+103%), overheads (+61%), interest (+75%), labour costs (+47%), energy and materials (+61%), insurance (+172%).

The increase in depreciation reflects asset revaluations and investment, resulting in higher asset replacement costs. Increases in interest costs reflect higher borrowing and interest rates. Increased labour costs reflect increased response requirements in relation to real time monitoring. Amongst other things, increases in overheads reflect inflationary costs and costs associated with increased FTE.

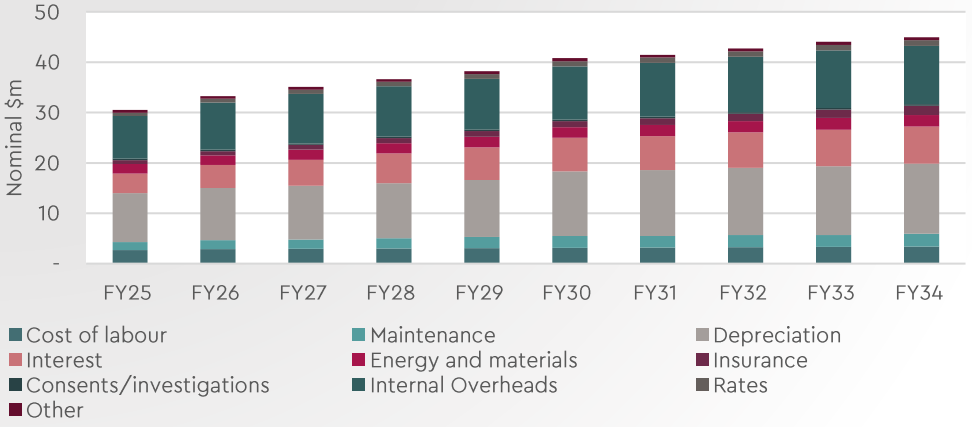
10-year outlook

Three waters operating costs are projected to continue to increase by 4.4% per annum over the next ten years – from $29.3 million to $45.0 million. Significant drivers of this include overheads (5.2% p.a.), interest (10.0% p.a.), depreciation expense (4.1% p.a.), insurance (11.6% p.a.) and maintenance costs (4.9%).

Historic operating costs – Three waters



Projected operating costs - Three waters



Three waters capital expenditure

Investment sufficiency

Capital delivery

The Council invested $56.8 million in three waters assets over the last six years compared with planned investment of $68.2 million (overall delivery rate of 83%). A step change in investment occurred from FY22, but actual capex was below budget in the last two years.

Capital expenditure plans

The Council plans to invest $213.1 million in three waters assets over the next ten years. This represents a significant increase in investment compared with the average over the last six years. In today's dollars, investment averaged $10.8 million per annum over the last six years, compared with $19.2 million per annum planned for the next ten years (77% increase). The capex profile shows the increased investment is 'front-loaded' in the first half of the LTP period, with lower investment planned in the second half.

This capex profile reflects Council decisions to defer investment including:

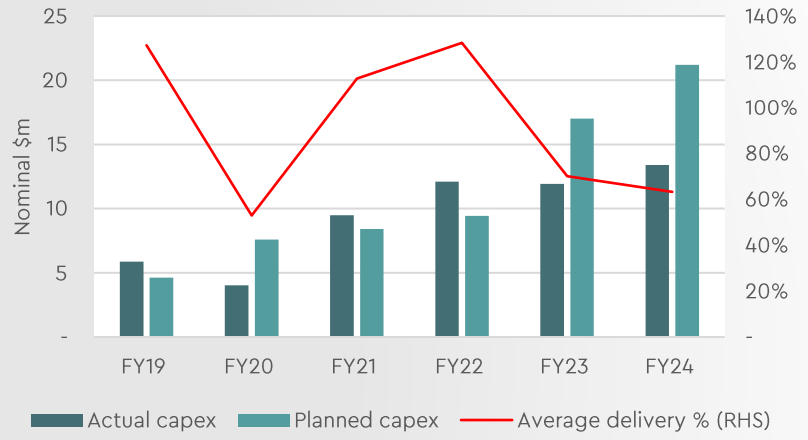
- No provision for wastewater treatment plant upgrades to support re-consenting.
- No provision for management of wastewater sludge from treatment ponds.
- Reduced renewals of existing assets down to 70 percent of what the needs-based AMP recommends.
- Referral of half the value of investment in compliance and resilience projects identified in the needs-based AMP.

A consequence of these decisions is **the current 10-year capex programme in the LTP is very unlikely to meet the requirement for investment sufficiency under Local Water Done Well.**

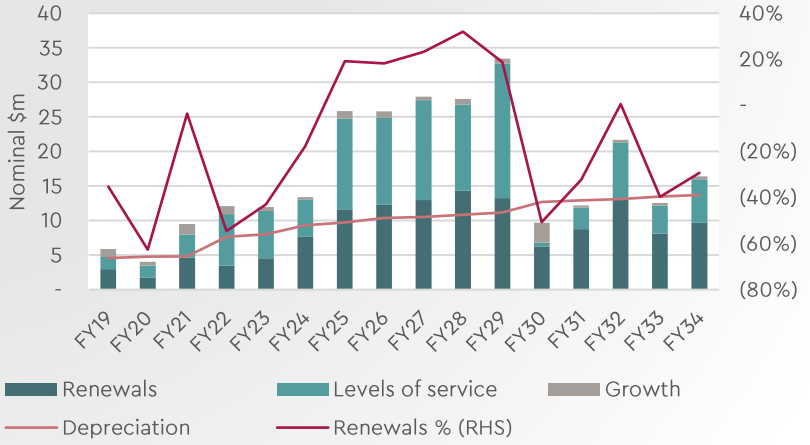
Depreciation and renewals

The Council spent $25.0 million over three waters renewals over the last six years compared with depreciation expense of $39.0 million (a renewals % of 64%). Over the next ten years, the Council is planning to spend $110.4 million on renewals, or around 93% of the projected depreciation expense. However, based on projections in the needs-based AMP, this will be insufficient to address the $95.9 million renewals backlog.

Actual vs planned capex - Three waters



Capex and depreciation - Three waters



Three waters revenues and operating balance

Revenue sufficiency

Revenues

Revenues for water services are expected to increase by 88% over the next ten years – from $25.5 million to $44.2 million. This represents a real increase of 46%, or 3.9% per annum above the rate of inflation.

Operating surpluses (deficits)

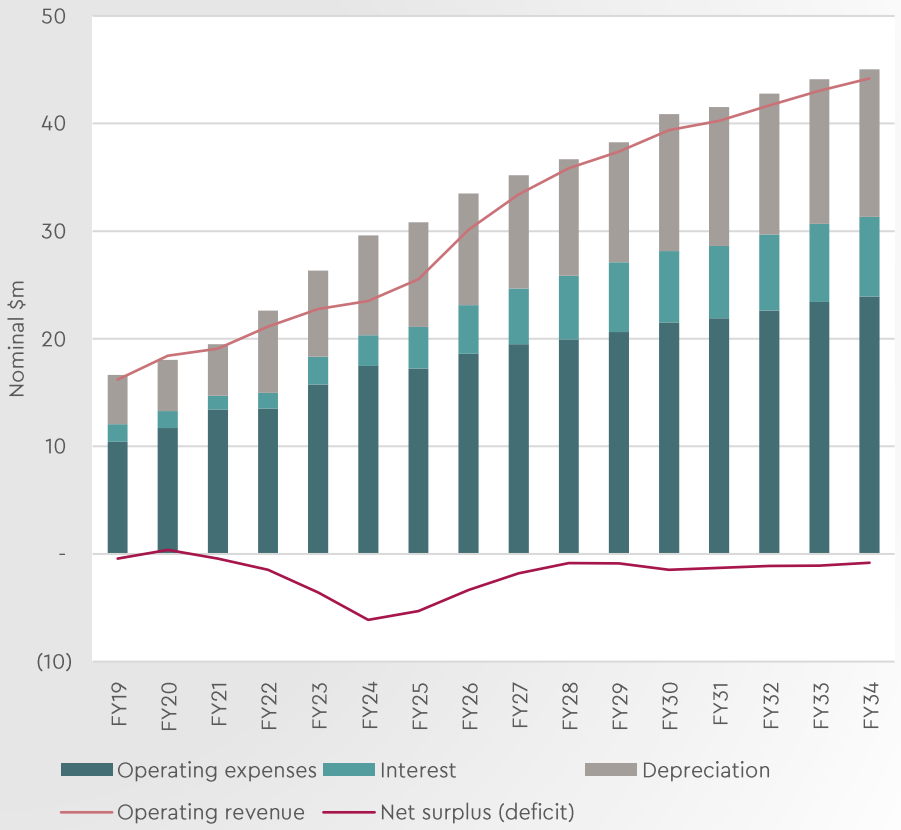
Water services operated close to financial balance over the period FY19-FY22 but have been in deficit for the last two years and are expected to remain in deficit until FY27. Following that, the Council plans to run small operating deficits over the remainder of the LTP period, with cumulative deficits over the ten years of $18.0 million (average of 4.8% of operating revenue). As previously noted, the bulk of these deficits are in the wastewater activity group, offset by small surpluses in water supply and stormwater.

Revenue sufficiency

The Council's long-term plan financial projections for three waters are not consistent with the requirement for revenue sufficiency under Local Water Done Well. This conclusion is preliminary, based on our high-level assessment, and is subject to future requirements being confirmed following the passage of the Local Government (Water Services Preliminary Arrangements) Bill.

In addition, the re-inclusion of deferred investment in water supply and wastewater treatment upgrades in the water services delivery plan capex projections would necessitate significant increases in both water supply and wastewater rates in addition to those required to eliminate the LTP's projected operating deficits in the wastewater activity group.

Revenues and expenses - Three waters



Three waters borrowing and debt sustainability

Financing sufficiency

Borrowing

Three waters net borrowing increased by $15.1 million over the last five years, from $43.9 million in FY19 to $58.9 million in FY24. Net debt for three waters is expected to increase by $91.1 million over the next ten years, reaching $150 million by FY34.

Net debt to revenue

Net debt to revenue decreased from 271% in FY19 to 189% in FY22 before increasing again to 251% in FY24. Significant borrowing over the next five years sees net debt to revenue reach 361% in FY28 before slowly declining to reach 339% by FY34.

Water activities are typically operated with higher leverage than non-water council activities, due to their capital-intensive nature. **The proposed level of borrowing for three waters represents significant leverage for water activities but is not excessive by New Zealand local government standards.**

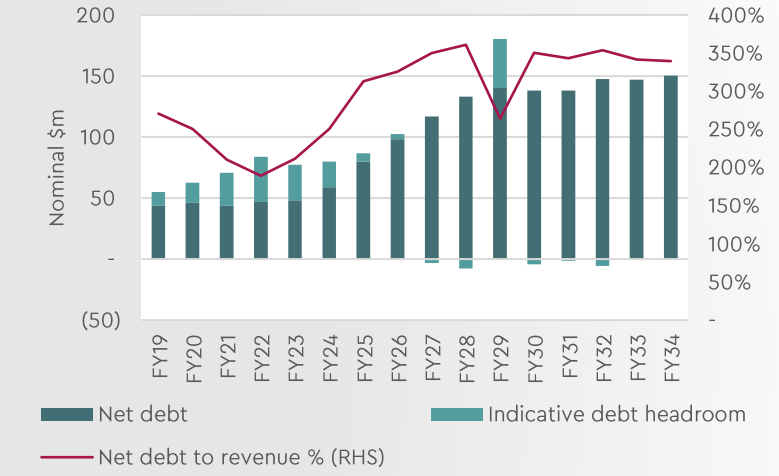
Debt sustainability

Funds from operations (FFO) to net debt improved from 11% in FY19 to 21% in FY22 before deteriorating to 5% in FY24. This represents a high-leveraged debt position. Looking ahead, FFO to debt improves gradually over the 10-year period to reach 9% by FY34. This represents an aggressive level of leverage and is expected to be below the level at which LGFA would lend to a standalone water CCO.

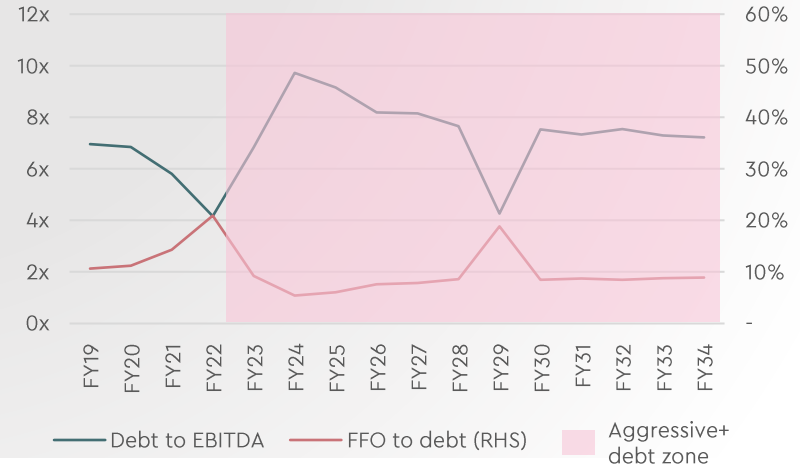
Debt to EBITDA broadly follows an inverse pattern, ranging between 4.2 - 9.7 over FY19-24, before slowly improving to 7.2 by FY34. Ratios above 5 represent a highly-leveraged debt position.

Overall, **the debt trajectory over the LTP period appears unsustainable for three waters services on a standalone basis**, however the projected debt trajectory may be sustainable at a whole-of-council level if borrowing for non-water activities remains low, as illustrated on slide 56.

Net debt to revenue - Three waters



Debt sustainability - Three waters



Three waters affordability

Affordability

Average water rates per connection

Total water charges per connection are projected to increase by $1,407 per connection, from $1,624 in FY24 to around $3,031 per connection by FY34.

When expressed in today's dollars, this represents a real increase of $803 per connection, or a real increase of 48% over ten years (an increase of 4.0% per annum above the annual rate of inflation).

Water rates as a % of median household income

The increase in water charges is estimated to increase average spending on water services per connection from 1.9% of the median household income in FY24 to 2.6% by FY30 before flattening off and slightly declining to 2.5% by FY34.

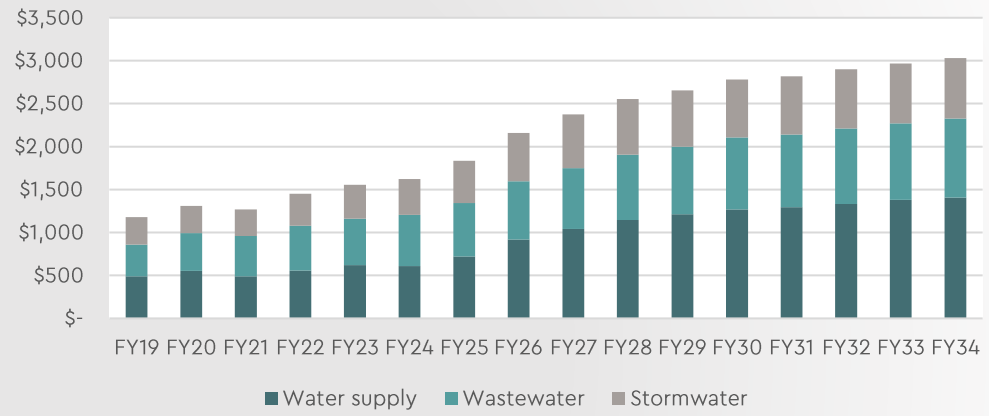
Affordability of water charges

A common international benchmark for water affordability is total annual user charges divided by median household income. For example, this measure is used by the US Environmental Protection Agency when assessing affordability of water services in small, rural communities. It is also the measure of affordability used in the Department of Internal Affairs template for Water Services Delivery Plans.

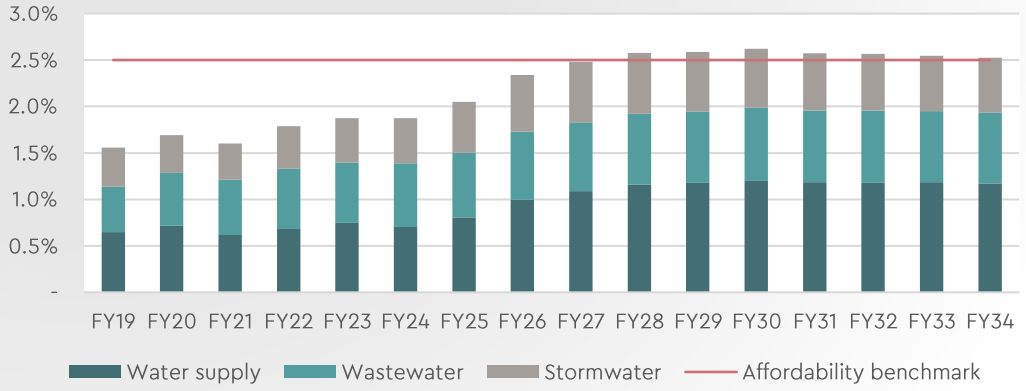
Using this measure, a threshold value of 2.5% of median household income is typically used to indicate when water charges are beginning to become unaffordable.

Based on the financial projections in the Council's long-term plan, this threshold is expected to be breached by year four of the LTP, though not significantly. However, addressing challenges with revenue and investment sufficiency would be likely to materially alter this and exacerbate affordability.

Water rates per connection (incl GST)



Water rates per connection (incl GST)
(% of median household income)



Water services standalone credit rating (S&P)

Credit rating

Overview

The standalone credit rating for water services would be determined by the business risk, the financial metrics, approach to economic regulation, and the strength of the link to the parent council(s).

LWDW structures

There is a trade-off between structures where the financial position of the water entity continues to impact council's credit rating (inhouse, single-council water organisation or multi-council water organisation with parent guarantee) and structures that no longer impact council's credit rating, if established and managed appropriately (i.e. multi-council water organisation without parent guarantee or Consumer Trust owned).

Competitive position ❶

Uncertainty regarding the incoming economic regulatory regime means it is likely that S&P would assign an adequate regulatory advantage assessment (rather than strong) - as a result, S&P's medial volatility table would apply (which requires higher core financial ratios).

Business risk ❷

Although other NZ regulated utilities are considered to have an 'excellent' business risk profile, water services are expected to be assessed as 'strong' until regulation is established.

Financial risk ❸

Financial risk profile is assigned based on the financial ratios for water activities over the next 3-5 years – the FFO/debt ratio is in the 'highly leveraged' band initially and improves to aggressive.

Government support ❹

The government support assessment shown assumes the water entity is structured as a multi-council water organisation without parent guarantee or Consumer Trust owned and the potential uplift is based on links to the Crown.

The financial profile ('highly-leveraged' initially and then 'aggressive') and business profile ('strong') mean water services would not be expected to achieve an investment grade standalone credit rating in the short-term. This means **CCO options would require parent council support to be viable**. It also means **independent CCO options (e.g., consumer trust-owned) would not be viable without significant revenue increases.**

Scenario	**1**	**2**	**3**	**4**
Country risk	Low risk			
Industry risk	Very low risk			
Competitive position ❶	Strong		Satisfactory	
Business risk ❷	**Excellent**		**Strong**	
Financial risk ❸	**Significant**	**Aggressive**	**Significant**	**Aggressive**
Modifier	None			
Standalone rating	**a-**	**bbb**	**bbb**	**bb+**
Government support ❹	Very high			
Issuer credit rating	**AA-**	**A**	**A**	**BBB+**

Ratio	**Significant**	**Aggressive**
FFO/Debt (%)	13 - 23%	9 - 13%
Debt/EBITDA (x)	3.5 - 4.5x	4.5 – 5.5x

Whakatāne water activities	**FY25**	**FY26**	**FY27**	**FY28**	**FY29**	**FY30**	**FY31**	**FY32**	**FY33**	**FY34**
FFO (incl DCs) / Debt	6%	8%	8%	9%	19%	8%	9%	8%	9%	9%
Debt / EBITDA (incl DCs)	9.2x	8.2x	8.1x	7.7x	4.3x	7.5x	7.3x	7.5x	7.3x	7.2x

Rest of council

Revenue sufficiency

Investment sufficiency

Financing sufficiency

Rest of council (excluding water) operating expenditure

Last five years

Council operating costs excluding three waters expenditure increased by 61% over the last five years – from $50.3 million in FY19 to $80.8m million in FY24.

The most significant driver of this increase is operating expenses, which increased by $18.5 million (+46%). Depreciation expense increased by $8.3 (+93%) and finance costs were up $3.7 million (+315%).

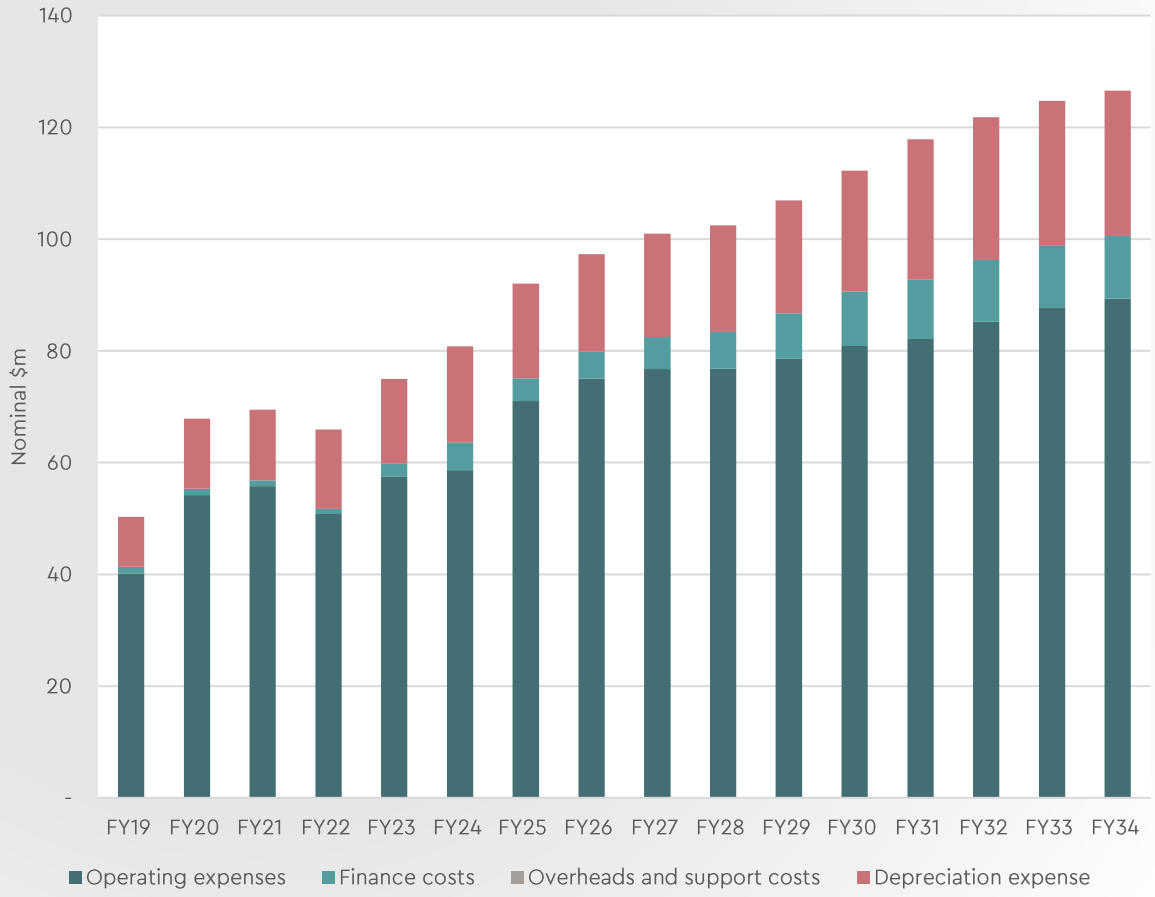
Higher depreciation costs reflect asset revaluations and investment, whereas higher finance costs reflect increased borrowing and higher interest rates.

Outlook

Total operating costs are projected to continue to increase over the next ten years from $80.8 million in FY24 to $126.6 million in FY34. This represents an annual average increase of 4.6% (2.0% above the rate of inflation).

The most significant driver of this is a projected increase in operating expenses from $58.6 million to $89.4 million (+52% increase). Depreciation is the next largest contributor to cost increases, growing by $8.8 million (+51%). Finance costs also grow significantly, increasing by $6.3 million (+127%).

Operating costs - Council excl water



Council (excluding water) capital expenditure

Capital delivery

The Council spent $148 million on the delivery of non-water assets over FY19-FY24:

- Renewals $64 million (43%)
- Levels of service $62 million (42%)
- Growth $22 million (15%).

Capital expenditure plans

The Council is planning to invest $414 million in non-water assets over the next ten years:

- Renewals $156 million (38%)
- Levels of service $244 million (59%)
- Growth $13 million (3%).

Depreciation and renewals

Over FY19-FY24, expenditure on renewals was less than the depreciation expense of $81 million (renewals % of 77%).

Over the next ten years, the Council is planning to spend $156 million on renewals, below the forecast depreciation expense of $216 million (renewals % of 72%).

Capex and depreciation - Council excl water

Council (excluding water) revenues and operating balance

Revenues

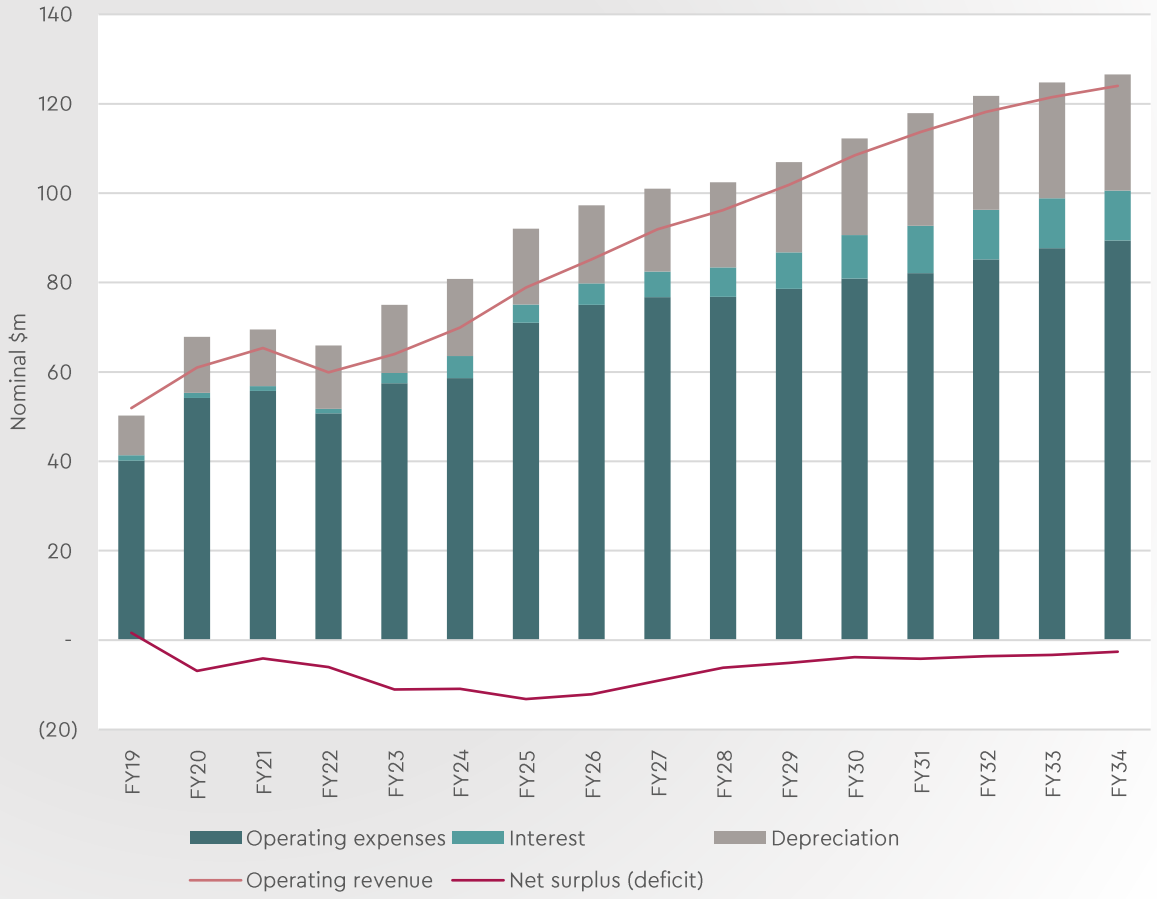
Revenues for non-water services are expected to increase by 77% over the next ten years – from $70 million in FY24 to $124 million in FY34. This represents an increase of 5.9% per annum (3.2% above the rate of inflation).

Operating surpluses / deficits

Non-water council services have operated with a deficit over the period FY20-FY24. This is forecast to continue over FY25-FY34, albeit with narrowing deficits from FY27 onwards due to projected revenues increasing at a faster rate than operating expenses.

We note that while the Council (excluding water services) is operating deficits, this does not result in cash deficits because transport activities receive subsidies from Waka Kotahi (NZTA) that reduce the level of rates revenue required. These capital subsidies are not included in the view presented.

Revenues and expenses - Council excl water



Council (excluding water) borrowing

Borrowing

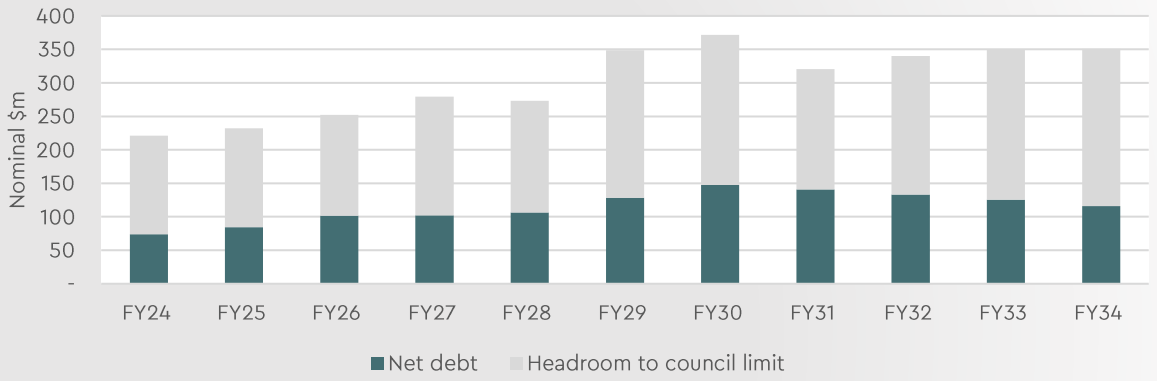
Council borrowing (excluding water) is expected to increase by $74 million over the next six years, from $74 million in FY24 to $148 million in FY30 before declining to $116 million in FY34.

Over the 10-year period, council (excluding water activities) maintains significant debt headroom relative to the council internal limit of 250%.

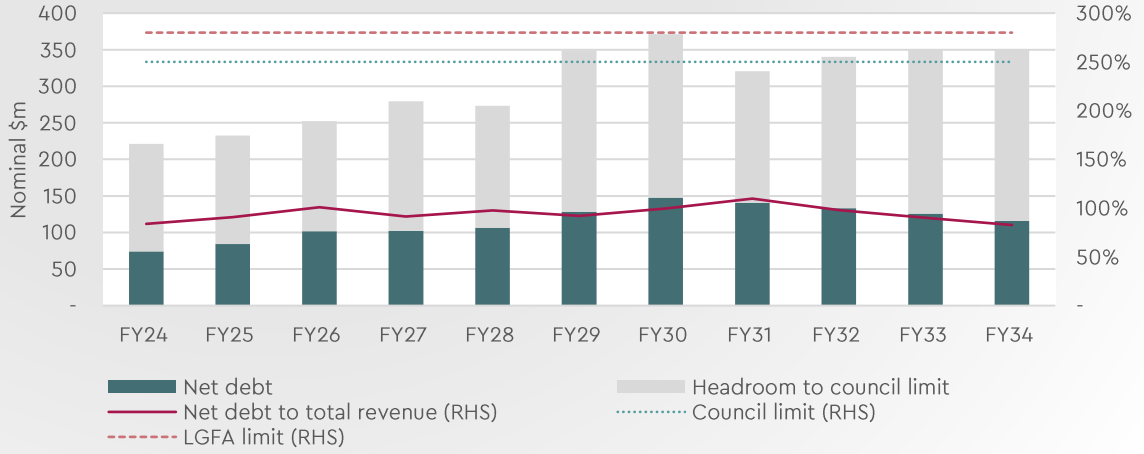
Net debt to revenue

Net debt to total revenue for non-water activities remains relatively steady over the 10-year period, tracking within a narrow range of 83% - 110%.

Borrowing headroom - Council excl water



Net debt to revenue - Council excl water



Council (including water) borrowing

Borrowing

Council borrowing (including water) is expected to increase rapidly over the next six years, with debt more than doubling from $133 million in FY24 to reach $309 million by FY30 before flattening off. Around 70% of the increase in council net debt is driven by three waters infrastructure investment.

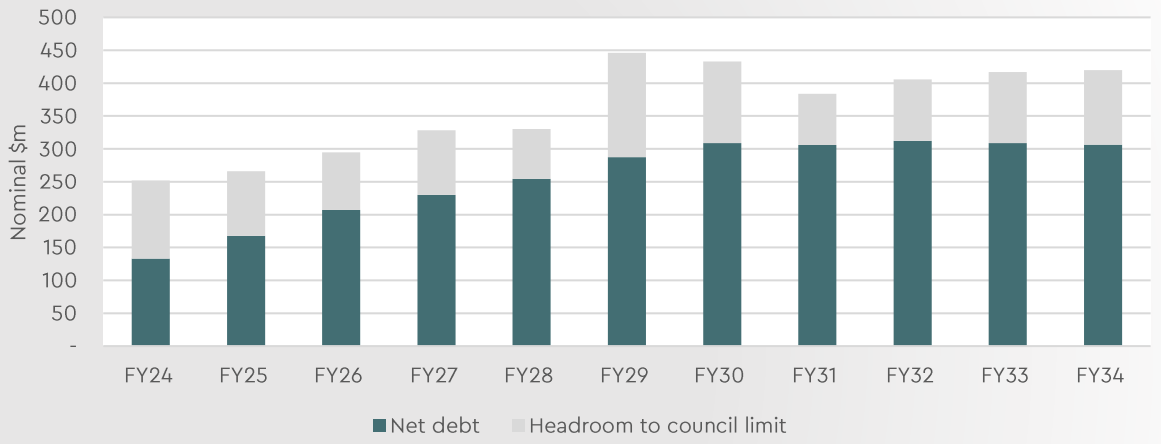
Net debt to revenue

Water activities are typically operated with higher leverage than non-water council activities, due to their capital-intensive nature. As a result, removing water activities results in a significant improvement in the debt to revenue ratio when water activities are excluded.

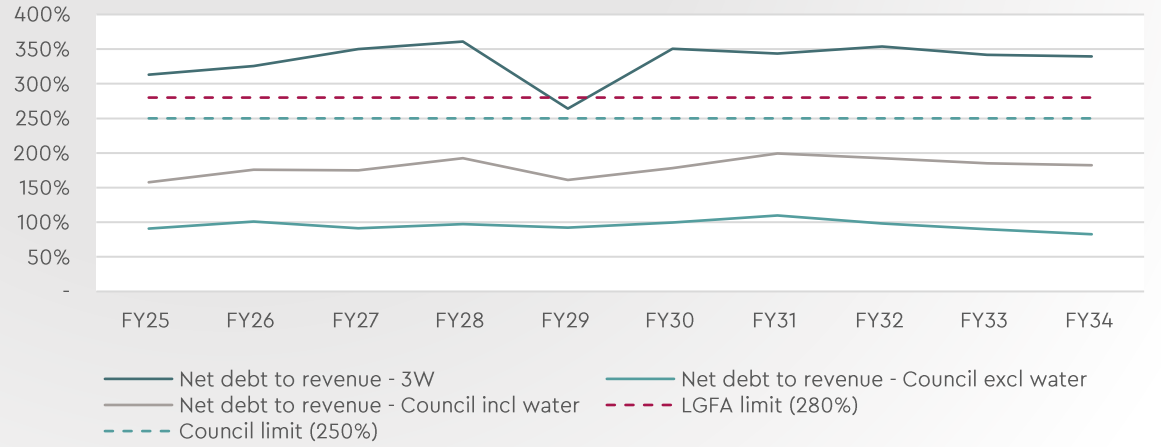
Council including water – Net debt to revenue increases from 158% in FY25 to 198% in FY29 before averaging around 180% for the remainder of the period. This is well within council's debt limit of 250% and the LGFA limit of 280%.

Council excluding water - Net debt to revenue for non-water activities is relatively stable and averages 95% over the period.

Borrowing headroom - Council incl water



Net debt to revenue – Council incl water (LGFA)



Long-term perspective

Adjustments to capital profile

Investment sufficiency

Infrastructure Strategy capex

The capital profile in the 30-year Infrastructure Strategy is lumpy, with significant investment from the 10-year LTP period having been deferred to years 11-15.

The increase in planned capex between FY35 to FY39 reflects projects deferred as part of LTP deliberations including:

- Equalised new drinking water treatment plant ($106 million)
- New wastewater treatment plants: Murupara ($30 million); Whakatāne, Edgecumbe, Tāneatua ($156 million).

Modelling renewals capital expenditure

We have modelled the renewals investment required based on the most recent available estimate of asset replacement value for short-life and long-life assets, divided by the estimated useful lives for those assets in WDC's asset management system. This measure of economic depreciation can differ from accounting depreciation rates. We estimate $543 million of renewals investment is likely to be required over the next 30 years, compared with around $653 million in the Infrastructure Strategy (17% lower). For the long-term scenarios, either renewals profile can be selected.

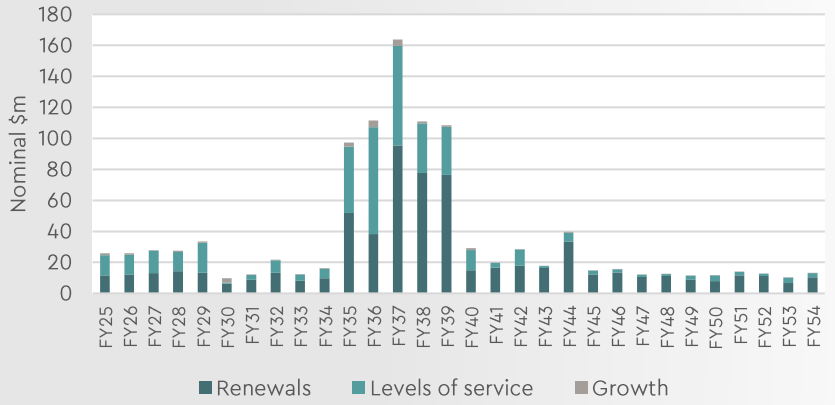
Smoothing capex to enable efficient delivery and financing

It is likely that renewals and other investments would be sequenced to avoid large increases in investment from one year to the next. For our indicative long-term financial scenario, we have smoothed the 30-year capex profile as follows:

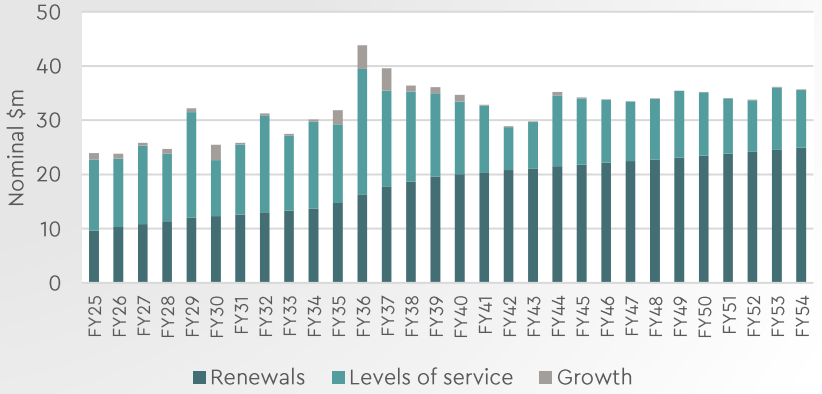
- We have brought forward a portion of deferred investment back into the LTP (around $68 million)
- We have spread the significant renewals expenditure planned in FY35-F39 over a longer period.

While these adjustments are somewhat artificial, and would benefit from more detailed capex project reprofiling, the scenario serves to illustrate the impact of a more realistic phasing of investment compared to the current LTP and Infrastructure Strategy capex profile and is expected to be more compatible with financial sustainability requirements under Local Water Done Well.

LTP + Infrastructure Strategy capex profile



Modelled renewals and smoothed capital delivery



Three waters revenues and operating balance

Revenue sufficiency

Revenues

In the 10-year model, we take the planned revenue increases in the LTP as a given. For the 30-year financial scenarios, we set the revenue increase each year based on a requirement to keep borrowing to within acceptable levels. For the purposes of the scenario illustrated here, water net debt to revenue has been kept to under 500%. This represents an aggressive level of debt for water services on a standalone basis but is consistent with the indicated LGFA limit on lending to dedicated water CCOs. We note however that LGFA has yet to finalise its water CCO lending policy, so this scenario is indicative only.

Under the scenario, average water charges per connection would increase from $2,150 in FY24 to around $7,535 per connection by FY54 ($4,113 in current prices). This represents an increase of 152% in real terms (3.1% per annum above the rate of inflation).

Operating surpluses (deficits)

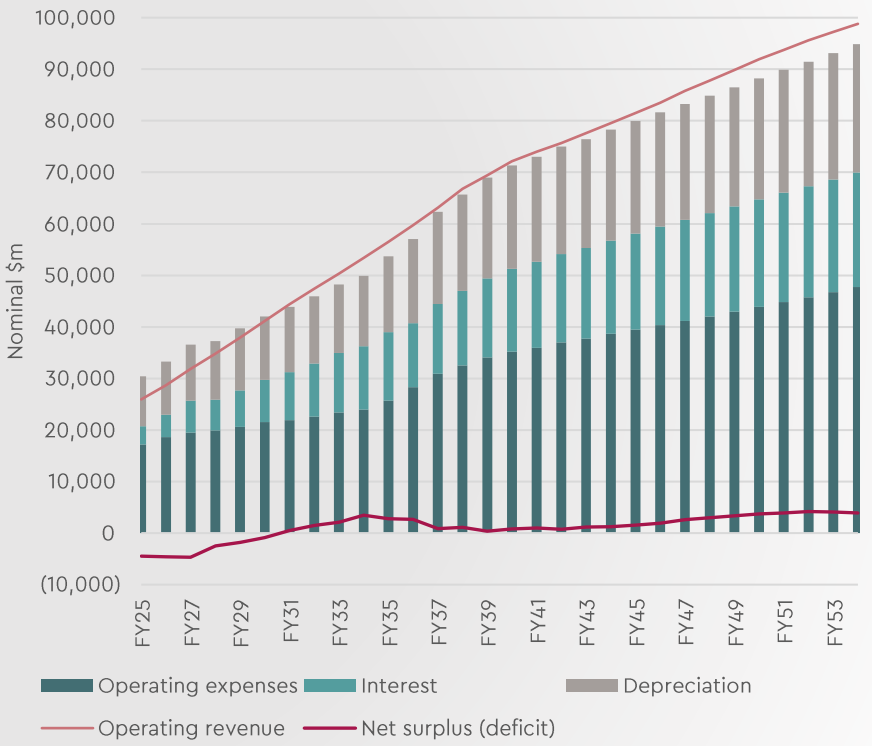
Over 30 years, financial sustainability is supported by maintaining operating surpluses averaging 0.2% over the period. These surpluses generate enough cash for capital investment to be made while maintaining borrowings at an acceptable level, albeit with the degree of leverage increasing steadily over the period.

Revenue sufficiency

Under this long-term scenario, the financial projections are consistent with the expected future requirement for revenue sufficiency over the 30-year period, provided that the provision for capital investment is sufficient to maintain assets, meet regulatory requirements, and provide for growth.

This conclusion is subject to a range of assumptions and significant uncertainties given the long-term nature of the modelling.

Three waters revenues and expenses



Three waters borrowing and debt sustainability

Financing sufficiency

Borrowing

In the 30-year model, net debt for water services is projected to increase by $370 million ($167 million in real terms), from $78 million in FY25 to $448 million in FY54. This represents an increase of 215% in real terms

Net debt to revenue

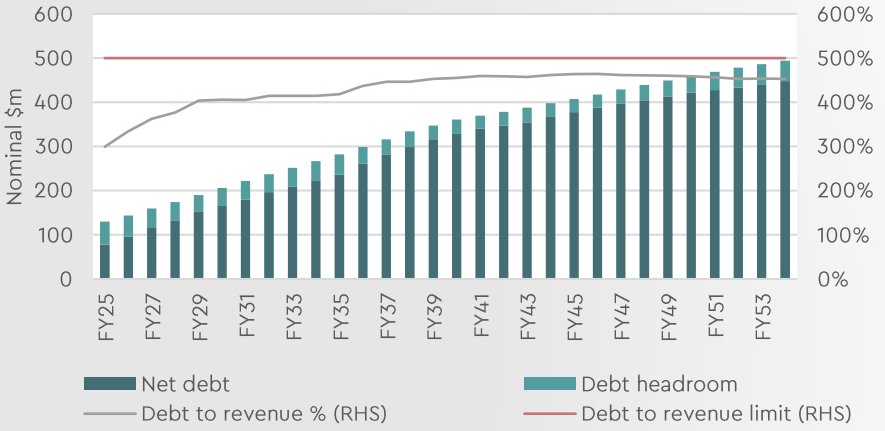
Net debt to revenue tracks up over the next fifteen years before flattening off at around 4.6 times revenue for the remainder of the period. Water activities are typically operated with higher leverage than non-water council activities, due to their capital-intensive nature. The proposed level of borrowing for water services is significant but below the maximum levels of gearing indicated by LGFA as suitable for water CCOs.

Debt sustainability

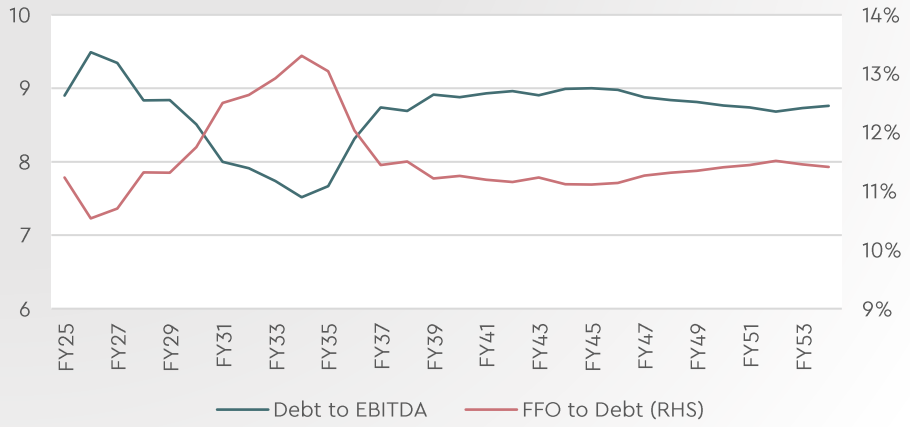
Funds from operations (FFO) to net debt improves over FY25-FY36 as revenues increase significantly, before declining to around 11-12% from FY37 onwards. A range of 9-13 percent represents an aggressive level of leverage.

Overall, the debt trajectory is aggressive and at the margins of sustainability for water services on a standalone basis when assessed against water industry benchmarks.

Three Waters debt and leverage ratio



Debt sustainability



Three waters affordability

Affordability

Average water rates per connection

Under this scenario, real water charges per connection are projected to increase by $1,960, from $2,155 in FY25 to $4,113 FY54.

This represents an almost doubling of water charges in today's dollars (2.3% per annum above the rate of inflation).

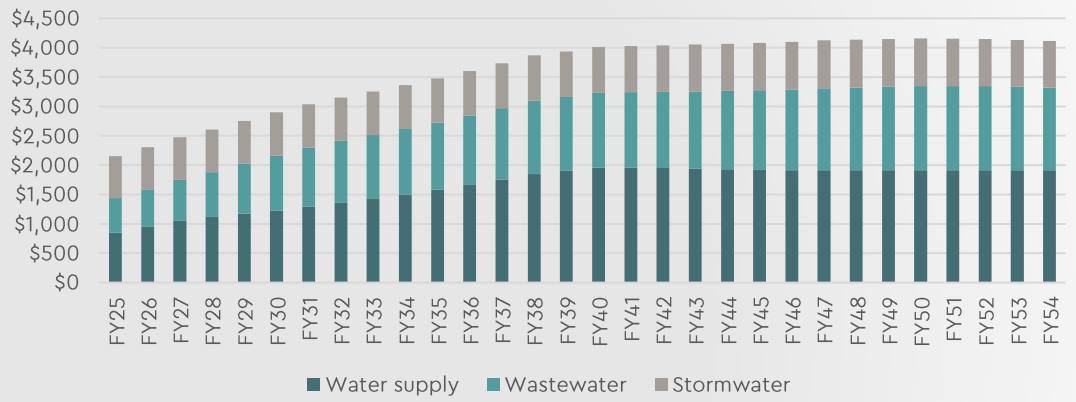
Water rates as a % of median household income

The increase in water charges is estimated to increase average spending on water services per connection from 2.4% to 3.9% of the median household income in FY40, before declining slightly to 3.5% by FY54.

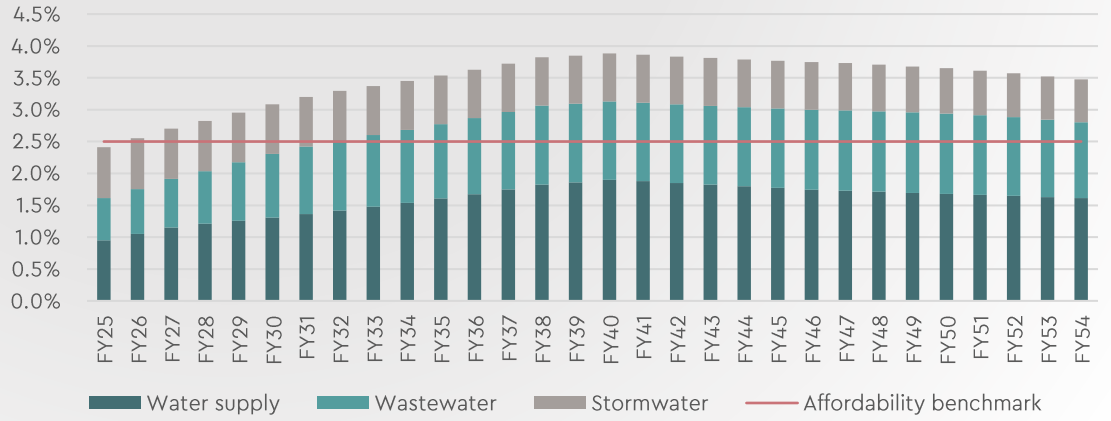
Affordability of water charges

Based on our long-term financial projections, the affordability threshold is expected to be reached by FY26 and continues to worsen over the next fifteen years.

Average water rates per connection (current prices)



Water rates per connection (% of median household income)



Summary of current state review findings

01 **LTP projections appear to be inconsistent with financial sustainability requirements under LWDW.**

Investment sufficiency

- There is low consistent compliance with drinking water quality assurance rules, and significant upgrades to four of six WWTPs will likely be required to meet replacement consent requirements. The LTP does not provide funding allocation for anticipated works.
- Future renewal investment roughly matches forecast depreciation expense, but this will be insufficient to address the $95.9 million renewals backlog.

Revenue sufficiency

- Projected revenue is not sufficient to cover the costs of water services delivery over the period of the LTP, with cumulative deficits over the ten years of $18.0 million (average of 4.8% of operating revenue). This primarily relates to revenue insufficiency for wastewater services.
- The inclusion of deferred investment in wastewater treatment upgrades in the WSDP capex projections would necessitate significant increases in wastewater rates in addition to those required to eliminate the LTP's projected operating deficits.

Financing sufficiency

- Significant borrowing over the next five years sees net debt to revenue for water services reach 361% in FY28 before slowly declining to 339% by FY34. This represents significant leverage for water activities but is not excessive by New Zealand local government standards.
- However, inclusion of investment required to achieve compliance would put pressure on borrowing without significant increases in water revenue.

02 **Water charges per connection are expected to exceed affordability benchmarks by year 4 of the LTP, though not significantly. The additional costs and revenue required to meet sufficiency tests would be like to materially alter affordability.**

- Under the LTP, total water charges per connection are projected to increase 4.0% per annum above the projected annual rate of inflation. The increase in water charges is estimated to increase average spending on water services per connection from 1.9% of the median household income in FY24 to 2.6% by FY30 before flattening off and slightly declining to 2.5% by FY34. However, addressing challenges with revenue and investment sufficiency would be likely to materially alter this and further exacerbate affordability.
- Based on our long-term financial projections, the affordability threshold would be expected to be reached by FY26 and continues to worsen over the next fifteen years. The increase in water charges is estimated to increase average spending on water services per connection from 2.4% to 3.9% of the median household income in FY40, before declining slightly to 3.5% by FY54.

03 **These conclusions are preliminary and subject to further work.**

Areas to further investigate as part of preparing a Water Services Delivery Plan include:

- Reassessment of the LTP capex programme with a view to including necessary compliance-related investments. We understand Tonkin & Taylor have been engaged to undertake this assessment.
- Review of wastewater rate setting (in light of revised LTP capex).
- Applying the principles of ringfencing of water services.
- Provision for higher compliance costs associated with economic regulation and changing expectations from resource consents.

As a result of this further work, adjustments to the Council's planned operating and capital expenditure projections are likely to be required, with updated projections to be included in the WSDP.

04 Other risks that could impact on viability and sustainability include quality of asset information, higher capital price inflation, uncertain future regulatory requirements, confidence about resource consenting, higher frequency extreme weather events, and ability to attract and retain staff.

High-level options assessment

Drivers for considering alternative water service delivery models

The drivers reflect the findings of our review of the viability and sustainability of the current service delivery model, and future needs and regulatory requirements.

Ensuring affordability for ratepayers and sufficient revenue to sustainably deliver water services *(revenue sufficiency + affordability)*

- Ensuring that water charges are set at a level at which water services can be sustainably delivered, while also ensuring water charges are affordable for Whakatāne District's communities.

Improving compliance with drinking water and environmental regulatory requirements *(investment sufficiency)*

- Addressing current challenges with compliance and meeting upcoming consent replacement requirements in order to protect and promote public health and the environment.

Improving water infrastructure resilience

- Ensuring that future investment requirements driven by geographical features of the district, natural hazards and increased climate change risk are properly anticipated.

Ensuring access to finance to fund investment in a manner that delivers best value for ratepayers *(financing sufficiency)*

- Ensuring that the financing of investment including to meet increased regulatory requirements can be met without undue burden on current or future ratepayers.

Risks to maintaining the capability and capacity for delivery *(resourcing sufficiency)*

- Ability to attract and retain workforce, particularly over the transition and into the future.

Ability to sustainably deliver other Council services

- Ensuring rest of council viability and ability fund investment in and delivery of non-water services on a sustainable basis.

The options for assessment were narrowed

	Internal business unit or division	Single council owned water organisation	Multi-council owned water organisation	Mix council / consumer trust-owned water organisation	Consumer trust-owned water organisation
Ownership	Council-owned (internal division)	100% owned by Whakatāne DC	Owned by Whakatāne DC plus others	Part-owned by council, part owned by trust	100% owned by trust
Governance	Council oversight (option of independent committee)	Council appointed or committee (Council officers and elected members cannot be on board)	Shareholder council	Shareholder council (trust + council)	Trustees appoint the board
Accountability	Water-focused annual reports and financial statements	Reports to owners quarterly, prepares audited annual report, acts consistent with statutory objectives	Reports to owners quarterly, prepares audited annual report, acts consistent with statutory objectives	Reports to owners quarterly, prepares audited annual report, acts consistent with statutory objectives	Reports to owners quarterly, prepares audited annual report, acts consistent with statutory objectives
Borrowing	Council borrows (LGFA limits)	Borrow via LGFA (up to 500% debt to revenue), if there is council support	Borrow via LGFA (up to 500% debt to revenue), if there is council support	Independent, likely via banks (more expensive)	Independent, likely via banks (more expensive)
Planning	Council prepares a Water Services Strategy, fully integrated with overall council strategy and budgeting	Water organisation prepares its own Water Services Strategy, guided by a council-issued Statement of Expectations	Multi-council shareholders jointly issue a Statement of Expectations; the water organisation prepares a Water Services Strategy	Shareholders (councils and trust) issue combined expectations; water organisation prepares its strategy to meet both councils and trust goals	Trustees issue a Statement of Expectations, with the water organisation preparing a strategic plan aligned with community goals
Operations	Integrated with council operations	New independent water organisation	Joint council ownership	Mixed ownership; community involvement	Full independence from council
	To be considered An enhanced status quo against which options can be compared	**To be considered** Some inherent advantages in the CCO model	**To be considered** A sub-regional and whole of region variant	**Discounted** Cannot access borrowing from LGFA	**Discounted** Cannot access borrowing from LGFA

Non-asset owning variant – Management CCO

Discounted
Cannot access borrowing from LGFA

Options considered

Design choices

Options:	1 **Internal business unit with possible shared service arrangements** *Enhanced status quo*	2 **Standalone council-owned water organisation (WSCCO)**	3a **Sub-regional asset owning water organisation (WSCCO)**	3b **Whole of region asset owning water organisation (WSCCO)**
Description:	Creation of dedicated ring-fenced unit within Council. Council may work with neighbouring councils to share corporate, planning and delivery services across multiple districts.	Council establishes a water organisation to deliver water services.	Council enters arrangement with other Councils to establish or join a sub-regional asset owning water services organisation. Possible partners TCC and WBOPDC.	Council partners with Bay of Plenty Councils to establish a regional asset owning water services organisation.
Who decides levels of service and investment intentions?	• Elected members continue to decide; current mechanisms maintained. Option for service level agreements.	• Elected members issue Statement of Expectations; governed by a competency-based board.	• Shareholding council issue Statement of Expectations, guided by ownership rights set out in constitution / shareholders agreement.	• As for Option 3a.
Who undertakes strategic planning and delivery?	• Council staff responsible for planning and delivery, working with private suppliers and contractors. Option to collaborate and share planning resources and seek efficiencies from joint procurement and delivery efficiencies.	• WSCCO plans and delivers services, but required to consult the council.	• WSCCO responsible for planning and delivery, likely with a requirement to consult with shareholding councils.	• As for Option 3a.
What are the mechanisms for mana whenua representation and influence?	• Existing Council relationships and processes will continue. Option to enhance these, depending on council mix, geography and hapū and iwi relationships.	• Council determines representation mechanisms in WSCCO design.	• Shareholding councils set representation mechanisms in WSCCO design.	• As for Option 3a.
What are the mechanisms for local voice and influence?	• Access to councillors through current mechanisms, consultation on LTPs and Annual Plans.	• Council appoints directors and sets local engagement mechanisms during design and establishment of WSCCO.	• Shareholding councils can appoint and remove directors. • If the council is involved in establishment, it can influence what mechanisms are included in the design of the water organisation.	• As for Option 3a.
Who owns the assets?	• Assets remain with council.	• Council may retain or transfer assets to WSCCO	• Councils transfer ownership of assets. Potentially an opportunity to contract for stormwater.	• As for Option 3a.
Who employees staff?	• Staff remain in council, either as part of unit, internal shared services arrangement, or shift to 'parent' council (if not Whakatāne).	• Water staff transition to WSCCO.	• Some water staff could transfer to WSCCO.	• As for Option 3a.
How is investment funded / financed?	• Council funding and debt via LGFA, limited at 280% debt to revenue.	• Water organisation charges water users, with borrowing up to 500% debt-to-revenue from LGFA supported by council guarantee or uncalled capital. • Likely council credit rating downgrade under this structure due to higher debt and council guarantee of water CCO .	• As for Option 2. • The parent council guarantee can be joint and proportionate however the proportionality terms would need to be negotiated (and could create risk for one council or another).	• As for Option 3a.

Key differences between the options

Options:	1 **Internal business unit with possible shared service arrangements** *Enhanced status quo*	2 **Standalone council-owned water organisation (WSCCO)**	3 a **Sub-regional asset owning water organisation (WSCCO)**	3 b **Whole of region asset owning water organisation (WSCCO)**
Description:	Creation of dedicated ring-fenced unit within Council. Council may work with neighbouring councils to share corporate, planning and delivery services across multiple districts.	Council establishes a water organisation to deliver water services.	Council enters arrangement with other Councils to establish or join a sub-regional asset owning water services organisation. Possible partners TCC and WBOPDC.	Council partners with Bay of Plenty Councils to establish a regional asset owning water services organisation.
Strategic focus	Strategic focus is broad, with elected member and executive leadership focus distributed across all council functions.	Benefits from a singular focus on water services. May create 'interface issues' with other council functions that need to be managed and have the potential to give rise to problems (e.g., relating to land use planning, provision for growth).	Benefits from a singular focus on water services. May create 'interface issues' with other council functions that need to be managed and have the potential to give rise to problems (e.g., relating to land use planning, provision for growth).	As for option 3a.
Governance	Elected members continue to have decision-making responsibility.	Asset-owning models, where responsibility for investment, pricing and financing decisions rest with the board, aligns decision making and incentives for asset stewardship and effective and efficient operations. Clarity for Board of having single shareholder.	Introduction of multiple shareholders requires careful consideration of ownership and shareholder decision rights, with greater scope for divergence of shareholder interests as the number of owners increases and/or with greater diversity in the underlying communities of interest.	As for option 3a.
Accountability	Accountability to elected members and through existing mechanisms under LGA (council and council committee structures) and management reporting lines. Bill 3 will introduce new strategy, planning and accountability mechanisms. These will be uniform across all service delivery models.	Oversight of performance by single council. Enables a direct relationship between the regulator, board and management, supporting effective regulation. Easier to regulate than Option 1, enabling greater scrutiny of performance and strengthened incentives for board and management. Well established frameworks for setting customer service levels, network performance standards, compliance requirements.	Similar to Option 2 but success of this model requires additional shareholder coordination mechanisms (e.g. shareholder forum or similar). There are good models to draw on here, for example TasWater.	Similar to Option 3a, noting that more shareholders can add complexity including in relation to shareholder decision rights.

Strategic objectives

STRATEGIC OBJECTIVES	ASSESSMENT APPROACH / MEASURE
The delivery of water services is **efficient, financially sustainable and affordable** for Whakatāne District's communities	• Financially sustainable – revenue, financing and investment sufficiency, and ring-fencing. • Resource sufficiency – sufficient resource to operate water services sustainability, and that the management of those resources is effectively and efficiently undertaken. • Affordable – the projected increase in water charges is affordable for the community.
There is investment at a level that **protects and promotes public health and the environment**	• Investment sufficiency – to meet public health and environmental regulatory requirements.
The right **workforce capability and capacity** is available	• Ability of the future delivery model (whether within council or not) to attract and retain people with the skills to plan, manage and deliver water services.
The model enables and supports high quality **development and growth outcomes**	• Investment sufficiency – to meet future growth needs. • Ability of the future delivery model to support integrated planning and decision-making around spatial, district and strategic planning with water infrastructure planning for housing development and economic growth.
Water services **meet the needs and expectations of Whakatāne District's communities**.	• Strength of mechanisms for local voice and influence provided for in the model. • Ability to act in the best interests of present and future consumers and communities.
Water services are **resilient to natural hazards and the effects of climate change**	• Investment sufficiency – to ensure resilience over the long-term. • Ability of the future model to support alignment and co-ordination with BOP Regional Council flood protection functions.
Responsibilities to hapū and iwi are met	• Strength of engagement with hapū and iwi ensures consistent levels of involvement that effectively influences decisions.

Assessment of options

1 of 3

Options:	1 Internal business unit with possible shared service arrangements *Enhanced status quo*	2 Standalone council-owned water organisation (WSCCO)	3 a Sub-regional asset owning water organisation (WSCCO)	3 b Whole of region asset owning water organisation (WSCCO)
Description:	Creation of dedicated ring-fenced unit within Council. Council may work with neighbouring councils to share corporate, planning and delivery services across multiple districts.	Council establishes a water organisation to deliver water services.	Council enters arrangement with other Councils to establish or join a sub-regional asset owning water services organisation. Possible partners TCC and WBOPDC.	Council partners with Bay of Plenty Councils to establish a regional asset owning water services organisation.
efficient, financially sustainable and affordable	• Potential for shared services would not materially alter financial position. • Will not meet new financial sustainability requirements over the short-term without significant increases in revenue and access to additional borrowing capacity. • Affordability breaches 2.5% benchmark in FY 28 under current LTP, though not significantly. The additional costs and revenue required to meet sufficiency tests would be like to materially alter affordability.	• Potential for strengthened governance with professional directors • Ability to leverage council shared services (WSCCO-lite), mitigates stranded costs. • Limited potential for efficiencies driven by a lack of scale, and potentially offset by higher costs. • Greater access to debt allows investment to meet future challenges with costs spread over generations, but would exacerbate affordability.	• Scale efficiencies likely, dependent on mix of councils involved (significant benefits would require involvement of TCC). • Greater access to debt allows investment to meet future challenges with costs spread over generations. • A multi-council, asset-owning organisation is likely to deliver greatest benefit to communities.	• Similar to Option 3a, albeit additional scale could offer some further potential for scale efficiencies but potentially offset by greater geographic area and lower population density.
protects and promotes public health and the environment	• Will not meet investment sufficiency requirements under current LTP (investment required to meet regulatory requirements), particularly for wastewater. • Submitting a compliant WSDP would require inclusion of significant additional capex to meet compliance requirements.	• Increased ability to meet drinking water quality and environmental regulatory requirements through increased investment capacity.	• Strongest ability to meet drinking water quality and environmental regulatory requirements through increased investment capacity. • Potential for funding to be prioritised towards needs of other councils.	• As for Option 3a. • Opportunity to take a catchment-based approach.
workforce capability and capacity	• Workforce attraction and retention risk if there are more attractive options in other locations with CCOs. • Relatively lower buying power in supply market	• Potentially improved ability to attract and retain specialist workforce compared to option 1, but shouldn't overstate the difference. • Could be hard to attract high quality board directors.	• More likely to attract skilled workers due to greater specialisation, better career paths. A larger entity would be more attractive from a talent and attraction perspective. • Increased buying power in supply market	• Similar to Option 3a, albeit significant additional scale would offer further opportunities.

Does not meet objective	*Partially meets objective*	*Meets objective*

Assessment of options

2 of 3

Options:	1 Internal business unit with possible shared service arrangements *Enhanced status quo*	2 Standalone council-owned water organisation (WSCCO)	3 a Sub-regional asset owning water organisation (WSCCO)	3 b Whole of region asset owning water organisation (WSCCO)
Description:	Creation of dedicated ring-fenced unit within Council. Council may work with neighbouring councils to share corporate, planning and delivery services across multiple districts.	Council establishes a water organisation to deliver water services.	Council enters arrangement with other Councils to establish or join a sub-regional asset owning water services organisation. Possible partners TCC and WBOPDC.	Council partners with Bay of Plenty Councils to establish a regional asset owning water services organisation.
development and growth outcomes	• Simple and efficient integration of planning functions across infrastructure types. • Significant challenge to long-term investment for growth and resilience.	• Greater debt capacity available to the organisation to invest. • Ability to set expectations in line with Council strategies and plans through a Statement of Performance Expectations. • Risk of losing integration and coordination with land use planning and roading, but mitigations exist.	• Greater debt capacity available to the organisation to invest. • Potential for integration with other councils to better manage spatial planning and climate change challenges • Harder to agree shared priorities for growth and development across councils with divergent community interests.	• Similar to Option 3a, albeit inclusion of a larger number of councils increases complexity.
meet the needs and expectations of Whakatāne District's communities	• Levels of service targets set by council are consistently achieved, but there are significant current and anticipated non-compliance issues. • Strong community voice mechanisms and direct accountability to communities.	• CCO would need to determine community voice mechanisms and would likely replicate some existing consumer consultation and engagement activities, specific to water services. • Subject to consumer protection regulations, including independent dispute resolution. • Stronger forms of economic regulation would be expected to drive a customer focus with requirements to engage communities.	• As for Option 2. • Opportunity for service improvements from consolidating operations and maintenance. • Would require agreed transition path including approach to harmonisation of investment plans and water charges. • Harder to agree shared priorities and expectations across councils with divergent community interests.	• Similar to Option 3a, albeit inclusion of a larger number of councils increases complexity.
resilient to natural hazards and the effects of climate change	• Climate and resilience related investments and reactive infrastructure upgrades have been deferred due to affordability and debt constraints. • Council borrowing constraints would likely limit ability to make the necessary investments.	• Greater debt capacity may make it possible to enhance investment in climate resilience, but affordability would remain a challenge.	• Greater debt capacity may make it possible to enhance investment in climate resilience.	• As for Option 3a.

Does not meet objective	*Partially meets objective*	*Meets objective*

Assessment of options

3 of 3

Options:	1 **Internal business unit with possible shared service arrangements** *Enhanced status quo*	2 **Standalone council-owned water organisation (WSCCO)**	3 a **Sub-regional asset owning water organisation (WSCCO)**	3 b **Whole of region asset owning water organisation (WSCCO)**
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Responsibilities to hapū and iwi (Note specific engagement has not informed this analysis in the time available)	• Ability to make use of existing mechanisms and channels for engagement and partnership.	• As for Option 1 but would likely require additional resourcing by the CCO or a service level agreement with Council to meet obligations.	• New engagement and partnership mechanisms would need to be developed that meet the needs and expectations of increased numbers of hapū and iwi. • There may be a preference for smaller/existing boundaries. Direct engagement with hapū and iwi would be required to explore this, including on the potential for greater investment capacity under multi-council options.	• As for Option 3a, albeit inclusion of a larger number of councils increases complexity.

Does not meet objective	*Partially meets objective*	*Meets objective*

Additional considerations

Options:	1 **Internal business unit with possible shared service arrangements** *Enhanced status quo*	2 **Standalone council-owned water organisation (WSCCO)**	3 a **Sub-regional asset owning water organisation (WSCCO)**	3 b **Whole of region asset owning water organisation (WSCCO)**
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Implementation and transition considerations and risks	• Easiest option to implement and transition to / from. • Key risk in not meeting LWDW requirements for revenue and investment sufficiency while maintaining affordability for community.	• Higher barriers to entry compared to option 1, but lower than options 3a and 3b. • Some implementation risk, and potential challenges in identifying an appropriate board.	• Approaches to asset, debt and staff transfer arrangements would need to be carefully considered, including considering stranded cost impact. • Implementation and timing uncertainties.	• As for Option 3a.
Timing and durability of benefits	• Small benefits from potential for shared services (e.g., sharing CCTV inspection capacity/capability). • Benefits would be enduring, but significantly less than other options	• Limited benefits due to lack of scale, with potential for additional costs (i.e. additional governance and management costs). • Benefits highly dependent on quality of board and management of CCO.	• Benefits likely to be realised over the medium- to long-term. • Comparatively larger benefits assumed compared with single council options. • Benefits would be durable and expected to be greatest under a multi-council option.	• Similar to Option 3a, albeit additional scale could give larger benefits.
Certainty of option	• Most certain, but not viable without unaffordable increases in water rates.	• High-level of certainty – within council's control to implement but carries implementation risk relating to governance oversight and management performance.	• Greater uncertainty – would require commitment from TCC and WBOPDC to progress development of option for consultation. • May be more feasible than option 3b given TCC/WBOP actively considering this option. • Less easily reversed than Option 2.	• Similar to Option 3a, albeit inclusion of a larger number of councils increases level uncertainty around ability to gain commitment. • Currently no formal commitment in place to progress region-wide water CCO.
Impact on rest of council	• More transparent cost allocation compared to status quo. • No stranded costs. • Risk that investment and borrowing required to meet LWDW requirements crowds out ability to invest in other council services.	• Debt headroom improved with removal of water services. • Potentially some impact on wider council functions, depending on level of shared services / stranded costs.	• Debt headroom improved with removal of water services. • Likely to see stranded costs, limiting ability to expend revenue on other council activities until this is resolved. • Stranded cost impact dependent on transition/implementation approach.	• As for Option 3a.

Additional considerations – CCO model

The CCO model has inherent benefits relative to inhouse delivery, provided the entity is set up well and that governance and management risks are avoided

A single-council CCO has the potential to generate benefits in terms of strategic focus (singular focus on water services delivery), governance (independent, professional board), and strengthened accountability (e.g., customers performance framework and greater scrutiny of performance). These benefits are inherent to the CCO model and are the reason why corporate forms of water services utility have been adopted in many jurisdictions.

The additional benefits of a multi-council CCO relative to a single-council CCO are dependent on scale. A larger, multi-council CCO can (theoretically) attract a more capable, skilled board and workforce (e.g., by offering more pathways for future development, greater scope for specialisation etc). However, the benefits of multi-council CCO (at least in terms of strategic focus, governance and accountability) shouldn't be overstated if the options you are comparing are not substantially different in terms of scale.

The role of the economic regulator is yet to be determined, and this may have an impact on benefit realisation

A key question will relate to the extent of attention a water CCO gets from the Commerce Commission under the future economic regulatory regime. This is an unknown as there is limited detailed information currently on the approach the Commerce Commission will take, and the threshold for when they will move from a predominantly Information Disclosure-based regime to stronger forms of regulation (e.g., Price-Quality regulation).

There are two plausible scenarios here:

1. Most water services providers (including inhouse council business units) are subject to information disclosure-only (ID), with only the largest metropolitan entities subject to a stronger form of regulation.
2. All inhouse council business units are subject to ID-only, with all independent water CCOs subject to some form of stronger regulation (see for example the PREMO model in Victoria).

What about implementation costs?

All options will require additional costs of implementation. These implementation costs need to be assessed against the value of long-term benefits.

The more complex the transition, the longer the benefits will take to realise and the greater the transition costs. For that reason, there is a value in acting strategically and quickly if a stand-alone approach is not financially viable.

Relevant implementation considerations for Whakatāne District Council will include:

- Establishment: Board establishment, establish reporting and accountability processes, and manage transfer of assets, relevant contracts and resource consents
- Workforce and Operations Shift: Determining workforce impacts, relevant systems and processes and maintain service delivery
- Mana Whenua and Community Engagement: Create engagement approaches for staff, Treaty partners, and ratepayers
- Risk and Performance Systems: Identify key transition risks, set clear performance measures, maintain environmental compliance, and monitor service levels

Additional considerations – multi-council models

A key focus for Council is ensuring local interests and influence is enabled in any model that brings together water services for multiple councils.

In a multi-council ownership situation, different councils are likely to have different interests or priorities specific to their communities. This includes both in the services communities receive and how they are delivered (e.g. local employment considerations).

Thought needs to be given in the design of the entity and its governance and accountability mechanisms to ensure local voice and influence is enabled in an agreed way, and that the board and management of the entity isn't pulled in different directions.

There are opportunities for Council to influence both in the design of the entity and its ongoing performance. Council could choose to enter into a Heads of Agreement with other councils to agree the principles driving the development of the joint model and the approach to developing many of the elements described here (this is the approach being followed for Waikato Water Done Well).

1. Entity design – Council input to design elements including, amongst other things, mechanisms for engagement with hapū and iwi, community voice, share allocations, shareholder representation and decision-making, and reporting requirements.
2. Transition plan – Council input and agreement to a transition plan that includes an approach to harmonising investment and pricing (or not) and agreement to the first asset management plan.
3. Statement of Performance Expectations – the legislative requirement for a single Statement of Performance Expectations means that shareholding councils need to come to an agreed view on priorities and direction, rather than individually conveying expectations.
4. Shareholder forum – a mechanism by which the interests of shareholding councils would be coordinated and expressed. Likely the mechanism through which Council would have input and influence in appointment of Board members setting the Statement of Performance Expectations.
5. Relationship agreements – set out the general principles governing the relationship between the parties, how the parties will work together in the performance or exercise of statutory functions and powers (e.g. stormwater management, spatial and land use planning, emergency management, Treaty settlement obligations), how the parties will share information and engage with each other, and how disputes will be resolved.
6. Service level agreement – set out the services to be provided and the parties' respective roles and responsibilities for the management, operation, or maintenance of the services to which the agreement applies, and how those responsibilities will be allocated and funded. This may be relevant to any shared services or transitional arrangements.

Potential efficiency benefits from joint arrangements

Under the previous reform process, WICS utilised the UK experience and Council provided information to estimate potential efficiencies that can be realised under a variety of models. Scenario 1 and 3 were assessed by WICs through this process and are summarised below.

MartinJenkins has applied professional judgement to propose efficiency assumptions. We consider it is appropriate to be more conservative relative to WICS to ensure the efficiencies are likely to be achieved. We note the evidence base for capex efficiencies is less extensive and, as such, it is appropriate to apply a more conservative assumption.

Further information on efficiencies is in the Appendix.

	Scenario 1: WDC only	Scenario 2: WDC, TCC, WBOPDC	Scenario 3: Bay of Plenty Region
WICS inputs			
Councils	1	3	6
Population served (2020)	27,480	202,821	276,769
Log (population/1000)	4.4	5.3	5.4
WICS opex and capex efficiency (p.a.)			
Years 5-10	0.2%	Not analysed	5.5%
Years 11-15	0.2%	Not analysed	2.8%
Years 16-20	0.2%	Not analysed	2.1%
Proposed assumptions			
Opex efficiencies (pa)	0.2%	1.0% - 1.5%	1.5% - 2.0%
Capex efficiencies (pa)	0.0%	0.5% - 0.8%	0.8% - 1.0%

The red rows in the table above represent a MartinJenkins view of reasonable efficiency assumptions that could be applied to support financial assessment of alternative options. The assumption should be applied on a compound (diminishing rate) basis from year 3-5 onwards. Note the above does not consider incremental, establishment or stranded costs (which should be estimated separately).

Summary assessment

OPTIONS	CHOOSE OPTION IF	KEY ADVANTAGES	KEY DISADVANTAGES
1 **Internal business unit with possible shared service arrangements** (enhanced status quo)	Analysis confirms this is financially achievable, Council wants least change to status quo and is confident it can meet new LWDW requirements in the short- to medium-term. ***This unlikely to be financially sustainable without unaffordable increases in water revenues, based on our current state review.***	• Ease of implementation, and ongoing flexibility. • Integrates well with existing council functions and infrastructure planning. • Unlikely to create stranded costs or adverse impacts on rest of council.	• Affordability and financing challenges if capital expenditure to comply with LWDW is brought back into the 10-year plan. • Potential workforce attraction and retention risks, exacerbated if neighbouring councils form a larger entity. • Benefits of potential shared services still to be explored with neighboring councils, but not likely to materially alter the financial position. • Does not provide any scale economies.
2 **Standalone council-owned water organisation (WSCCO)**	Council can meet LWDW requirements on its own but needs additional debt capacity offered through LGFA. This would require a significant adjustment in the current funding approach. ***This unlikely to be financially sustainable without unaffordable increases in water revenues, based on our current state review.***	• Greater access to debt (compared to Option 1) to meet future challenges and enable additional investment in resilience.	• Affordability challenges if capital expenditure to comply with LWDW is brought back into the 10-year plan. • Significant efficiencies likely limited due to lack of scale and may be diseconomies of scope. • Some loss of oversight and control by elected members. • Potential implementation risks.
3 a 3 b **Regional / sub-regional asset owning water organisation**	Mutual benefits to Council from partnering with others to establish a joint organisation and Council is confident in design of prioritisation mechanism, and ability for communities to engage. ***These two options have similar advantages and disadvantages, albeit dependent on the mix of participating councils. The key differences between the options relate to the potential scale efficiencies and level of complexity with increasing number of councils involved.***	• Scale efficiencies likely to be greatest under these options. • Potential integration with neighbouring councils to better manage demographic, environmental compliance and spatial planning challenges. • Access to debt, and longer-term financing to address future challenges and affordability. • Greatest ability to attract and retain workforce.	• No formal commitment from potential partners to explore options at this point in time. • No certainty about the design of the model, including mechanisms for agreeing shared priorities and expectations across councils and engaging with hapū and iwi. • Stranded costs are likely (but may be mitigated through careful transition planning). • Potential for diseconomies of scope (e.g., loss of integration with spatial planning, transport). • Higher costs and timeframe for implementation

Conclusions and recommendations

Conclusions and recommendations

Whakatāne District has limited options that would satisfy a strict interpretation of financial sustainability requirements under the Local Government (Water Services Preliminary Arrangements) Act 2024

This conclusion is provisional and based on information provided to date. The provisional findings show that:

- the current delivery model would not meet financial sufficiency tests, and potential benefits from shared services would not materially alter this.
- the additional borrowing capacity available under a standalone CCO option is unlikely to be sufficient to achieve financial sustainability without unaffordable increases in water revenues.

Of the options assessed, only regional or sub-regional multi-council options at scale have the potential to fully satisfy the financial sustainability requirements under LWDW in an affordable way.

OPTIONS	CONTINUE TO EXPLORE?
1 **Internal business unit with possible shared service arrangements** (enhanced status quo)	**Yes** – the provisional findings show that the current delivery model would not meet financial sufficiency tests. However, Council needs to continue to consider how it can meet LWDW requirements on its own for consultation given multi-council options are not well advanced at this stage.
2 **Standalone council-owned water organisation (WSCCO)**	**No** – the provisional findings show that the additional borrowing capacity of this option is unlikely to be sufficient to achieve financial sustainability without unaffordable increases in water revenues.
3 a **Regional / sub-regional asset owning water organisation** 3 b	**3a** **Yes** – strong future benefits. Opportunity exists to approach TCC and WBOPDC to join development of option for consultation (TCC/WBOPDC already have joint work underway to explore this option). It may be more straightforward to secure commitment to explore this option than to pursue a region-wide option. **3b** **Yes** – strong future benefits. CE-level discussions have been held but requires a firmer mandate and commitment from participating councils to progress towards development of a more tangible option for consultation within WSDP timeframes.

Council should continue to explore how it could meet LWDW requirements under **option 1**

While provisional findings show that the current delivery model would not meet financial sufficiency tests, the Council should continue the work it has initiated to explore how it could develop a WSDP for Council alone that is fully compliant with the Act.

This recommendation is both because Council will be required to consider this option when making a decision on future service delivery arrangements, and because no regional or sub-regional opportunities have been developed to a point where they could be consulted on at this stage.

Significant work will be required to reforecast the Council's revenue and expenditures to better address investment sufficiency issues (primarily related to wastewater treatment plans), and to meet financial sustainability tests. This will be challenging to achieve while keeping water services affordable.

Conclusions and recommendations continued

Council already has work underway to stress-test and reforecast its capital delivery programme under the LTP and 30-year infrastructure strategy and the outcome of that work may result in Council being able to meet the requirements, albeit over a longer timeframe. We understand that Tonkin & Taylor have been commissioned to do this.

To determine whether option 1 will be viable will require early discussions with the Department of Internal Affairs and the Bay of Plenty Regional Council about the acceptability of achieving compliance with wastewater discharge requirements over longer period.

The Council should expedite exploration of potential joint arrangements with other councils, prioritising **option 3a**

Both sub-regional and whole of region options could bring significant future benefits relative to the current service delivery model. However, there is not currently a formal mandate or commitment from potential partner councils to explore a multi-council option involving Whakatāne District Council.

The Council could continue to explore both options at this point in time. However, based on the balance of judgements, **the most practical viable option would be for Whakatāne District Council to join a sub-regional joint arrangement with TCC and WBOPDC** if it is able to, given that work on developing this model is already underway and because of the scale benefits that this entity would present. Whakatāne District also shares a coastline, transport and other linkages with Tauranga City and Western Bay of Plenty.

We recommend the Council resolve to progress discussions with TCC and WBOPDC at pace.

The Minister for Local Government recently reconfirmed his strong expectation that councils will look at regional water services delivery models, and highlighted the availability of Crown Facilitators to support councils who require assistance to explore joint arrangements with other councils. This could be an option for the Council to consider if that is deemed necessary.

This report represents a first step towards narrowing down options to a viable short-list of service delivery options to inform community consultation. Council may wish to share this work with potential partners.

The analysis and recommendations of this report should position Council well for the next phase of work it will need to undertake to meet the requirement to submit a Water Service Delivery Plan in September 2025.

Appendix

Efficiency assumptions

We have had to make assumptions regarding the policy and regulatory environment (including economic regulation) and quality of governance and management given their critical impact on potential realisable efficiency gains

What efficiencies are gained by moving to professional Boards but with sole council ownership?

International water reform has tended to involve a combination of legislative reform, improved quality and economic regulation, corporatisation and professionalisation of governance, aggregation or amalgamation of service delivery and, in some cases, privatisation. As a result, it is very difficult to disentangle the impact of any one element from other changes.

We consider corporatisation and professional Boards provide an opportunity to improve governance and management, when supported by appropriate institutional and regulatory frameworks. Professional Boards alone, as demonstrated by entities like Wellington Water Limited, are insufficient to drive high-performance improved efficiency. A key differentiator is having Boards empowered with integrated oversight of investment, pricing, and financing decisions, and subject to economic regulation. This alignment of decision-making responsibilities with asset stewardship creates stronger incentives for effective and efficient operations than a professional Board operating with limited decision-making scope.

The assumption of improved governance and strategic focus is reflected in all scenarios being analysed. However, evidence clearly suggests that stronger corporate governance alone is insufficient to realise significant efficiency benefits without being coupled with clear strategic priorities, a service delivery model that provides appropriate incentives for the Board, and a strong-form economic regulation.

We have assessed efficiency on the basis that corporate structure, council performance and clear policy priorities are not compromising factors.

We have had to make assumptions regarding the policy and regulatory environment (including economic regulation) and quality of governance and management given their critical impact on potential realisable efficiency gains

The role of the economic regulator is yet to be determined, and this may have an impact on efficiency realisation.

Separate water CCOs can expect more focused attention from future regulators, with structural separation supporting greater transparency and accountability for delivery. However, given the costs of customised, entity-specific regulation, this is likely to be reserved for a small subset of the largest entities.

A key question is the extent of attention a water CCO gets under the future economic regulatory regime, and the degree of customisation to the entity's particular circumstances. This is an unknown as there is limited information currently on the approach the Commerce Commission will take, and the threshold for when they will move from an Information Disclosure regime to stronger forms of regulation (e.g., Price-Quality regulation). However, we know that Watercare will be subject to a price-quality path from 1 July 2025 under an interim regulatory scheme and is expected to transition to price-quality regulation under the enduring regulatory framework.

There are two plausible scenarios here:

1. Most water services providers (including inhouse council business units) are subject to information disclosure-only, with only the largest metropolitan CCOs subject to a stronger form of regulation
2. All inhouse council business units are subject to ID-only, with all independent water CCOs subject to some form of stronger regulation (see for example the PREMO model in Victoria).

Evidence base to support efficiency assumptions

Significant improvements in efficiency have been achieved in overseas jurisdictions that have pursued reform of a similar nature to that proposed in New Zealand. For example:

Productivity Commission

- In Australia, the Productivity Commission found that service delivery reform has helped to improve efficiency and deliver significant benefits for water users and communities. National Water Reform - Draft Report (pc.gov.au)

Frontier Economics

- In its review of the experience with water services aggregation in Australia, Great Britain, Ireland and New Zealand (Auckland) finds that there is "strong and consistent evidence" that reforms have led to significant improvements in productivity and efficiency. Review of experience with aggregation in the water sector (dia.govt.nz)

FarrierSwier

- In its review of WICS methodology, FarrierSwier commented on the potential that exists for efficiency gains from amalgamating water services in New Zealand and notes significant improvements are possible through aggregation and associated reforms, including improving the ability to attract and retain skilled management and staff, more effective procurement functions, asset level optimisation and reduction in corporate overheads and duplicative functions. Farrierswier - Three Waters Reform Programme - Review of WICS methodology and assumptions underpinning economic analysis of aggregation - 2 May 2021 (dia.govt.nz)
- In an independent review of the Essential Services Commission's PREMO regulatory model in Victoria, Australia, FarrierSwier found that water companies set efficiency targets through its 2018 Price Review ranging from 1.0% p.a. to 2.7% p.a. (averaging 1.8% p.a. across 15 regulated water authorities). While all but two companies delivered reductions in controllable opex per connection, the actual opex savings reported were lower than the target (ranging from 2.2% to -0.2% and average 0.9% p.a.) Victoria's water sector: The PREMO model for economic regulation

WICS

- WICS reports that Scottish Water has been able to reduce its operating costs by over 50% since reform, while improving levels of service to customers and absorbing the new operating costs associated with its investment programme. WICS Supporting Material 2 - scope for efficiency (dia.govt.nz)

UK Water Trade Association

- A report for the United Kingdom water trade association found that reform of the water industry in England resulted in annual productivity growth of 2.1% or 64% over 24 years when adjusted for service quality improvements. Water-UK-Frontier-Productivity.pdf

The Victorian model is a strong example of driving greater focus on customer, and driving cost efficiencies and reducing customer bills

In the mid-1990s, Victoria's water industry underwent significant restructuring. The provision of water services was largely corporatised, so that over 80 water providers became 20. This reform had an impact on the price consumers pay for water, as well as the terms of service delivery. As part of the restructuring process (in conjunction with the privatisation of the energy industry), the Kennett Government established the Office of the Regulator-General, which later became the ESC. On 1 January 2004, the ESC became the economic regulator for all water businesses in Victoria.

In the State of Victoria in Australia, the Essential Services Commission makes individual price determinations using its PREMO framework for four metropolitan water businesses (South East Water, Yarra Valley Water, Greater Western Water, Melbourne Water) and 11 regional urban water authorities (Barwon Water, Central Highlands Water, Coliban Water, East Gippsland Water, Gippsland Water, Goulburn Valley Water, Lower Murray Water (urban), North East Water, South Gippsland Water, Wannon Water and Westernport Water). These entities range in size, from 20,000 customers (Westernport Water) to 2 million customers (Yarra Valley Water).

There is strong evidence that regulation under the PREMO regime, combined with well governed and managed water businesses, led to a much greater focus on their customers and improved customer outcomes (see two independent reviews by FarrierSwier of the PREMO model on the Essential Service Commission's website). Under the PREMO framework, water businesses are required by the regulator to commit to a range of customer outcomes and associated performance measures and targets as part of their price submissions.

The PREMO model in Victoria has been effective in incentivising water businesses to pursue cost efficiencies and minimise prices for customers. Water businesses' opex efficiency improvement targets averaged 1.3% in the 2023 price review. This is lower than the 1.8% average opex efficiency hurdle in the 2018 price review, but higher than the standard 1.0% rate the commission applied prior to the introduction of PREMO.

The lower efficiency hurdles in the 2023 price reviews reflects the view that Victorian water businesses are now operating close to the 'efficient frontier' following years of regulation.

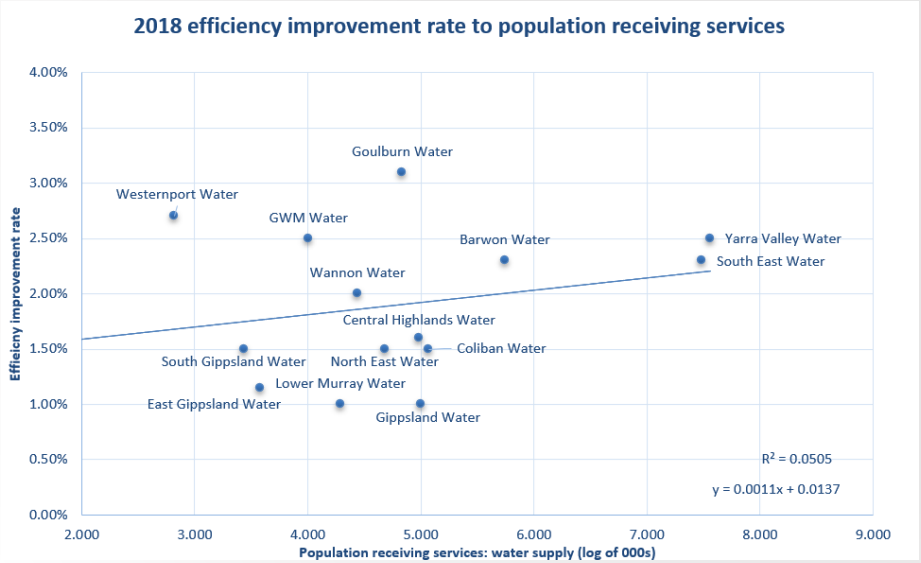
Analysis of Victorian utilities demonstrates potential deliverable efficiencies may improve with scale

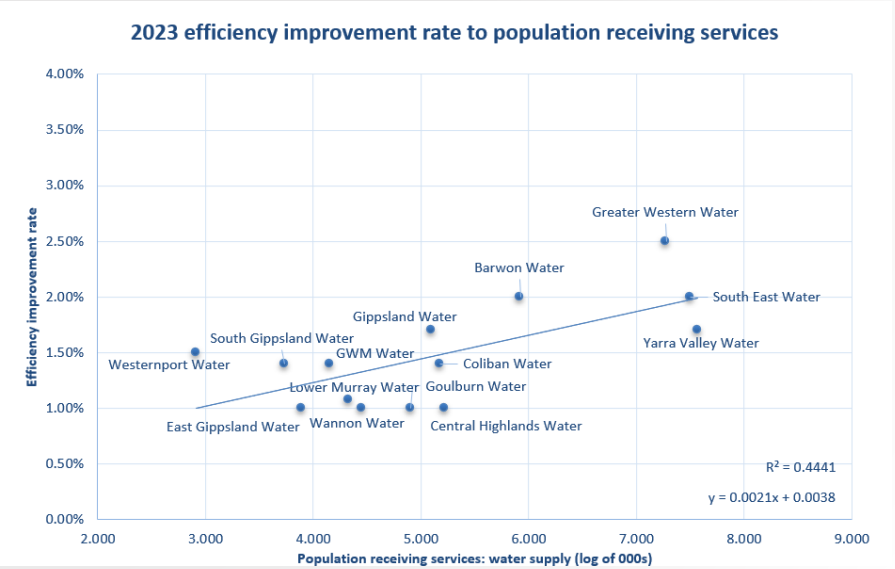
While actual performance data across Victorian utilities is limited and inconsistent (discussed on the next slide), analysis of regulatory efficiency targets (hurdles) provides valuable insights into the relationship between scale and expected improvements.

We have analysed the efficiency improvement hurdle imposed by or agreed with the Essential Services Commission in Victoria for each of the price reviews in 2018 and 2023 against scale (measured by population served).

The analysis highlights a clear relationship in the 2023 price review where larger entities were set a higher efficiency improvement hurdle for the ensuing five years. Larger entities were set efficiency hurdles of 1.5 – 2.5% per annum despite already being regulated for over 15 years.

The relationship in the 2018 price review is less clear (largely driven by a number of smaller entities with efficiency improvement hurdles of 2.5 – 3.0%), reflective of a greater weighting on industry-wide catch-up efficiency. The larger entities in this price review were still set efficiency targets of approximately 2.5% per annum for the ensuing 5 years. We also note that most entities serving 200,000 or less population (5.3 on X-axis) were set targets of 1 – 1.5% in both price reviews.





Source: Essential Services Commission, Victoria Water Price Reviews 2018 and 2023

The Australian national performance report does not measure efficiency however average operating expenditure per property can be analysed

This analysis captures all Australian water utilities however does not track actual efficiency improvement and as such is only intended to be used for verification rather than in determining the efficiency opportunity purposes. We note that inferences from this data should be undertaken with caution given the limited sample size in each category (shown below graph) and the numerous factors influencing operating costs per property. External variables such as geographic dispersion, water sources, treatment requirements, growth impacts and infrastructure delivery methods make comparisons challenging (despite averaging approach).

Operating costs vary significantly by utility size

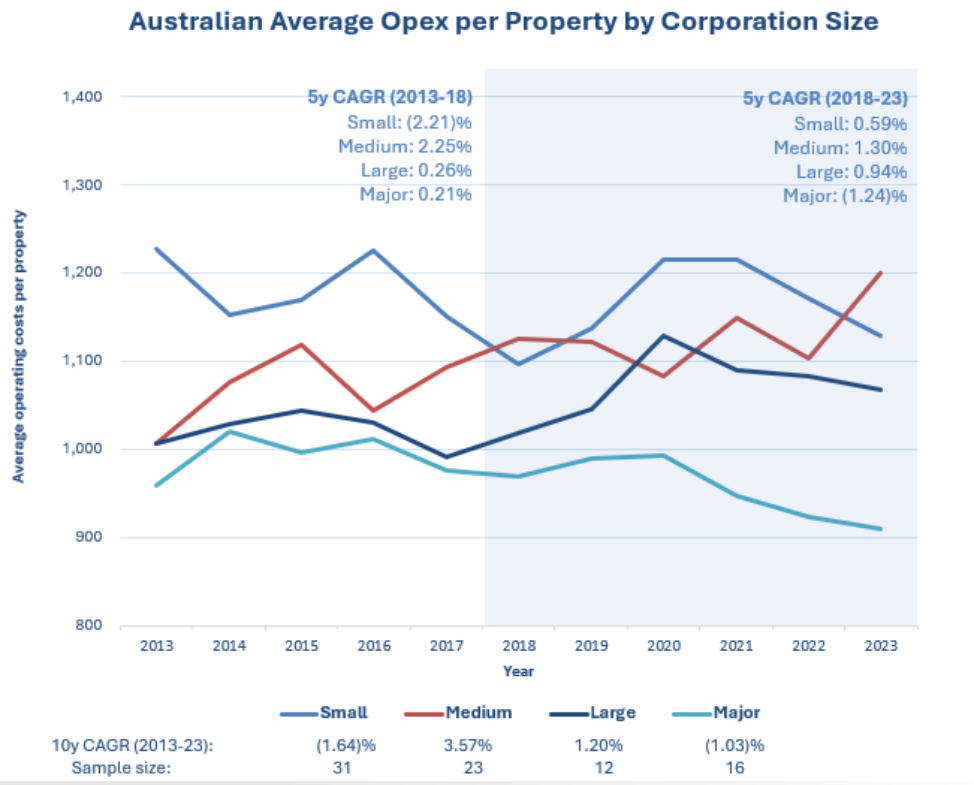
Major utilities (100,000 plus connections) consistently demonstrate the lowest operating costs per property (around $900–1,000) likely partly due to economies of scale as well as higher density.

10-year horizon highlights benefit of scale

Major utilities annualised growth over the period 2013 – 2023 outperformed large and medium utilities by 2.2% and 4.6% respectively. Small utilities average operating cost per property reduced by more than the major utilities however off a substantially higher base.

Dataset highlights variability over time

We note there are limited differences between medium, larger and major utility cost per property changes in the first five-year period (2013 – 2018) with all of the differential occurring in the second five-year period (2018 – 2023). The small utility dataset shows an irregular pattern over time.



Small	Medium	Large	Major
Less than 20,000 connected properties	Between 20,000 and 50,000 connections	Between 50,000 and 100,000 connections	Over 100,000 connections

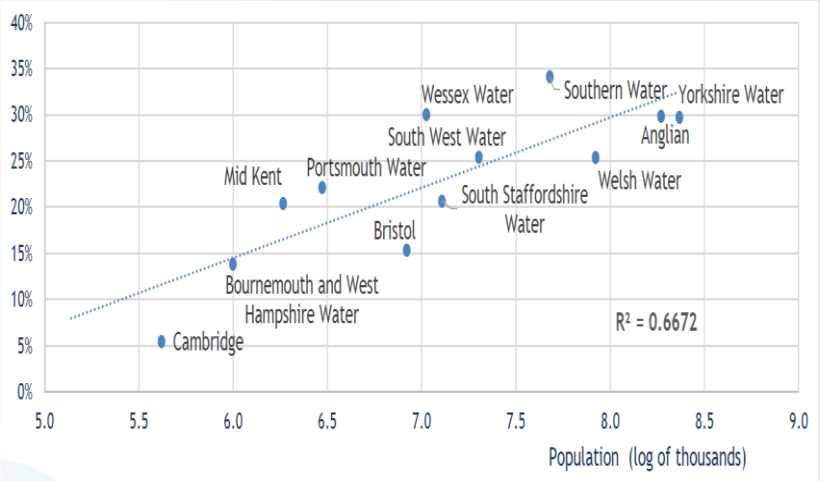
Source: Urban NPR Dataset 2023
Note: four outliers with extreme operating costs per property have been removed from the Small utility group dataset.
Note: CAGR stands for 'Compound Annual Growth Rate', which is the cumulative average annual growth rate over the period.

WICS compared efficiency for different scale UK water utilities following corporatisation, and used this to inform estimates for NZ councils

Water Industry Commission for Scotland (WICS) undertook analysis of the observed operating efficiency improvement for the different UK entities over a six-year period commencing with corporatisation (between 1994 and 1996) relative to the population served. In terms of quantifying the gains, the evidence indicates a non-linear relationship between scale (measured as population size or number of connections) and potential efficiency (see graph below). The WICS models are based on models developed by Ofwat and have been in use for 20+ years in England, Wales and Scotland.

There are diminishing returns to scale, with maximum scale reached with a connected customer base of 600,000-800,000. For councils below 60-70,000 population there is minimal scope for efficiency gains. This is consistent with management theory, whereby small entities are unable to achieve high levels of asset management maturity, procurement gains etc. WICS utilised the below to estimate efficiency gains for different scales of entity. WICS reduced the potential efficiency gains by a factor of 5 for scenarios where economic regulation, strong corporate governance and clear policy objectives were considered not present.

WICS calculated improvement in efficiency (over 6-year period following corporatisation) for UK water utilities and assessed catch-up potential for NZ



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%

Source: Water Industry Commission for Scotland

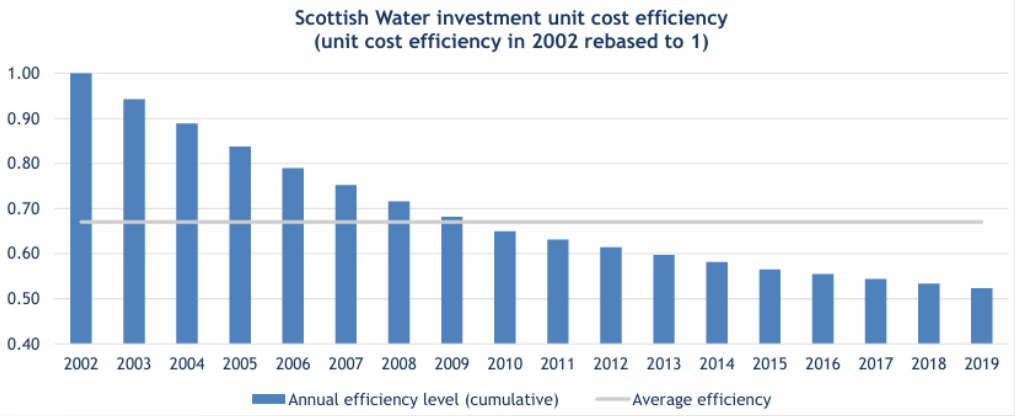
The table above shows the estimated potential efficiency improvement (%) that each NZ council could achieve relative to Watercare (i.e., New Zealand's most efficient water company), based on the observed efficiency improvements of similar-sized UK water utilities in their first 6 years following corporatisation.

The capital efficiency evidence base is less robust due to information scarcity. WICS utilised the capital efficiency achieved in Scotland reforms to estimate potential efficiency deliverable in NZ

There is limited international information readily available that enables a robust estimate of the potential capital efficiency gains possible from water reform in New Zealand. This reflects a lack of investment unit cost efficiency reporting which is necessary to ensure capital efficiency can be identified (as opposed to capital expenditure deferral or other driving factors).

WICS are the economic regulator for Scottish Water under a detailed and comprehensive economic regulation model. As such WICS have a detailed understanding of the Scottish Water investment unit cost efficiency over time. This information is presented below and highlights that as a result of reform, Scottish Water achieved approximately 45-50% lower capital expenditure unit costs between 2002-2019. WICS also noted that Scottish Water had recently committed to achieving further 0.75% real improvements in capital expenditure unit costs annually until 2040 suggesting significant further long-term efficiency gains were possible.

WICS considered that under the previous NZ water reform model (including necessary scale, professionalisation of Boards / governance and strong-form economic regulation) that NZ entities could achieve similar improvements. WICS worked closely with Watercare (and other councils) to understand potential differences between NZ and Scotland that would limit the potential capital efficiency achievable and edit efficiency targets to account for these differences.



Source: Water Industry Commission for Scotland

FarrierSwier in reviewing the WICS approach noted that:

- While this represents a reasonable starting point the analysis suffers from several limitations, including that Scottish Water's experience could differ markedly from what may be achievable in New Zealand.
- The top-down efficiency assumption was also not adjusted to account for differences between Scotland and New Zealand in key expenditure drivers, potential for asset optimisation and any other driving factors.
- Without such adjustments or comparison to other case studies, it is hard to say whether the Scottish Water experience is a reasonable guide for what is achievable in New Zealand.

As such we believe it is prudent to use a significantly more conservative capital efficiency assumption (relative to WICS) and vary this less with increasing scale. We can provide further detail on our professional judgement of the expected capital efficiency opportunities if useful.

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