

Extract of 8 September 2021
Hutt City Council Agenda

27 August 2021

File: (21/1334)

Report no: HCC2021/4/207

Three Waters Reform Update

Purpose of Report

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

Recommendations

It is recommended that Council:

- (1) notes that in July 2020 the Government announced an initial funding package of \$761M to provide a post COVID-19 stimulus to maintain and improve water networks infrastructure, and to support a three-year programme of reform of local government water services delivery arrangements;
- (2) notes that in August 2020 Council agreed to enter into a Three Waters Reform Memorandum of Understanding and Funding Agreement with the Government which resulted in Council receiving funding of \$10.6M;
- (3) notes the Government's 30 June and 15 July 2021 Three Waters Reform announcements, which includes a \$38.7M 'better off' funding for Lower Hutt, refer Section B of the report ;
- (4) notes the need to ensure and uphold active engagement, involvement and partnership with Mana Whenua throughout the three waters reform programme, refer Section C of the report;
- (5) notes officer's advice on the information provided to Council in June and July 2021 as a result of a Request for Information process and Water Industry Commission Scotland (WICS) modelling processes, refer Section D of the

report;

- (6) notes officer's high level overview and analysis of the options available to Council for three waters service delivery, refer Section E of the report;
- (7) notes that a decision to support the Government's preferred three waters service delivery option is not lawful (would be ultra vires) at present due to section 130 of the Local Government Act 2002 (LGA), which prohibits Council from divesting its ownership or interest in a water service except to another local government organisation, and what we currently know (and don't know) about the Government's preferred option;
- (8) notes that Council cannot make a formal decision on a regional option for three waters service delivery without doing a Long Term Plan amendment and ensuring it meets section 130 of the LGA;
- (9) notes that the Government intends to make further decisions about the three waters service delivery model after 30 September 2021;
- (10) notes that it is Council's position that it is necessary to gain an understanding of the community's views through consultation and engagement once Council has further information from the Government on the next steps in the reform process;
- (11) requests the Chief Executive to seek further information and guidance from the Government on the following key areas:
 - (a) the proposed boundaries and rationale for these;
 - (b) plans for consultation with mana whenua and communities;
 - (c) ensuring that communities have a voice in the system and influence over local decisions;
 - (d) prioritisation of investment, particularly ensuring integration with spatial and local planning, including growth planning;
 - (e) effective representation on the new water service entities' oversight boards; and
 - (f) the criteria and conditions that will be associated with the Government funding packages for 'better off' and 'no worse off';
 - (g) integration with other local government reform processes;
 - (h) the scope of the stormwater role that entities will play, including in relation to growth and development planning, asset management and maintenance; and
 - (i) how Councils will be involved in holding future entities accountable for performance and customer service levels;
- (12) considers any further areas of the Government's proposals that Council needs more information or guidance on;
- (13) considers any feedback to be provided on the Government's proposal or process;
- (14) notes that the Chief Executive will report back further once further information and guidance from Government has been received on what the next steps look like and how these should be managed; and
- (15) in noting the above, agrees it has given consideration sections 76, 77, 78, and 79 of the Local Government Act 2002 and in its judgment considers it has complied with the decision making process that those sections require (including, but not limited to, having sufficient information and analysis that

is proportionate to the decisions being made).

For the reason that Council needs to be in a position to seek guidance and provide feedback to Government's water reform programme in line with the expectations of the "eight week" process.

Executive Summary

2. Over the past four years central and local government have been considering the issues and opportunities facing the system for regulating and managing the three waters (drinking water, wastewater, and stormwater) – Three Water Reform. The background is provided in Appendix 1.
3. Taumata Arowai became a new Crown entity in March 2021 and will become the dedicated water services regulator later this year. There is an expectation that monitoring, compliance and enforcement of mandatory standards will increase substantially on the status quo requirements and costs, as will the coverage and requirements of the standards themselves. Further information on the role and work of the regulator as it affects local government is provided in Appendix 1.
4. The Government has concluded that the case for change¹ to the three waters service delivery system has been made and that there is the need for system-wide reform to achieve lasting benefits for the local government sector, communities and the environment (refer Appendix 2 for further information). During June and July 2021 the Government released information and made announcements on:
 - the direction and form of Three Waters Reform, including proposed new Water Service Entities (four and their indicative boundaries), their governance arrangements and public ownership
 - individual Council data based on the information supplied under the Request for Information (RFI) process
 - a package of investment (\$2.5B) for councils to invest in the future for local government, urban development, and the wellbeing of communities, ensuring no council is worse off as a result of the reforms, and funding support for transition
 - an eight-week process for councils to understand the implications of the reform announcements, ask questions and propose solutions and for Government to work with councils and mana whenua on key aspects of the reform (including governance, integrated planning and community voice).
5. Hutt City Council has been placed in Entity C and our 'better off' funding allocation is \$38.7M.
6. While the Government and Local Government New Zealand (LGNZ) considers that the national case for change has been made, each council will

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

ultimately need to make a decision based on its local context if the process to join one of the proposed entities remains voluntary.

7. As a part of the three waters reform the Government has agreed to recognise and provide for Iwi/Māori rights and interests with a specific focus on service-delivery. This approach has been informed through numerous engagements with iwi / Māori which will continue through the reform programme lifetime. Council have been engaging with Mana Whenua on the three waters reform and will continue to do so until it is finalised.
8. This report provides Council with the initial analysis of the information provided and assesses the Government's proposal and currently available service delivery options. The intent here is to assist Council to understand the information that has been provided to date and enable Council to prepare for future decisions and community consultation and engagement.
9. In summary,
 - WICs analysis undertaken estimates that in order to meet future investment pressures the average household cost per annum of three waters would increase in Lower Hutt from \$880 to \$2,380 in 2051. Through adopting reform, this would be reduced to \$1,260. The analysis shows that the projected average cost per household is not unreasonable, particularly given the higher level of capital investment forecast and noting that there are a range of uncertainties and risks (refer Appendix 5 report by PWC).
 - Given the peer reviews of the modelling and underlying assumptions by Beca and Farrierswier (which always carry a degree of uncertainty) no further analysis of this work has been done or is proposed and officers have focussed on the reasonably practicable options and their implications for Council and the community.
 - Four feasible options available to Council for three waters service delivery have been considered. This has been done at a high level and provides a comparison with the Government's proposed reforms model. These options are:
 - Option A - Government reforms proposal
 - Option B - Wellington Water model at higher level of service (effectively the status quo or do minimum option)
 - Option C - asset transfer to an enhanced Wellington Water type model
 - Option D - Council delivery of water services.
 - Under all options except the Government proposal, Council bears the risk of meeting the new water standards, environmental requirements and achieving compliance.
10. Other Government reforms (Resource Management Act, Future of Local Government) pose opportunities and challenges for each option.
11. If the Government's proposal was to proceed, effective management of the transition risks by Council, Government and partners will be critical.

12. The law currently prohibits Council's deciding to opt-in to the current proposal (given section 130 of the Local Government Act 2002 and what we know about this option at present). Current decision-making requirements, including the need to take account of community views and strategic nature of the assets involved, would also preclude Council deciding to opt-in at this time without consultation.
13. Similar requirements apply if the council wishes to consider alternative arrangements that involve asset transfers, divestment, or change in ownership to deliver water services in the future.
14. There are a number of issues, concerns and uncertainties for the Government and councils to work through before a Council decision can be produced, including whether legislative change will enable or require the Water Services Entity to be adopted. Therefore, there is no expectation that councils will make a decision to opt-in (or out) or commence community engagement or consultation over the eight-week period.
15. Officers request Council to consider the issues that arise from the Government's proposal and any potential solutions so these can be raised with Government and LGNZ before the end of September 2021.
16. Government decisions on entity boundaries, governance and transition and implementation arrangements are expected to occur after the eight week-process ends (30 September 2021).
17. On the assumption that the reform goes ahead, it is anticipated that councils will continue to deliver water services until 30 June 2024 and council involvement in transition will be required throughout.

Section A - Background and context

18. Council has received the following reports and briefings on Three Waters Reform:
 - 25 August 2020, Council report entitled "Three Waters Reform – Memorandum of understanding" (HCC/2020/5/173),
 - 24 February 2021 Council briefing on Three Waters Reform,
 - 13 July 2021, Policy, Finance and Strategy report entitled "Three Waters Reform update, including financial analysis of potential impacts" (PFS 2021/3/152),
 - 18 August 2021, Council briefing on Three Waters Reform.
19. Following the serious campylobacter outbreak in 2016 and the Government's Inquiry into Havelock North Drinking Water, central and local government have been considering the issues and opportunities facing the system for regulating and managing the three waters (drinking water, wastewater, and stormwater).
20. The focus has been on how to ensure safe drinking water, improve the environmental performance and transparency of wastewater and

stormwater network and deal with funding and affordability challenges, particularly for communities with small rating bases or high-growth areas that have reached their prudential borrowing limits.

21. The Government's stated direction of travel has been for publicly-owned multi-regional models with a preference for local authority ownership. Te Tari Taiwhenua, the Department of Internal Affairs (DIA), in partnership with the Three Waters Steering Committee (which includes elected members and staff from local government) commissioned specialist economic, financial, regulatory and technical expertise to support the Three Waters Reform Programme and inform policy advice to ministers.
22. The initial stage (Tranche 1 - MOU, Funding Agreement, Delivery Plan and RFI process) was an opt in, non-binding approach. It did not require councils to commit to future phases of the reform programme, to transfer their assets and/or liabilities, or establish new water entities. Council received \$10.6M funding through this initial Three Waters Reform funding process. The 2020 indicative reform programme and then anticipated next steps can be found in Appendix 1.
23. Council completed the RFI process in January 2021 and the Government has used this information, evidence, and modelling to make preliminary decisions on the next stages of reform and has concluded that the case for change has been made (Appendix 2).

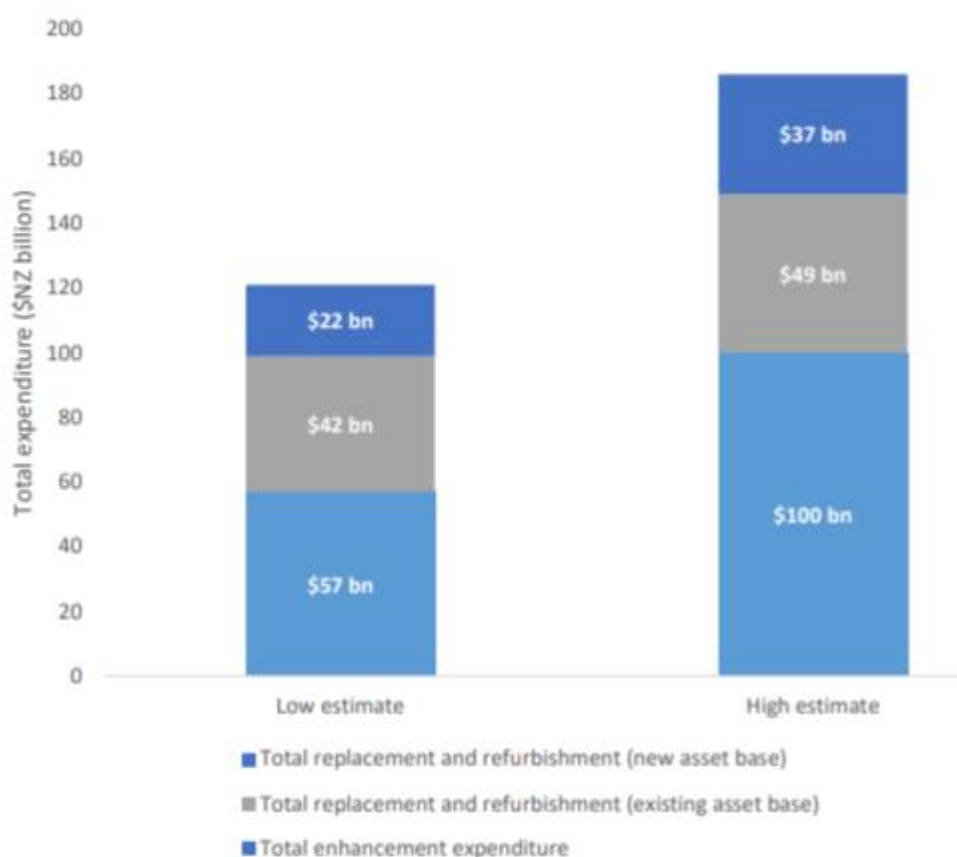
Section B - Government's June 2021 and July 2021 announcements and information releases

24. In June 2021 a suite of information was released by Government that covered estimated potential investment requirements for New Zealand, scope for efficiency gains from transformation of the three waters service and the potential economic (efficiency) impacts of various aggregation scenarios.²

² This information, including peer reviews and the Minister's briefing can be accessed at: <https://www.dia.govt.nz/Three-Waters-Reform-Programme> and [release-of-second-stage-evidence-base-released-june-2021](#).

25. In summary the modelling indicated a likely range for future investment requirements at a national level in the order of \$120B to \$185B.

Figure 3: Estimated future capital investment requirement for three waters infrastructure



Source: Water Industry Commission for Scotland, 2021

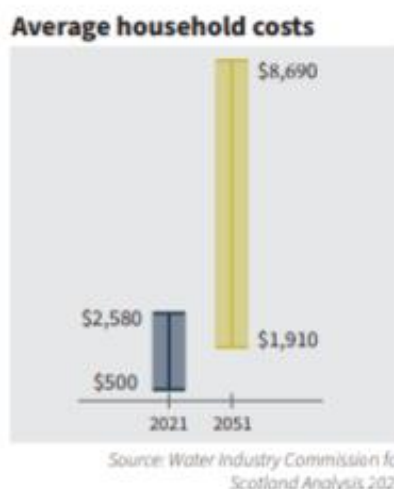
26. The modelling also estimated that an average household cost for most councils on a standalone basis to be between \$1,910 and \$8,690 by 2051, and that these costs could be reduced to between \$800 and \$1,640 per household and efficiencies in the range of 45% over 15 to 30 years if the reform process went ahead. An additional 5,800 to 9,300 jobs and an increase in GDP of between \$14B to \$23B in net present value terms over 30 years, were also estimated.

5. POTENTIAL IMPACTS

Difference in household costs

Average household costs for most councils on a standalone basis in 2051 are likely to range from between \$1,910 to \$8,690.

The scale of investment required between now and 2051, would require average household costs to increase by between three to 13 times in real terms for rural councils, between two and eight times for provincial councils and between 1.5 and seven times for metropolitan councils.



Current household costs

Currently there are a wide range of current (2019) average household costs.

	LOW	HIGH	MEDIAN	MEAN
Metro	\$500	\$1,920	\$1,050	\$1,120
Provincial	\$610	\$2,550	\$1,120	\$1,300
Rural	\$210	\$2,580	\$1,340	\$1,390

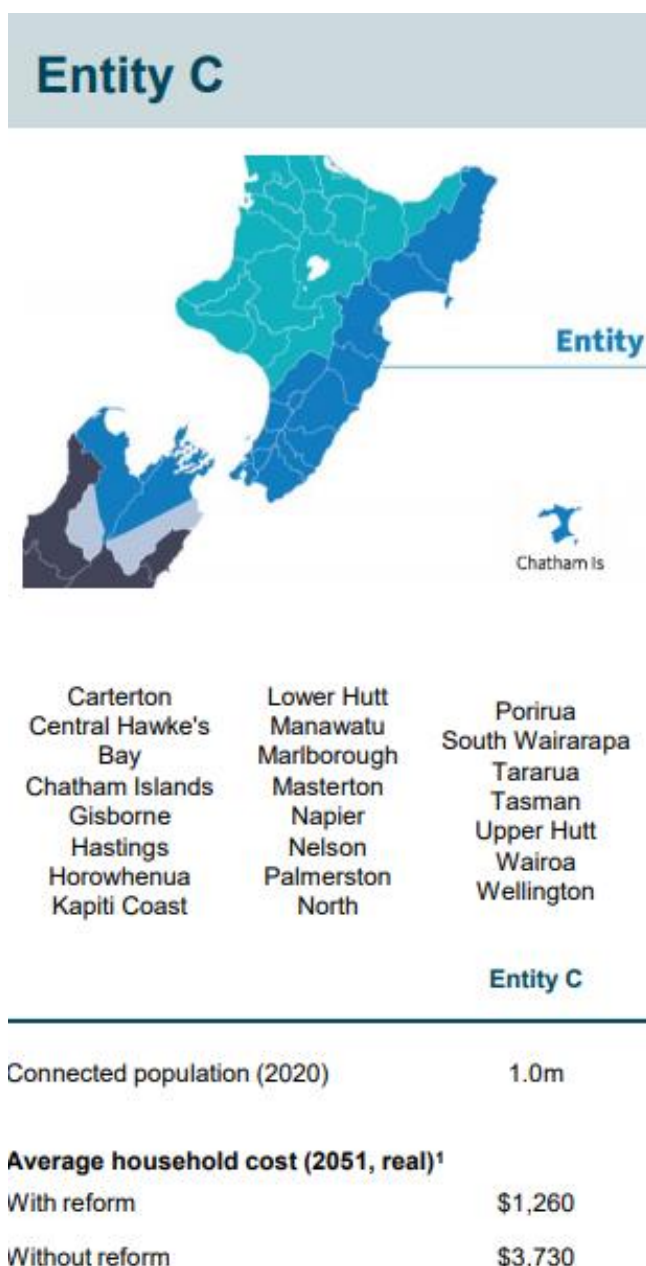
Source: Water Industry Commission for Scotland Analysis 2021

Current costs are not necessarily a good reflection of what funding is required to meet the full costs of economic depreciation (that is, to provide resources for asset maintenance and renewal).

27. The efficiencies noted are underpinned by evidence across a range of countries based on joined up networks, greater borrowing capability and improved access to markets, procurement efficiencies, smarter asset management and strategic planning for investment, a more predictable pipeline of investment and strengthened benchmarked performance, governance and workforce capabilities.
28. As a result of this modelling, the Government has decided to:
 - establish four statutory, publicly-owned water services entities that own and operate three waters infrastructure on behalf of local authorities
 - establish independent, competency-based boards to govern
 - set a clear national policy direction for the three waters sector, including integration with any new spatial / resource management planning processes
 - establish an economic regulation regime
 - develop an industry transformation strategy.

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

29. Both DIA and LGNZ have produced two page national overviews, available on the [DIA website](#)³ and [LGNZ websites](#)⁴ respectively. Appendix 2 contains more detail on the national context and Appendix 3 provides the DIA and LGNZ overviews.
30. Hutt City Council has been placed in Water Services Entity C. The diagram that follows shows the boundaries, although it is important to note the precise boundaries are still up for discussion. Refer Appendix 2 for further information on the boundaries of the other entities.



³ [2872-DIA-A3-A New Water with-without reform Map 20210526 v2.7](#)

⁴ [Three-Waters-101-Infographic.pdf \(lgnz.co.nz\)](#)

31. On 15 July 2021, in partnership with LGNZ under a [Heads of Agreement](#)⁵, the Government announced a package of \$2.5B to support councils to transition to the new water entities and to invest in community wellbeing. This funding is made up of a 'better off' element (\$500M will be available from 1 July 2022 with the investment funded \$1B from the Crown and \$1B from the new Water Services Entities) and 'no council worse off' element (available from July 2024 and funded by the Water Services Entities). The 'better off' funding can be used to support the delivery of local wellbeing outcomes associated with climate change and resilience, housing and local placemaking, and there is an expectation that councils will engage with iwi/Māori in determining how to use their funding allocation.
32. Hutt City Council's funding allocation is \$38.7M. A small portion of this may be re-allocated to GWRC in recognition of its responsibilities for bulk water supply. The detail of the funding and the full list of allocations is available in Appendix 4. Conditions associated with the package of funding have yet to be worked through.
33. In addition to the funding announcements, the Government has committed to further discussions with local government and iwi/Māori over the next eight weeks on:
- the boundaries of the Water Service Entities,
 - how local authorities can continue to have influence on service outcomes and other issues of importance to their communities,
 - ensuring there is appropriate integration between the needs, planning and priorities of local authorities and those of the Water Service Entities,
 - how to strengthen the accountability of the Water Service Entities to the communities that they serve, for example through a water ombudsman.
34. As a result, the original timetable for implementing the reform (outlined in Appendix 1) and for councils to consult on a decision to opt-in (or not), no longer applies. Further advice on the difficulties and risks of making a decision to opt-in or not is included at section G of this report.
35. Next steps are expected to be announced after 30 September 2021, which would include the timeframes and responsibilities for any community or public consultation.
36. It is also important to note that the Government has not ruled out legislating for an "all-in" approach to reform to realise the national interest benefits of the reform.
37. In the interim DIA continues to engage with council staff on transition matters on a no regrets basis should the reform proceed. These discussions do not pre-empt any Government decisions.
38. On the assumption that the reform goes ahead, it is anticipated that councils will continue to deliver water services until 30 June 2024 and council and Wellington Water's involvement in transition will be required throughout.

⁵ [https://www.dia.govt.nz/diawebsite.nsf/Files/Three-waters-reform-programme/\\$file/heads-of-agreement-partnering-commitment-to-support-three-waters-service-delivery-reform.pdf](https://www.dia.govt.nz/diawebsite.nsf/Files/Three-waters-reform-programme/$file/heads-of-agreement-partnering-commitment-to-support-three-waters-service-delivery-reform.pdf)

Section C – Mana Whenua

39. As part of the three waters reform proposals, Cabinet has agreed to recognise and provide for Iwi/Māori rights and interests with a specific focus on service-delivery. It is proposed that Iwi/Māori will have a greater role in the new Three Waters system, including pathways for enhanced participation by whānau and hapū as these services relate to their Treaty rights and interests.
40. The Department of Internal Affairs led engagement with iwi/ Māori through many workshops across the country, webinars, technical reference groups and one on one discussions.
41. DIA expect to continue its engagement on three waters service delivery reforms with iwi/Māori throughout the reform programme lifetime (anticipated to take until 1 July 2024). The Water Services Entities, when live, will also be required to form relationships with mana whenua and resource this relationship.
42. Council, as a part of our regular meetings with Mana Whenua, included discussions on the three waters reform proposal. Mana Whenua were invited to the 18 August 2021 Council briefing on the three waters reform and will also be included in any further engagements and activities related to the reforms as it progresses through its programme.
43. Mana Whenua involvement in reform programme, whether working alongside DIA and or Council, will ensure that a strong foundation is built which will enable active engagement when and if the government proceeds with its three water reforms.

44. The table that follows sets out the current opportunities for iwi/Māori in the three waters reform.

Design feature	Description	Opportunity for Iwi/Māori
Statutory recognition of the Treaty of Waitangi	Rights and interests of Iwi/Māori will be recognised and provided for in service-delivery arrangements for the new Three Waters system	Uphold existing Treaty Settlement arrangements, including through transition and the standing-up of new entities
Statutory recognition of Te Mana o Te Wai	Te Mana o Te Wai will be recognised and provided for in service-delivery arrangements for the new Three Waters system	Each entity will be required to give effect to Te Mana o Te Wai both in legislation and as articulated by mana whenua over a defined waterbody
Creation of Mana Whenua Groups for each Entity	A Mana Whenua Group for each of the four entities will be established to guide strategic performance expectations alongside local government	Each Mana Whenua Group will have equal voting rights to local government and the new entities will have statutory obligations to fund and ensure Mana Whenua participation
Te Mana o Te Wai statements	Legislation will broadly describe Te Mana o Te Wai, however the emphasis is that mana whenua define what Te Mana o Te Wai means to their specific location. Operationally, a statement can take the form of an Iwi Management Plan, Cultural Impact Statement or the like	Provides an instrument for mana whenua to prioritise their capacity and capability to participate in the new system and recognises the role of whānau and hapū in providing kaitiakitanga activities

Section D - Council local context and information

45. While the Government and LGNZ considers that the national case for change has been made, each council will ultimately need to make a decision based on its local context.
46. Councils do not have a national interest test for their decision making. Councils are required to act in the interests of their communities and the community's wellbeing (now and into the future), provide opportunities for Māori to contribute to their decision-making processes, ensure prudent stewardship and the efficient and effective use of its resources in the interests of the district or region (including planning effectively for the future management of its assets) and take a sustainable development approach⁶.

⁶ See for example sections 5 and 14 of the LGA.

47. Council currently delivers three waters services through a Council Controlled Organisation Wellington Water Ltd (WWL), alongside other shareholding councils Wellington City Council, Porirua City Council, Upper Hutt City Councils, South Wairarapa District Council and Greater Wellington Regional Council. WWL fully manages under contract the water, wastewater and stormwater assets for these councils. WWL is a non-asset owning entity as the assets are owned by the shareholder Councils. The book values of the Hutt City Council three water assets are \$0.5B.

Network condition and renewal of three waters assets in Lower Hutt:

48. Using the age profile of the assets we know that there is a current backlog of approximately 27% in renewals for the water network, representing around 190 kilometre of pipe, along with a backlog of 14% in renewals for wastewater representing 90 kilometres of pipe. The estimated cost of this backlog of deferred renewals is \$230M. A large portion of this backlog has occurred in the period 2012 to 2016. This poses a growing risk to service reliability for the city. On this basis the overall condition of these networks is considered to be low.
49. Much of the city's three waters network is at, or close to, capacity, while approximately 60 per cent of our pipes are due for renewal in the next 30 years. The capital investment needed for this infrastructure is substantial, particularly when these assets need renewing or require significant maintenance.
50. WWL is working to improve the understanding of the condition of high and very high critical assets and prioritising the renewal of these assets where there is evidence that they are failing. Through the Long Term Plan (LTP) 2021-2031 external audit process, a modified audit opinion was issued due to the risks and uncertainties over the three waters capital investment forecasts, with a need to improve asset condition information.
51. Our maintenance costs have been increasing, particularly in maintaining the water network to cope with the increased number of leaking pipes. This trend has been particularly noticeable since the Kaikoura Earthquake of November 2016. The increase in maintenance costs is directly attributable to the current backlog of renewal work and will continue until such time as the renewal programme has caught up. WWL has advised Council that the maintenance budgets are unlikely to be adequate for current and future years and that stimulus funding will need to be utilised again this financial year to offset an expected overspend.

Whaitua

52. The Whaitua-Te-Whanganui-a-Tara Committee (Whaitua) is an advisory body established by Greater Wellington Regional Council (GRWC) and tasked to develop recommendations, with community and stakeholder engagement, that would improve the quality of freshwater bodies in the Wellington/Hutt catchment. At the heart of this programme is GRWC's need to meet the requirements of the National Policy Statement for Freshwater Management .

53. The Committee has been active since late 2018 and is now finalising its recommendations to GWRC. At a recent Council briefing we were advised that the recommendations of the Whaitua would include aspirational outcomes, reflecting the high community desire for clean waterways, which will likely go beyond what can be achieved with the current LTP funding provision. GWRC officers stated that they would take into account affordability and do-ability issues when considering the Whaitua recommendations in drafting the Regional Policy Statement for Freshwater Management.

Climate change impacts

54. Wastewater is a significant contributor to Council's carbon emissions, with the treatment and disposal to Landfill of the sludge. While we have included some budget provision in the LTP to investigate options for a new sludge treatment facility to reduce carbon emissions, further funding provision (likely to be not insubstantial) will be required to address our longer term responsibilities including NZ Emissions Trading requirements.
55. Expected sea-level rise will have impacts on three water infrastructure. This projected rise in sea level will likely compromise the ability of the stormwater network to drain effectively and further exacerbate the impacts of flooding. Additionally, the projected sea-level rise means that some of the city's key three water infrastructure, particularly the Seaview Wastewater Treatment Plant, is likely to face inundation, which is a threat to the functioning of the wastewater system.
56. The increased likelihood of heavy rainfall events with global warming will have an effect on our stormwater and wastewater networks with a higher number of wet-weather overflows and flooding. Future freshwater standard requirements will place increasing costs on Council to meet its consent requirements to reduce wastewater overflows.

Resilience

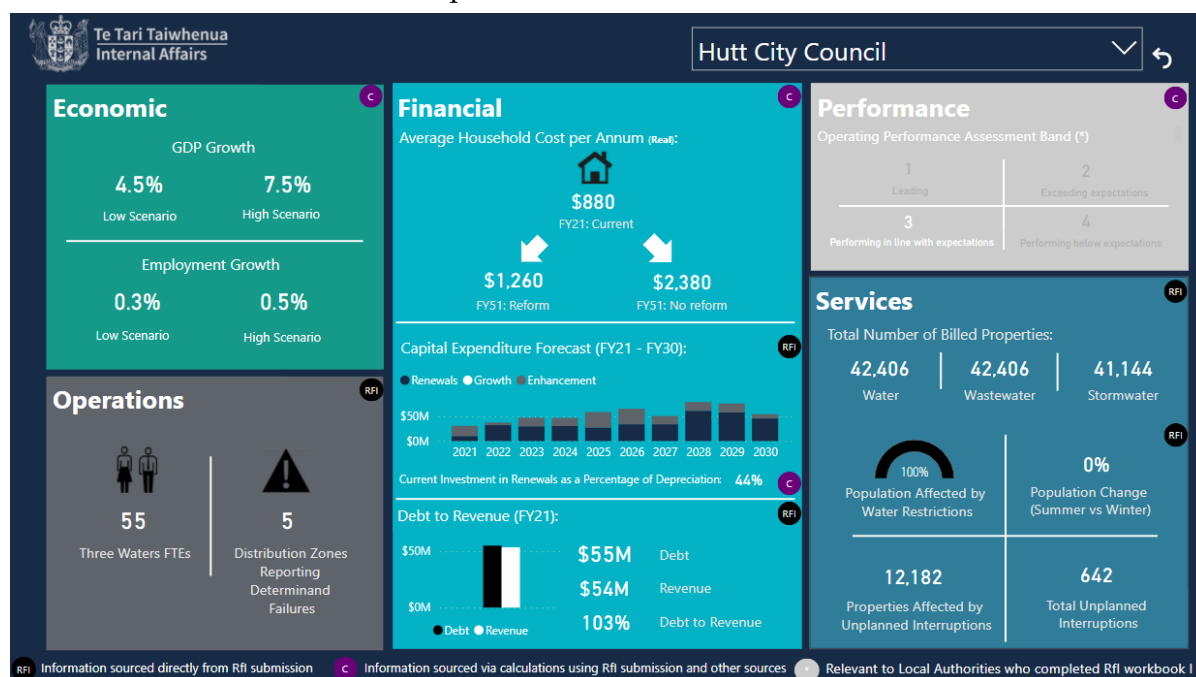
57. A major earthquake is likely to cause disruptions to water supply and wastewater networks, both in terms of structural damage to pipes or pumping stations and our ability to ensure continuation of supply. Council's planning focuses on both wider change and treatment capacity, to ensure people have access to clean drinking water and sanitation. Earthquakes may also cause significant damage to the stormwater network, leading to significant problems, particularly if heavy rainfall follows a seismic event.

Stormwater network assets

58. The reform process was unclear in the earlier stages as to whether the stormwater network assets would be included or not. Most recent feedback from the Government is that stormwater network will be included. With the stormwater network managed by WWL for Council and the other City or District Council shareholders, this move is supported.
59. There are some technical issues which arise with this, particularly around ownership/management of assets that have multi-functionality such as roads and water sensitive design assets (e.g. rain gardens). This is being considered by one of the expert technical groups established to consider details of the proposed reform changes.

Three Waters Reform - DIA local dashboard

60. The DIA local dashboard for HCC was reported to the Policy, Finance and Strategy Committee 13 July 2021 (PFS2021/3/152). Underpinning the DIA local dashboard is modelling undertaken by the Water Industry Commission for Scotland (WICS) to assess the potential benefits from amalgamating three waters infrastructure and delivery for the 67 councils across New Zealand into a limited number of independent water service entities.



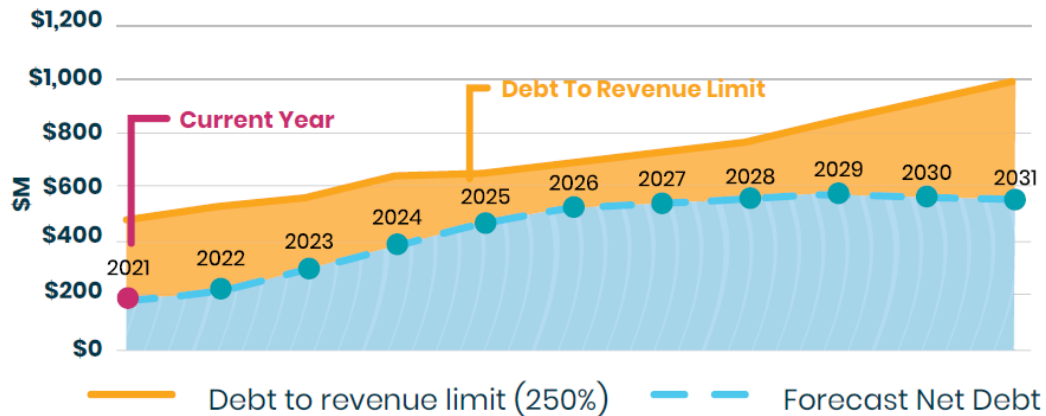
61. The key aspects of the local dashboard are detailed below. PWC has assisted with detailed analysis and appendix 5 provides further information.

Average cost per household:

- DIA local dashboard, (based on several assumptions) assumes a current (FY21) annual cost per household of \$880; our estimate, based on the Long Term Plan 2021-2031(LTP) is \$1,100 per household.
- Projected out to 2031 (again based on assumptions) is \$2,212 (DIA uninflated) and our Council LTP is \$1,767 (uninflated).
- Projected out to 2051 is \$2,380 (DIA uninflated) and our council (using DIA's assumed compounded annual growth in 2032-2051) is \$1,861 (uninflated).
- While the DIA analysis includes capital expenditure and debt estimates that pre-date Council's finalised LTP 2021-2031, our analysis shows that DIA's estimated average cost per household is not unreasonable; particularly given the level of capital investment forecast (DIA forecast \$932M between FY22-FY31 compared with Council's 2021 LTP forecast of \$489M).
- DIA estimates that average household costs in Entity C in 2051 is \$1,260 with reforms or \$3,730 without reforms.

Debt

62. Council’s debt projection from the LTP is shown in the graph that follows:



63. Based on Council’s LTP investment levels, Council does not have issues with delivering necessary investment in three waters infrastructure on a debt basis as there is adequate headroom within borrowing limits. It is however important to note that in the early stages of the LTP development Council chose the “modified mid-option” investment level due to affordability considerations. This option excluded some investment choices, for example a proposed \$200M placeholder for future growth in the city (refer Long Term Plan/ Annual Plan Subcommittee LTP2020/5/206 and LTP2020/6/223). Further information about the network condition risks is detailed above; this has significant flow on risks to debt capacity for HCC in the future.

64. In support of the reform process, DIA has developed a high-level financial impact tool (released 17 August 2021) to provide councils with an indication of how the proposed transfer of water-related debt, assets and revenues may affect the financial position, credit ratings and/or financial covenants of each Council.

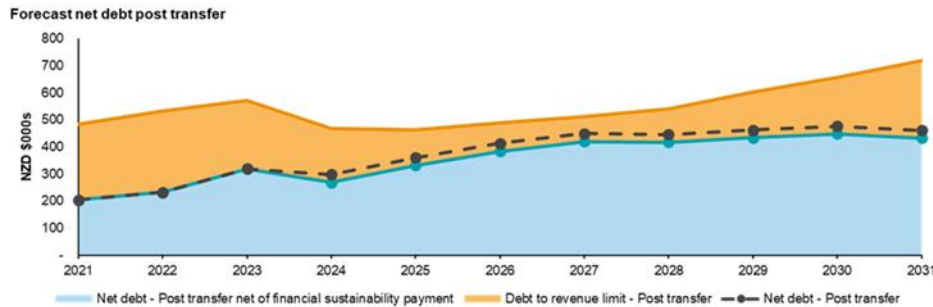
65. The financial impact tool primarily uses the data in Council’s final LTP, with an opening balance three waters debt figure from Council’s RFI. These calculations are at 30 June 2024, the proposed transfer date.

66. The output of the financial impact tool (following updating the opening balances to reflect actuals) is Council will transfer \$71M of revenue and \$104M of debt to the new water entity, having the impact of increasing Council’s debt to revenue ratio from 186% to 206%. This is summarised in the table that follows:

Metric	Without Transfer	Transfer	With Transfer
Revenue	\$216M	\$71M	\$145M
Debt	\$402M	\$104M	\$298M
Debt to Revenue	186%		206%

Note: Revenue transferred above includes general rates allocated to three waters. However, the allocation of general rates in the LTP needs to be considered in light of the balanced budget deficits in the LTP until 2028/29, which are largely driven from affordability considerations. Council will need to consider this position in further discussion with DIA.

- 67. The Government has committed to ensuring that councils are ‘better off’ and ‘no worse’ from the three waters reform. The HCC allocation for ‘better off’ funding is \$38.7M. The financial impact tool indicates that any council with a reduction in debt headroom will receive a payment equal to the loss in debt headroom to ensure debt to revenue ratios are not affected. The tool indicates that HCC will receive \$29M, which ensures its net debt to revenue ratio remains at 186% (this would be part of the ‘no worse’ allocation).
- 68. Council’s debt projection in 2021-2031 have been reproduced below to show forecasted net debt post transfer. This assumes HCC receives a ‘no worse’ payment from Government.



- 69. To assess whether the proposed ‘better off’ and ‘no worse’ funding to Council is sufficient, Council needs further information on the conditions that will be associated with that funding. It is reasonable to expect that the funding would provide Council with an opportunity to address a range of issues and opportunities to improve community wellbeing.
- 70. It should be noted that the financial impact tool is indicative only to support the reform process and may not be a true reflection of final amounts paid to Council. Should the reforms proceed as proposed, a due diligence process will be undertaken to assess the actual assets, debt and revenue at the point of transfer on 1 July 2024.
- 71. Council does not allocate its debt to each of the Council activities and takes a portfolio approach to managing borrowings. The quantification of Council’s three waters related debt is yet to be finalised and, as such, officers will provide further advice on the reasonableness of the estimated debt transfer generated from the financial impact tool. Further advice is also being sought on the appropriate method to calculate debt associated with three waters.

Capital expenditure

- 72. Significant investment in three waters infrastructure is forecast to be required over the next 30 years, underpinned by assumptions that regulatory standards will increase and that there will be more monitoring and enforcement in the future.
- 73. DIA is forecasting \$932M (uninflated) on capital projects on three waters infrastructure over the 10 year period 2021-2031. Over a 30 year period to 2051, this investment is forecast to grow to \$3.02B (uninflated), of which \$1.7B relates to renewals (capital maintenance of existing assets). Note all figures are provided on a real basis (inflation stripped out).
- 74. Council’s LTP 2021-2031 is budgeted to spend \$489M (uninflated) on capital projects on three waters infrastructure. Over the life of Council’s 30 year Infrastructure Strategy, that investment grows to \$1.6B (uninflated). These

amounts are materially less than those forecast by DIA which is a key cause for Council's forecast cost per household being lower.

75. There are a few specific items to draw Council's attention to:
- While prepared at the national level, the WICS model underpinning the DIA local dashboard has been peer reviewed by [Farrierswier](#) and [Beca](#) to ensure that both the modelling and underlying assumptions are reasonable in the New Zealand context. It therefore provides a reasonable indication of the "direction and order of magnitude"⁷ of the gains that can be delivered through the new system and the level of future investment Council is likely to need to make over the next 30 years.
 - A key factor in realising the benefits achieved through the amalgamated entity (reform) are achieved through increased leverage as Entity C (which Council is proposed to be part of) has debt to revenue of 645% by FY51. The use of significantly higher leverage combined with forecast cost efficiencies are key contributors to the lower forecast cost per household under the reform.
 - At this stage it is not possible to fully test the projections as the standards for New Zealand out to 2051 are not known, although it is reasonable to assume that there will be greater community and mana whenua expectations around environmental performance and quality, tougher standards to meet for water quality (drinking and receiving environment) and that monitoring, compliance and enforcement will be greater than it is now. This affects both operational and capital expenditure (costs will go up), including the number of staff (or contractors) that council will need to ensure Council outcomes for water and community and legal requirements are met.
 - There is always a level of uncertainty and therefore risk around assumptions and forecasts, whether prepared by Council for our LTPs or by others, including government agencies, to facilitate policy decisions, such as the current Three Waters Reform process. Officers consider that it would likely not be a good use of Council's limited resources to spend time and money on a detailed review of the assumptions and modelling, particularly given the relative similarity of council projections to the DIA local dashboard. We note that the WICS analysis has received both a financial model and technical peer review.
 - Under the proposed reform process HCC will be one of the owners of the new water service entries, but will have no direct control (necessary to achieve balance sheet separation). HCC may still be seen as responsible in ratepayers eyes. Prioritisation of investment for the local community may be challenging in the future when HCC's "voice" can only influence, including alignment with growth planning.
 - There will be additional financial considerations for Council as further information is provided by DIA. Officers are mindful of ensuring value for ratepayers and are already taking steps to mitigate the impact of these reforms on the Council's borrowing portfolio. It is unclear how

⁷ Page iv, 2021, Farrierswier, Three Waters Reform, Review of methodology and assumptions underpinning economic analysis of aggregation available at [https://www.dia.govt.nz/diawebsite.nsf/Files/Three-waters-reform-programme-\\$file/farrierswier-three-waters-reform-programme-review-of-wics-methodology-and-assumptions-underpinning-economic-analysis-of-aggregation-released-june-2021.pdf](https://www.dia.govt.nz/diawebsite.nsf/Files/Three-waters-reform-programme-$file/farrierswier-three-waters-reform-programme-review-of-wics-methodology-and-assumptions-underpinning-economic-analysis-of-aggregation-released-june-2021.pdf)

financial derivatives (interest rate swaps) and loan break fees will be treated and accounted for upon the transfer of debt. A liability may exist for HCC when it “closes out” financial derivatives following the transfer of debt to the new water service entities, however, this is being managed currently to mitigate liability.

Section E – Options available to Council for three waters service delivery

76. This section provides a high level overview and analysis of feasible options available to Council to compare with the Government’s proposed reform model.
77. This options analysis has been informed by advice from LGNZ, Taituarā and DIA [guidance](#)⁸ and our risk framework and policy. It provides an overview of the potential impact of reform and other practicable options (both today and in the future) in terms of service, finance and funding, economic development and growth, workforce, delivery and capability and social, cultural and environmental wellbeing.
78. Four feasible options are considered:
- i. Option A – Government reforms proposal,
 - ii. Option B – Wellington Water model at higher level of service (effectively the status quo or do minimum option),
 - iii. Option C – asset transfer to an enhanced Wellington Water type model,
 - iv. Option D – Council delivery of water services.
79. It is important to note that there is further information to be developed and Government decisions to be made ahead of Council proceeding with any decisions and a community consultation process. Refer to Section G for further information on Council decision making and consultation.

Option A - Government Proposal

80. This option is outlined in the report above. Under this option, HCC is in water services entity C, a publicly owned water services entity (WSE) that owns and operates three waters infrastructure on behalf of councils, mana whenua and communities.
81. The ownership and governance model is a bespoke model, with councils listed in legislation as owners, without shareholdings or financial interests, but an advocacy role on behalf of their communities. Iwi/Māori rights and interests are also recognised. Representatives of local government and mana whenua will sit on the Regional Representative Group, who issue a Statement of Strategic and Performance Expectations and receive a Statement of Intent from the WSE. WSEs must also consult on their strategic direction, investment plans and prices/charges.
82. The proposed reforms model represents a very significant change process to address fundamental issues of future standards and affordability. Implementation of this model will require ongoing decisions by Government and legislative change followed by 5-10 years for the proposed WSE to develop a maturity model and realise the anticipated benefits of the reforms.

⁸ <https://www.lgnz.co.nz/assets/Three-Waters-Guidance-for-councils-over-the-next-eight-weeks-FINAL.pdf>

Key benefits of Option A	Key risks and issues with Option A
<ul style="list-style-type: none"> ○ Potentially very significant efficiency gains through scale, procurement, governance, capability, economic regulation ○ Increased financial capacity/ borrowing ○ Increased affordability of water services ○ Ability to respond to water regulation ○ Reduction in Council's current risk profile including compliance risk and the risk of not meeting standards 	<p>Aspects of the model remain unclear at this time and could lead to risks or sub-optimal outcomes:</p> <ul style="list-style-type: none"> ○ Governance and oversight, including the role of Iwi/Māori across such a large geographical area and multiple interests and owners ○ Protections from future privatisation ○ Prioritisation of investment including: local needs, alignment with growth and wider community outcomes ○ Financial impacts on Council including debt transfer and the details of the package for local government ○ Impacts on local government from wider sector reforms ○ Transition including impacts on communities through the change process, workforce and capability ○ Benefits realisation, including stated efficiency gains.

Option B – Wellington Water model at a higher level of service

83. Option B is effectively the status quo option whereby WWL continues as a CCO to deliver three waters services for the six shareholding Councils.
84. This model would need to respond to the proposed changes in the regulatory environment, including increased investment to ensure compliance with drinking water and environmental standards. It would also need to respond to the oversight and expectations of a potential future economic regulator.
85. This option requires making assumptions about
- the future regulatory requirements. This would apply the assumptions underpinning the WICS modelling and the Government's proposal and draft/emerging standards and compliance regimes eg those coming from Taumata Arowai as well as early assessment from WWL.
 - the ability of non-WWL drinking water supplies to meet standards and requirements and the risks to Council and WWL in relation to these
 - Increased Council investment to meet both regulatory requirements and network requirements.

86. Any changes to levels of service or material changes to the cost of service would require consultation and an LTP amendment (or consultation on those changes as part of the next LTP 2024-34 and potentially later ones). These would need to be agreed and aligned across the WWL shareholder Councils.

Key benefits of Option B	Key risks and issues with Option B
<ul style="list-style-type: none"> ○ Lowest risk option in short term ○ Less disruption from transition to communities through the change process, workforce and capability ○ Responds to increased regulatory requirements ○ Known option with established workforce, oversight and governance ○ Greater Council control and more certainty over local infrastructure integration (planning and delivery) with land use plans and council objectives 	<ul style="list-style-type: none"> ○ Does not address the fundamental drivers for change of affordability, efficiency gains and costs to community = longer term risk ○ Ongoing challenges of alignment between Council investment / affordability and required levels of investment ○ Potential for future change to be imposed by government ○ Unforeseen future impacts on Councils and WWL from new water regulation and economic regulation ○ Loss of capability and capacity from WWL to WSE if these are established elsewhere in NZ

Option C – Asset transfer to enhanced Wellington Water model

87. This option would build upon Option B by including aspects of the Government's reform model whereby three waters assets would be transferred to an enhanced Wellington Water type CCO entity.
88. This type of model was identified as a potential option through the Wellington City Council Mayoral task force report⁹ and through the Hawkes Bay Councils three waters review business case process¹⁰.
89. Depending on how this option was developed, it may allow for some form of balance sheet separation from Council to enable greater borrowing and investment. This would however most likely require some form of legislative change to enable this.
90. Significant further analysis and buy-in from the shareholder councils would be required to develop and then implement this model. This would include working through similar aspects of the Government's model that have been identified as unknowns or potential risks above.

⁹ [Water - Mayoral Taskforce – Three Waters - Wellington City Council](#)

¹⁰ [Morrison-Low-Report-ofHB-Three-Waters-Review.pdf \(hb3waters.nz\)](#)

Key benefits of Option C	Key risks and issues with Option C
<ul style="list-style-type: none"> ○ Potentially lower risk option (relative to Government reform) in the short term ○ Builds on known WWL model with established workforce, oversight and governance ○ Potentially less disruption from transition to communities through the change process, workforce and capability ○ Greater Council control and more certainty over local infrastructure integration (planning and delivery) with land use plans and Council objectives <p>Potential to realise similar types of benefits to Option A:</p> <ul style="list-style-type: none"> ○ Efficiency gains through scale, procurement, governance, capability, economic regulation ○ Financial capacity / borrowing ○ Increased affordability of water services ○ Ability to respond to water regulation 	<p>Significant further work would be required to develop this model which raises a range of risks and challenges. This would need to include consideration of:</p> <ul style="list-style-type: none"> ○ How to address the fundamental drivers for change of affordability, efficiency gains and costs to community ○ Buy-in, capability and capacity to manage and govern this process as a major change programme ○ Governance and oversight model, including the role of Iwi/Māori ○ Asset and debt transfer and borrowing model ○ Costs to households and systems for charges ○ Potential or future process for further councils to join this model (eg wider Wellington region, Horowhenua, Tararua) ○ Legislative changes and government buy-in required to enable the model ○ Process requirements and timeframe including consultation ○ Potentially lower benefits than Option A due to smaller scale

Option D – Council to deliver three water services

91. Council could also opt to deliver three waters services itself / through a contracted model / through a mixed model of in-house and contracted services. This might include contracts with a WSE or other Councils.
92. This model would require the shareholder Councils to agree to wind up WWL (WWL would also need to be wound up under Option A) or for the Council to withdraw from this model.
93. This model would present a range of challenges and risks to Council given the interconnected nature of the Wellington three waters system and that Council has effectively transferred capacity and capability for water functions to Wellington Water Limited.

Key benefits of Option D	Key risks and issues with Option D
<ul style="list-style-type: none"> ○ Potential for more Council control of aspects of three waters – investment, delivery, alignment with wider planning and outcomes 	<ul style="list-style-type: none"> ○ Does not address the fundamental drivers for change of affordability, efficiency gains and costs to community ○ Council liable for regulatory requirements and oversight from Taumata Arowai ○ Unknown implications of economic regulator on Council <p>Complexities of establishment:</p> <ul style="list-style-type: none"> ○ Winding up or opting out of WWL ○ Developing drinking water supply agreements from GWRC (or WSE) owned assets ○ Commercial arrangements with other Councils – such as for transfer and treatment of wastewater and stormwater ○ Rebuilding of internal three waters capability and capacity ○ Council’s capability and capacity to manage and govern this process as a major change programme in relation to other priorities

Key priorities in the Council’s LTP 2021-2031

94. The Government's reform proposals have also been considered in relation to high level alignment with the Council's key priorities identified by the LTP relative to the Council's current position. This is briefly summarised below:

[Investing in infrastructure | Whanake i ngā poupou o te hāpori](#)

[Increasing housing supply | Hei āhuru mōwai mō te katoa](#)

- As noted above, Council has considerable investment required in three waters infrastructure which presents a range of funding and affordability challenges. Enabling future growth and housing supply to facilitate housing affordability is contingent upon enabling investment in three waters infrastructure. Through the LTP process, whilst some funding to enable growth has been included this was restricted due to affordability considerations (for example a \$200M placeholder for future growth was excluded).

- The three waters reforms are intended to address this affordability challenge and enable investment required for growth.
- It is however noted that prioritisation of investment for the local community may be challenging in the future when HCC's "voice" can only influence, including alignment with growth planning, unless legislative provision is made that better ensures this.

Caring for and protecting our environment | Tiaki taiao

Supporting an innovative, agile economy and attractive city | Taunaki ōhanga auaha, tāone whakapoapoa

Connected communities | Tūhono hapori

- Locally aspirations for improved water quality are being reflected through the outcomes of the Whaitua process and the recent LTP investment decisions.
- The Government's reform programme in part responds to the need to improve the quality of freshwater which will be enforced through a strengthened regulatory regime and supported by an increase to the capability and capacity of the water sector to make the necessary investment to meet community expectations and regulatory requirements.
- Ensuring a 'local voice' in the governance and direction of the WSE and ensuring that investment aligns with broader community outcomes may present some challenges given the scale of the WSE and the proposed governance arrangements

Being financially sustainable | Whakauka ahumoni

- The long term benefits of the reform proposals are clearly focused on financial sustainability and addressing affordability constraints.
- The significant scale and size of the proposed system-wide changes for the local government sector enables efficiency opportunities in the medium to long term, however there are a range of risks and uncertainties in establishing the new entities and transitioning to this new structure.

Section F – Transition

95. If the Government's proposal were to proceed, effective management of the transition by Council, Government and partners will be critical. There are a range of risks that will need to be considered in this regard, and includes:
- Loss of customer experience,
 - Poor transition management could cause delays and confusion over responsibility exposing Council to liabilities and affecting continuity of service delivery,
 - Different local approaches may reduce the economies of scale,

- Staff/contractor retention ,
 - Stranded overheads,
 - Transition resourcing in tight and challenging labour market
 - Deferred decision making - development projects may stall
 - Liability for environmental damage – lack of clarity for monitoring environmental impacts may expose Council to liabilities.
96. Transition away from the status quo to any other option, carries inherent risks, with potential mitigations to reduce both impact and likelihood and therefore residual risk and sticking with the status quo may not be sustainable in the short, medium or long term.

Section G – Council decision making and consultation

97. Part 6 of the LGA, sections 76 to 90, provide the requirements for decision making and consultation, including the principles of consultation and information that needs to be provided including the reasons for the proposal and the reasonably practicable options.
98. In particular, section 76 requires that in making a significant decision, which a decision on the future management and or ownership of three waters assets will be, Councils must comply with the decision-making provisions. This is a ‘higher bar’ than the “promote compliance with” that applies for ordinary decisions.
99. Section 77 states that Councils must seek to identify all reasonably practicable options and then assess the advantages and disadvantages of each option.
100. Section 78 requires that in the course of making a decision a Council must consider community views but section 78(3) explicitly says that consideration of community views does not require consultation, which is reinforced by case law.
101. Section 79 gives Council discretion to decide how the above Part 6 requirements are met including the extent of analysis done etc. Therefore, while a decision could be challenged, a judicial review is unlikely to be successful unless the decision made by Council was manifestly unreasonable, the process was flawed or the decision was beyond its powers (as given in law, ie the Council did not act within the law).
102. However, despite section 79 of the LGA, a decision to transfer the ownership or control of a strategic asset from the Council (or to it) must explicitly be provided for in the Council’s LTP (and have been consulted on specifically in its consultation document).
103. An LTP amendment and consultation process on the ownership and governance arrangements and asset transfers proposed would be necessary.
104. There are also provisions in the LGA that relate to unlawful decisions to sell or dispose of assets, which can be investigated by the Auditor-General.¹¹

¹¹ See sections 43 to 47 of the LGA.

105. A decision to opt-out would also be affected by the consultation and decision-making requirements set out in this report, including the need to follow a robust process that could survive a judicial review, as well as make a final decision that was not manifestly unreasonable in the circumstances.
106. Given the Government's
- 8 week period of engagement with mana whenua and Councils
 - commitment to explore issues such as council and community influence of service outcomes, integration with other reform proposals, spatial and local planning
 - request for Councils to give feedback on the proposal, identify issues and solutions
 - and uncertainty around next steps, including whether the reform may become mandatory or legislative change will remove legal barriers to opting in
- it would be premature to make a decision to opt out of the reform process and may expose the Council to litigation risk.
107. A Government Bill to progress the reforms could address the issues raised above, for example removing the section 130 requirements has explicitly been raised.
108. At this stage no decision is required on future delivery arrangements. Based on the analysis in this report, Council should wait until it has further information before consulting on and/or making a decision on the Government's proposal.
109. It is recommended that the Council therefore notes the options canvassed in this report, the high-level analysis of them and the information and decisions that are yet to be made.
110. If reform is not made mandatory, to ensure sufficient information is available to meet the moral and legal requirements of Council decision-making officers will further develop the analysis of options (based on further information from the Government, advice on next steps, and regional discussions) prior to Council decision making and consultation on future water services delivery. Whether this is ultimately required will be dependent on where the Government gets to with the reform process and the decisions it makes after 30 September 2021.

Section H – Information that the Council requires or potential solutions to outstanding issues that Council would like to convey to Government and LGNZ

111. There are still several issues that need to be resolved, including:
- the final boundaries
 - protections from privatisation
 - plans for consultation with mana whenua and communities
 - how the community voice be heard within the new entities, and what influence local authorities will have (and what the community can realistically expect Council to influence particularly if it is not on the Regional Representation Group).
 - representation from and on behalf of mana whenua

- integration with other local government reform processes
 - integration with spatial and local planning processes and growth
 - prioritisation of investment, and alignment with Council priorities
 - workforce and capability planning for the new entities
 - what will a Government Bill cover and whether the reform will be mandatory
 - conditions associated with the Government's package of funding for local government
 - transition arrangements, including workforce challenges (without transition challenges on top) and due diligence for asset transfers etc.
 - the scope of the stormwater role that the entities will play, both in relation to growth and development planning, development control, asset management and maintenance particularly of green and water sensitive assets
 - After reform, how the entity intends to engage with local communities, and the role of Council (for example with advocacy, facilitation of communication, response to failures)
 - How Councils will be involved in holding future entities accountable for performance and customer service levels.
112. Council is invited to discuss whether there are specific information needs, issues or solutions that the Council would like officers to convey to the Government or LGNZ.

Section I – Conclusion

113. While there is uncertainty about the future steps in the Government's reform proposal, and current legislative impediments to it, the current eight-week period gives Council the opportunity to understand the information it has received (and will continue to receive) from the RFI and modelling processes.
114. It also provides an opportunity for Council to understand its potential options, including the financial, workforce and sustainability impacts for Council and the wider economic, social and cultural implications of each option, using the guidance that has been issued. It also provides an opportunity to engage in discussions with other Councils in its entity grouping, share information and ask questions and propose solutions to issues it sees to Government and LGNZ.
115. All of this information will be useful to inform future decision making by both council and Government and consultation and engagement with mana whenua and communities.

Engagement and consultation

116. Council is not required to consult at this time as detailed in section G of this report. Further advice regarding any future consultation requirements will be provided after September 2021.
117. Whilst there has not been any formal consultation process with the community as yet as we are awaiting further information from Government, there has been some initial informal feedback from the community that has been received along the following lines:

- People understand the challenges we have with three waters infrastructure, and the need to invest. They broadly recognise the commitments we have made through the LTP, and also that the reform process is in response to similar challenges across New Zealand.
- People are seeking further information/clarification on some aspects of the reform. People generally recognise there are big changes being considered, but often not across enough detail to understand and have a strong view.
- There is a need for community consultation. People are saying that these assets are the community's assets, and they therefore want to be involved in the decision process. There has been some comments raised that people are concerned Council will make a decision without this community input.

Climate Change Impact and Considerations

118. The matters addressed in this report have been considered in accordance with the process set out in Council's Climate Change Considerations Guide.
119. Climate considerations (both mitigation and adaptation), resilience and environmental impacts are drivers of the reform process. While there are no specific impacts arising from this report the decisions that occur post September 2021 will have an impact on climate and environmental issues. Some of these impacts have been considered in this report based on currently available information – please refer to Section D of the report.

Risks, legal and financial considerations

120. Significant risks, legal responsibility and financial implications have been identified in analysing the reform proposals and considering the options in this report. However, there is no decision required, other than to note those issues and to request further information from Government if Council wishes to, to reduce the risks and implications to Council and its communities.

Appendices

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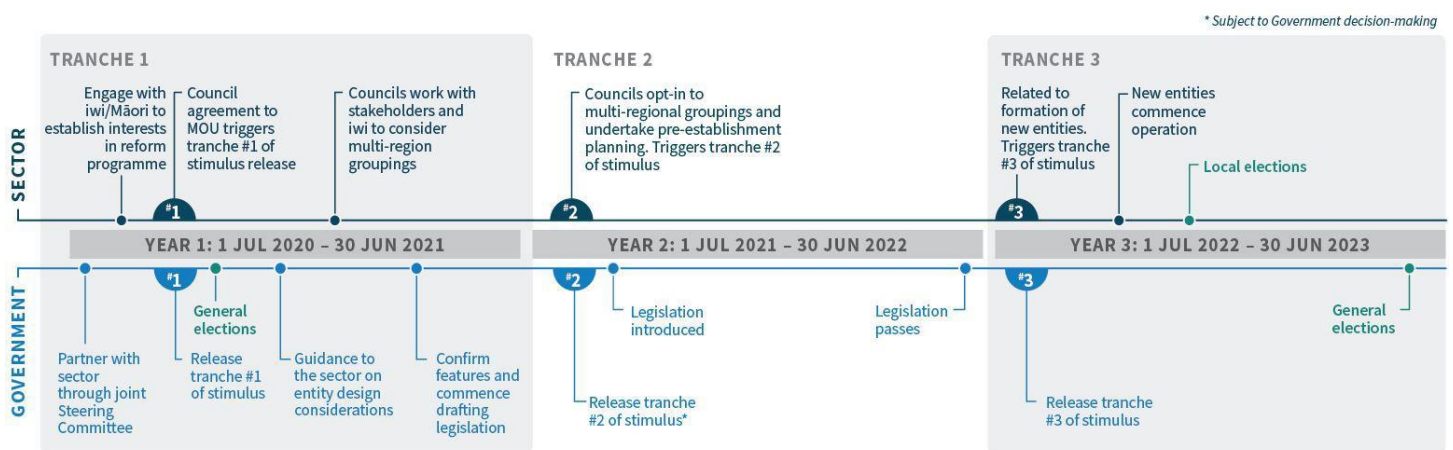
Approved By: Jo Miller, Chief Executive

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

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

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

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



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

Following initial reports (that used publicly available council information) from the Water Industry Commission for Scotland (WICS), between October 2020 and February 2021, (all) 67 councils participated in the Government's Request for Information (RfI) on council's three waters assets, including future investment requirements. In return they received what was known as Tranche 1 stimulus funding (under a MoU and funding agreements with Government) for operating or capital expenditure that supported the reform objectives, economic recovery through job creation and maintaining, increasing and/or accelerating investment in core water infrastructure delivery, renewals and maintenance. Council received \$10.6M under this arrangement and is currently completing the agreed delivery plan. A Council report 25 August 2021 entitled "Three Waters Reform – Memorandum of Understanding" HCC/20202/5/173 details the reasons for Council participation.

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

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

Taumata Arowai will have the authority to prepare standards and rules that water suppliers (such as councils) must comply with. Their [initial working drafts](#) are available online¹² and are currently being updated. Consultation will occur later this year. Guidance to support the operational compliance rules is also being developed and will be available when the rules are consulted on.

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

¹² www.taumataarowai.govt.nz/for-water-suppliers/

Water Services Bill obligations of local authorities

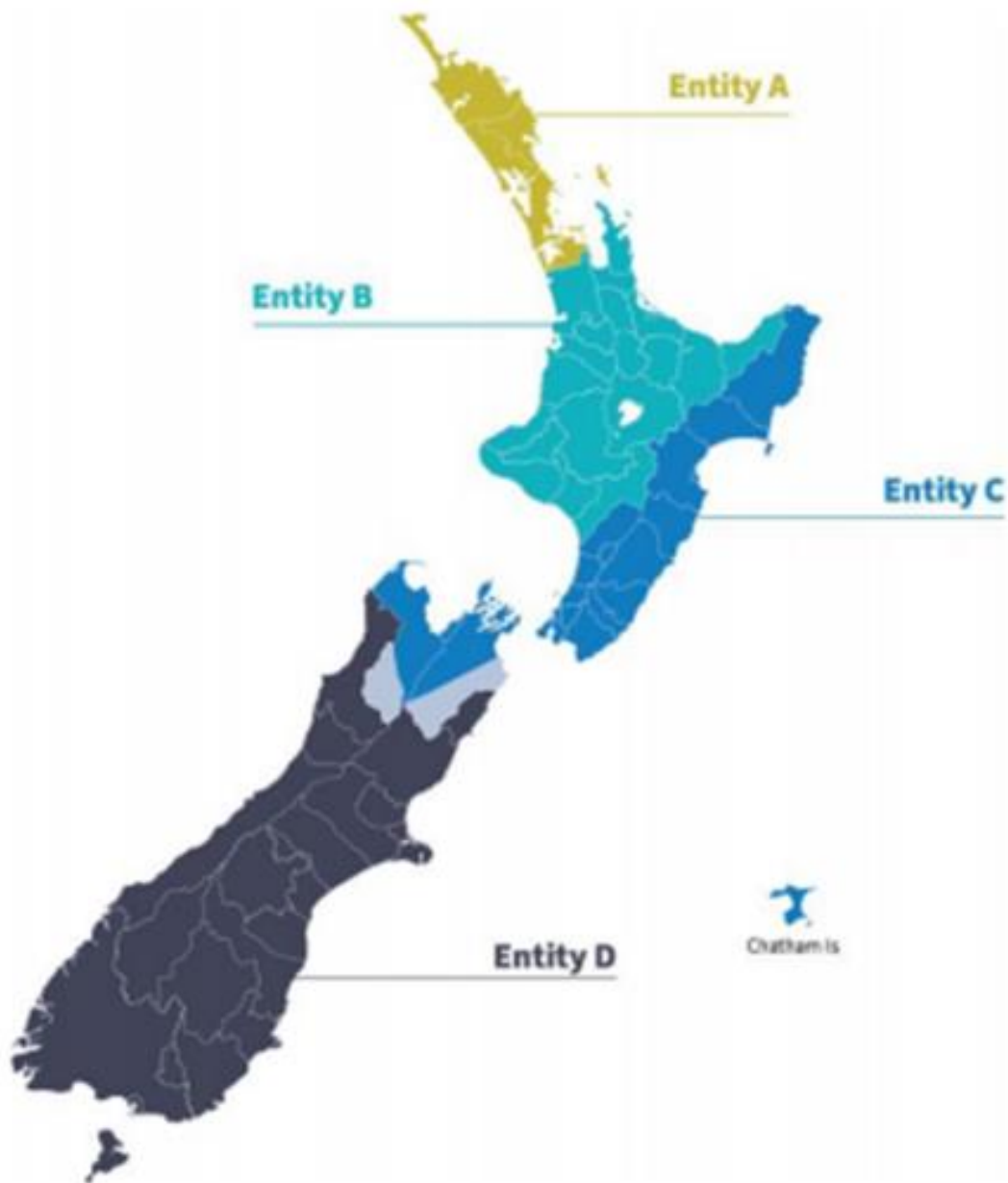
Local authorities as suppliers of water services	General obligations of local authorities
<ul style="list-style-type: none"> • Duty to provide safe drinking water and meet drinking water standards, and clear obligations to act when water is not safe or fails to meet standards • Key provisions include: <ul style="list-style-type: none"> ○ Suppliers need to register with Taumata Arowai ○ Local authority suppliers will need a drinking water safety plan and a source water risk management plan ○ Water suppliers must give effect to Te Mana o te Wai • Taumata Arowai will have significant compliance and enforcement powers, including powers to direct suppliers and enter into enforceable undertakings with suppliers • Officers, employees and agents of suppliers will have a duty to exercise professional due diligence • Complying with these new requirements is expected to require significant capital and operating expenditure by local authorities (including paying levies to Taumata Arowai for operation of the regulatory system) 	<ul style="list-style-type: none"> • Local authorities will have a duty to ensure communities have access to drinking water if existing suppliers face significant problems in complying with drinking water standards including: <ul style="list-style-type: none"> ○ Requirements to work with suppliers and consumers to identify solutions ○ Intervention responsibilities if a supplier is unable to meet standards, including potentially taking over management and operations of private or community supplies • In rural communities, this could represent a significant risk (contingent liability) for local authorities • Local authorities will be required to make assessments of drinking water, wastewater and sanitary services to ensure communities have access to safe drinking water • Local authorities will need to assess drinking water services available to communities at least once every three years, including private and community supplies (excluding domestic self-supplies)

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

Appendix 2 - the Government's conclusion that the case for change has been made

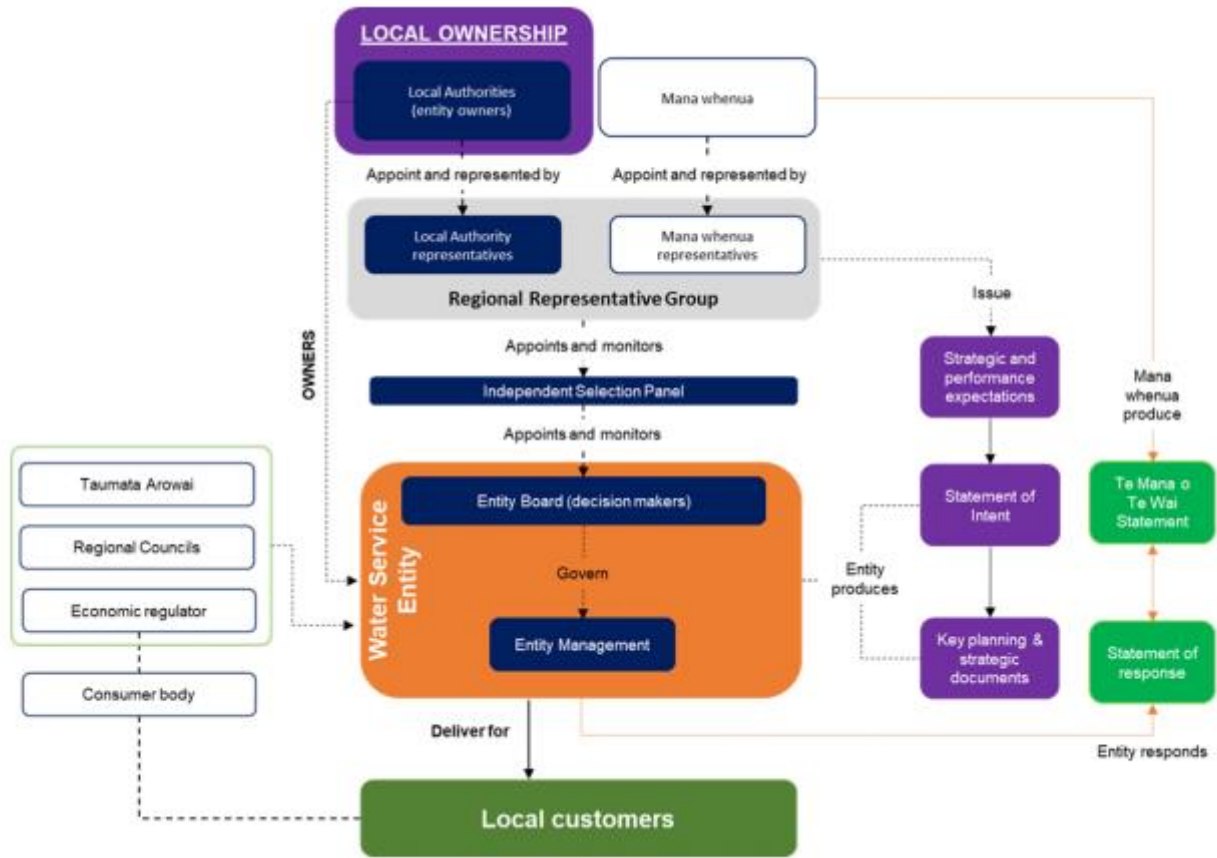
1. The modelling has indicated a likely range for future investment requirements at a national level in the order of \$120 billion to \$185 billion, an average household cost for most councils on a standalone basis to be between \$1,910 and \$8,690 by 2051.
2. It also estimated these average household costs could be reduced to between \$800 and \$1,640 per household and efficiencies in the range of 45% over 15-30 years if the reform process went ahead.
3. The efficiencies noted are underpinned by evidence across a range of countries based on joined up networks (the conclusion is that 600,000 to 800,000 connections achieve scale and efficiency), greater borrowing capability and improved access to markets, procurement efficiencies, smarter asset management and strategic planning for investment, a more predictable pipeline and strengthened benchmarked performance, governance and workforce capabilities.
4. The [briefing to the Minister](#) notes that this "investment is what WICS has estimated is necessary for New Zealand to meet current United Kingdom levels of compliance with EU standards over the next 30 years, which in its assessment (and confirmed by Beca) are broadly comparable with equivalent New Zealand standards."
5. However, this is caveated as a conservative estimate that does not take into account iwi goals and aspirations, higher environmental standards or performance standards that are anticipated in future legislation, uncertainties in asset lives, seismic and resilience risk, supply chain issues, and the current workload to manage and deliver improvements as well as address renewal backlogs.
6. For councils with non-council drinking water suppliers in their areas there is additional risk if they are unable to consistently provide safe drinking water to their consumers, including the potential for council to have to take on the water supply. Council operating on expired consents or with consent renewals in the next 15 years also face uncertainty over the standards they will need to meet in the future and therefore the level of investment that needs to occur.
7. Councils could also add to the above list of uncertainties and challenges their business as usual workload, the workload associated with delivering on stimulus packages and associated with responding to other government reform initiatives such as reform of the Resource Management Act, and general workforce retention and attraction issues, which are exacerbated by public sector competition for talent and skills.
8. The modelling indicated that between one and four water services entities would provide the most efficiencies and reduce costs to individual households.
9. When this is added to
 - a. known variations across the nation in water suppliers' compliance with drinking standards, including permanent and temporary boil water notices
 - b. evidence of poor health and environmental outcomes, including expired resource consents for wastewater treatment plants (and the need for 110 of these plants to go through the resource consenting process in the next 10 years)
 - c. stormwater overflows and other challenges
 - d. climate change

- e. Te Tiriti obligations and the need to uphold Te Mana o te Wai
 - f. the size and scale of current service delivery units and workforce issues
 - g. the obligations and responsibilities that councils (and other water suppliers) will face when the Water Services Bill and associated regulations are enacted
 - h. the Government has concluded that the status quo is not sustainable and that the [case for change](#) has been made.
10. The four entities and their proposed boundaries (which may yet change) and the proposed structure for the system are as follows



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

11. Proposed governance structure



12. Further information about each of the entities:

Entity A

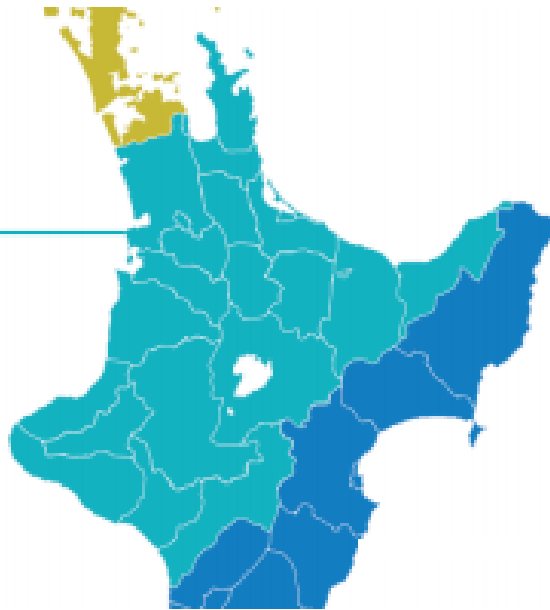


Auckland
Far North
Kaipara
Whangarei

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

Entity B

Entity B

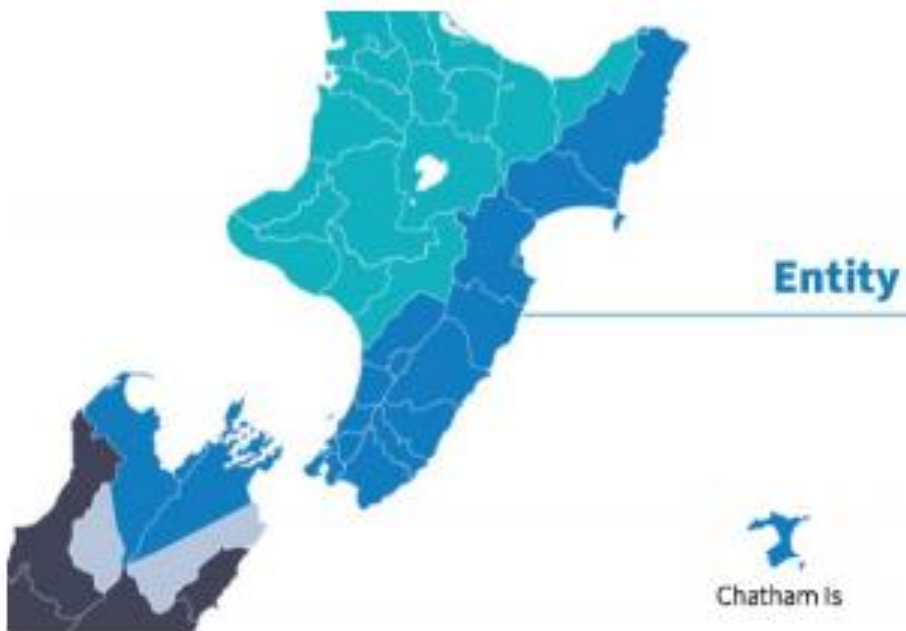


- | | | |
|----------------|----------------|----------------|
| Hamilton | Rotorua Lakes | Waikato |
| Hauraki | Ruapehu | Waipa |
| Kawerau | South Taranaki | Waitomo |
| Matamata-Piako | South Waikato | Western Bay of |
| New Plymouth | Stratford | Plenty |
| Opotiki | Taupo | Whakatane |
| Otorohanga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

Entity B

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

Entity C



- | | | |
|---|--|---|
| <ul style="list-style-type: none"> Carterton Central Hawke's Bay Chatham Islands Gisborne Hastings Horowhenua Kapiti Coast | <ul style="list-style-type: none"> Lower Hutt Manawatu Marlborough Masterton Napier Nelson Palmerston North | <ul style="list-style-type: none"> Porirua South Wairarapa Tararua Tasman Upper Hutt Wairoa Wellington |
|---|--|---|

Entity C

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

Entity D



Entity D

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

Entity D

Connected population (2020)	0.9m
-----------------------------	------

Average household cost (2051, real)¹

With reform	\$1,640
Without reform	\$4,970

Appendix 3 - DIA two-page summary

A new system for three waters service delivery

DIAGRAM 1

JUNE 2021

1. A CASE FOR CHANGE

This Government has ambitions to significantly improve the safety, quality, resilience, accessibility, and performance of three waters services, in a way that is efficient and affordable for New Zealanders. This is critical for:

- public health and wellbeing;
- environmental outcomes;
- economic growth and employment;
- housing and urban development;
- adapting to the impacts of climate change;
- mitigating the effects of natural hazards.

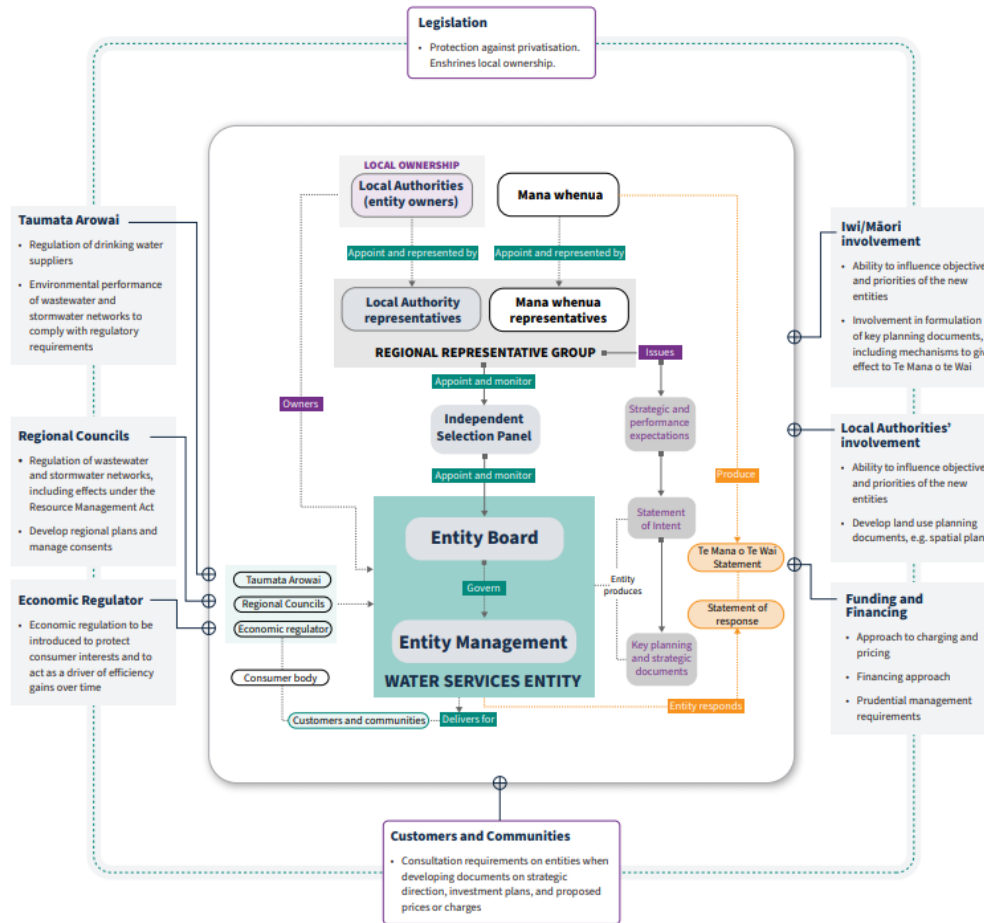
Government also wants to ensure it delivers on Treaty-related obligations, including by improving outcomes for iwi/Māori in relation to three waters service delivery.

Integral to this is effective infrastructure delivery, underpinned by an efficient, high-performing, financially-sustainable, and transparent three waters system.

2. KEY DESIGN FEATURES

- Maintaining local authority ownership of water services entities;
- Protecting against privatisation;
- Retaining influence of local authorities and mana whenua over strategic and performance expectations;
- Providing the necessary balance sheet separations from local authorities; and
- An integrated regulatory system.

3. A NEW WATER SERVICES SYSTEM



4. OBJECTIVES FOR THE CROWN/MĀORI RELATIONSHIP

Enabling greater strategic influence to exercise rangatiratanga over water services delivery.

- A Integration of iwi/Māori rights and interests within a wider system.
- B Reflection of a holistic te ao Māori perspective.
- C Supporting clear account and ensure roles, responsibilities, and accountability for the relationship with the Treaty partner.
- D Improving outcomes at a local level to enable a step change improvement in delivery of water services for iwi/Māori.

5. A PARTNERSHIP-BASED REFORM

- Government will continue to work in partnership with iwi/Māori and local authorities.
- A large scale communication effort is required to ensure local government support reform.
- Further decisions are yet to be taken by Cabinet on the arrangement for transition to, and implementing, the new system.

A new system for three waters service delivery

The number and boundary of entities needs to balance scale with other factors

DIAGRAM 2

JUNE 2021

1. FACTORS CONSIDERED TO DETERMINE NUMBER AND BOUNDARIES

A range of factors have been analysed to help determine how many entities there should be, and their boundaries:

- A** Potential to achieve scale benefits from a larger water service delivery entity to a broader population/customer base.
- B** Alignment of geographical boundaries to encompass natural communities of interest, belonging and identity including rohe/takiwā.
- C** Relationship with relevant regulatory boundaries including to enable water to be managed from source to the sea - ki uta ki tai.

Applied economic analysis, informed by international evidence, provides further confidence that each entity would need to serve a connected population of at least 600,000 to 800,000 to achieve the desired level of scale.

The preferred approach is to create four new water services entities, and to enable all communities to benefit from reform.

2. PROPOSED BOUNDARIES

Government has agreed to a preferred set of entity boundaries. However, the Government remains interested in continuing discussion with local government and iwi/Māori most affected by the proposed boundary choices. In particular:

1 South Island entity

Whether there should be a single entity covering the whole of the South Island, or instead take an approach that uses the Ngāi Tahu takiwā.

2 Taranaki region

Which entity would include the Taranaki region, taking into account ki uta ki tai, whakapapa connections, and economic geography/community of interests.

3 Hauraki Gulf

Whether to include other districts surrounding the Hauraki Gulf, enabling a more integrated approach to the management of the Hauraki Gulf marine catchment.

The map highlights the recommended boundaries.

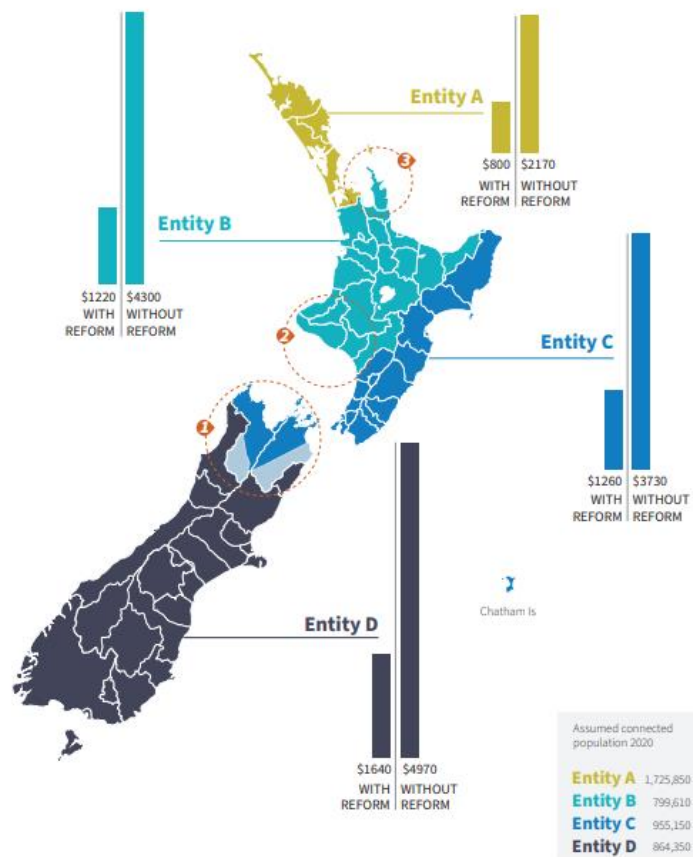
3. OUR INTENTION IS THAT ALL COMMUNITIES BENEFIT FROM REFORM

Latest estimates indicate that the amount of investment required to:

- provide for future population growth
- replace and refurbish existing infrastructure
- upgrade three waters assets to meet drinking water and environmental standards

is in the order of
\$120 billion to \$185 billion
 over the next 30 to 40 years.

4. PROJECTED HOUSEHOLD COSTS 2051



The figures presented above for household bills with and without reform set out what an average household would be likely to pay for three waters services in 2051, in today's dollars, based on analysis by the Water Industry Commission for Scotland.

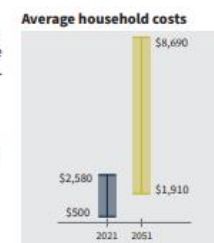
A weighted average figure is presented for household bill estimates without reform, to account for the wide variance between council pricing policies. This weighted average figure reflects the proportion of the connected population that resides in each council area relative to neighbouring councils within the relevant water services entity.

5. POTENTIAL IMPACTS

Difference in household costs

Average household costs for most councils on a standalone basis in 2051 are likely to range from between \$1,910 to \$8,690.

The scale of investment required between now and 2051, would require average household costs to increase by between three to 13 times in real terms for rural councils, between two and eight times for provincial councils and between 1.5 and seven times for metropolitan councils.



Source: Water Industry Commission for Scotland Analysis 2021

Current household costs

Currently there are a wide range of current (2019) average household costs.

	LOW	HIGH	MEDIAN	MEAN
Metro	\$500	\$1,920	\$1,050	\$1,120
Provincial	\$610	\$2,550	\$1,120	\$1,300
Rural	\$210	\$2,580	\$1,340	\$1,390

Source: Water Industry Commission for Scotland Analysis 2021

Current costs are not necessarily a good reflection of what funding is required to meet the full costs of economic depreciation (that is, to provide resources for asset maintenance and renewal).

Potential economic impact of reform

The economic impact assessment estimates the impact of a material step up in investment in connection with reform, relative to the level of investment that might be expected in the absence of reform.

Change relative to counter-factual, 2022-2051

Net change in GDP p.a. over 30 years	▲	0.3% to 0.5%
Present value increase in GDP	▲	\$14b to 23b
Average increase in FTEs	▲	5,850 to 9,260
Increase in average wages	▲	0.2% to 0.3%
Present value increase in taxes	▲	\$4b to \$6b

Source: Debitate Three Waters Reform Economic Impact Assessment 2021

LGNZ two-page summary

THREE WATERS 101.

The Government is proposing major reform of New Zealand’s drinking water, wastewater and stormwater system. Here LGNZ synthesises the issues, the opportunities and what it means for local government.

**We are.
LGNZ.**
Te Kāhui Kaunihera ō Aotearoa.

1. What’s the problem?

Councils currently own and operate three waters services, which cover drinking water, wastewater and stormwater. More investment is needed in water infrastructure to meet the environmental and public health aspirations of our communities. The Government has estimated that dealing with 30 years of systemic failure will require an investment of more than \$185b over the next 30 years.

This scale of investment would be extremely challenging for councils to fund on their own. Climate change will only exacerbate this challenge.

-  Significant investment needed in water infrastructure
-  Councils can’t carry future costs
-  The current system lacks:
 - Economic regulation
 - Consistent data collection
 - Enforcement of standards

2. Government’s proposed solution

The Government has told us it wants to deliver water services more cost effectively. It also wants to deliver them in an equitable and sustainable way.

It proposes changing the whole system:

-  A new water regulator called Taumata Arowai
-  A smaller number of large, specialist water service entities
-  Water services are delivered on a significantly larger scale
-  Water entities remain publicly owned
-  Water services providers meet standards or face significant penalties for noncompliance
-  Entities have strong strategic links to councils and mana whenua

3. Impact on councils

The Government’s proposal would mean significant change to the delivery of water services. For a start, councils would shift their focus from delivery to kaitiakitanga of water services. Requirements on local authorities to ensure safe drinking water for private and community supplies would transfer to new entities.

For most councils, removing water-related debt from their balance sheets would improve their financial position. It would potentially create more opportunity to focus on delivering wellbeing to their communities.

-  Three waters kaitiakitanga focus
-  Water-related debt removed from balance sheet
-  Increased capacity to borrow to fund community services

We know there’s not universal agreement on the case for change. But to meet councils’ own RFI projections, spending across New Zealand as a whole would need to increase by 50 percent annually for the next 10 years. With strong regulatory enforcement, the picture would be very different for councils, creating difficult trade offs if large investments are required to meet water standards.

LOCAL GOVERNMENT CAN HELP SHAPE THREE WATERS REFORM.

**We are.
LGNZ.**
Te Kāhui Kaunihara o Aotearoa.

What's important to the sector in this reform?

-  Everyone has access to safe drinking water and the same level of three waters service.
-  Infrastructure and systems are resilient and well-funded.
-  Three waters are delivered in partnership with Iwi.
-  Delivery is responsive to climate change.
-  Catchments are managed from the mountain to the sea.
-  Districts retain high-paying, skilled jobs.
-  Any transition is well-managed and people are looked after.
-  Local voices are heard and local priorities are responded to.

What the sector needs from central government

-  Transparency about the process and what's on the table.
-  A robust transition plan that makes sure the benefits of reform are delivered.
-  Government to support councils so they can keep delivering. This means makes sure councils are economically sustainable without water.
-  A fair deal, including that councils are not financially worse off, and that communities are better off.
-  To support and grow effective local democracy.
-  That any new system reflects the relationship with mana whenua under Te Tiriti o Waitangi

LGNZ is working for councils

Our work on Three Waters is guided by the principle that we need to seize any opportunity to create the best possible outcome for local government.

We're using our influence to work with the Government on a model that better includes the perspective of our communities. Representatives from local government are helping to steer this work and pose the hard questions. We are also actively working with government on what a package to go with reforms might look like. We'll work to optimise this package before decisions are made.

Find out more

We encourage you to stay informed and up to date of the reforms as they evolve. We'll be with you every step of the way. Here's where you can start:

Read what DIA has published: www.dia.govt.nz/Three-waters-review

Check out the info on our website: www.lgnz.co.nz
Get in touch if you have questions: feedback@lgnz.co.nz



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

1. On 15 July, in partnership with LGNZ under a [Heads of Agreement](#)¹³, the Government announced a package of \$2.5 billion to support councils to transition to the new water entities and to invest in community wellbeing.
2. The 'better off' element: an investment of \$2B into the future for local government and community wellbeing.
 - The investment is funded \$1B from the Crown and \$1B from the new Water Services Entities. \$500M will be available from 1 July 2022. The funding has been allocated to territorial authorities (which includes unitary authorities)¹⁴ on the basis of a nationally formula that takes into account population, relative deprivation and land area.
 - The funding can be used to support the delivery of local wellbeing outcomes associated with climate change and resilience, housing and local placemaking, and there is an expectation that councils will engage with iwi/Māori in determining how to use their funding allocation.
3. The 'no council worse off' element: an allocation of up to around \$500M to ensure that no local authority is in a materially worse position financially to continue to provide services to its community as a direct result of the reform.
 - This element is intended to ensure the financial sustainability of councils and address reasonable costs and financial impacts associated with the transfer of assets, liabilities and revenues to new water services entities.
 - Up to \$250M is available to meet the unavoidable costs of stranded overheads and the remainder for other adverse impacts on financial sustainability of territorial authorities (including future borrowing capacity).
 - Of this \$250M up to \$50M is allocated to Auckland, Christchurch and Wellington Water councils, the remainder is available to other councils.¹⁵ This funding is not available until July 2024 and is funded by the Water Services Entities.
4. Hutt City Council's funding allocation is \$38.7M.
5. The package is in addition to the \$296M announced in Budget 2021 to assist with the costs of transitioning to the new three waters arrangements. The Government will "meet the reasonable costs associated with the transfer of assets, liabilities and revenue to new water services entities, including staff involvement in working with the establishment entities and transition unit, and provision for reasonable legal, accounting and audit costs."¹⁶

¹³ [https://www.dia.govt.nz/diawebsite.nsf/Files/Three-waters-reform-programme/\\$file/heads-of-agreement-partnering-commitment-to-support-three-waters-service-delivery-reform.pdf](https://www.dia.govt.nz/diawebsite.nsf/Files/Three-waters-reform-programme/$file/heads-of-agreement-partnering-commitment-to-support-three-waters-service-delivery-reform.pdf)

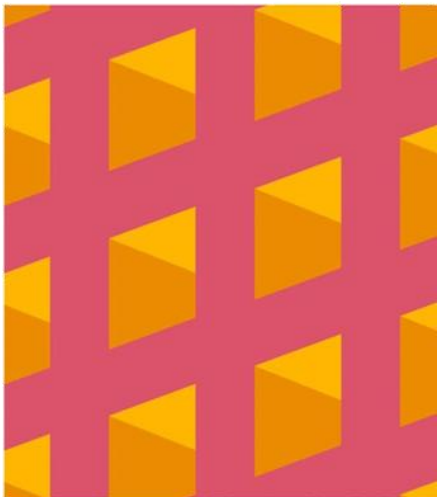
¹⁴ Please note that any allocation to Greater Wellington Regional Council (the only regional council affected by the proposed changes) is not clear at this stage.

¹⁵ Due to their size and in the case of Wellington Water and Auckland's WaterCare having already transferred water service responsibilities (to varying degrees)

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

6. The Government is also encouraging councils to use accumulated cash reserves associated with water infrastructure for this purpose. There are likely to be practical limitations on a council's ability to do this set by councils' own financial strategy and policies (including conditions on the use of the reserves i.e. targeted reserve funds must be used for the purpose they were collected for in the first instance e.g. if collected for capital works).
7. There are also political and / or community acceptance challenges with this approach - if the assets are transferred under a voluntary or mandatory process the reserve balances are expected to be used to invest those funds in the communities that paid for them, consistent with the conditions under which they were raised rather than pooling as a general fund. Councils and communities are unlikely to embrace using these funds instead to enable the transition.
8. The proposed national allocations are as follows:

Council	Allocation
Auckland	\$ 508,567,550
Ashburton	\$ 16,759,091
Buller	\$ 14,009,497
Carterton	\$ 6,797,415
Central Hawke's Bay	\$ 11,339,488
Central Otago	\$ 12,835,059
Chatham Islands	\$ 8,821,612
Christchurch	\$ 122,422,394
Clutha	\$ 13,091,148
Dunedin	\$ 46,171,585
Far North	\$ 35,175,304
Gisborne	\$ 28,829,538
Gore	\$ 9,153,141
Grey	\$ 11,939,228
Hamilton	\$ 58,605,366
Hastings	\$ 34,885,508
Hauraki	\$ 15,124,992
Horowhenua	\$ 19,945,132
Hurunui	\$ 10,682,254
Invercargill	\$ 23,112,322
Kaikoura	\$ 6,210,668
Kaipara	\$ 16,141,395
Kapiti Coast	\$ 21,051,824
Kawerau	\$ 17,270,505
Lower Hutt	\$ 38,718,543
Mackenzie	\$ 6,195,404
Manawatu	\$ 15,054,610
Marlborough	\$ 23,038,482
Masterton	\$ 15,528,465
Matamata-Piako	\$ 17,271,819
Napier	\$ 25,823,785
Nelson	\$ 20,715,034
New Plymouth	\$ 31,586,541
Opotiki	\$ 18,715,493
Otorohanga	\$ 10,647,671
Palmerston North	\$ 32,630,589
Porirua	\$ 25,048,405
Queenstown Lakes	\$ 16,125,708
Rangitikei	\$ 13,317,834
Rotorua Lakes	\$ 32,193,519
Ruapehu	\$ 16,463,190



Three Waters Reform

Hutt City Council
August 2021



Important notice

Important message to any person not authorised to have access to this report.

Any person who is not an addressee of this report or who has not signed and returned to PwC a Release Letter is not authorised to have access to this report.

Should any unauthorised person obtain access to and read this report, by reading this report such person accepts and agrees to the following terms:

1. The reader of this report understands that the work performed by PwC was performed in accordance with instructions provided by our addressee client and was performed exclusively for our addressee client's sole benefit and use.
2. The reader of this report acknowledges that this report was prepared at the direction of our addressee client and may not include all procedures deemed necessary for the purposes of the reader.
3. The reader agrees that PwC, its partners, principals, employees and agents neither owe nor accept any duty or responsibility to it, whether in contract or in tort (including without limitation, negligence and breach of statutory duty), and shall not be liable in respect of any loss, damage or expense of whatsoever nature which is caused by any use the reader may choose to make of this report, or which is otherwise consequent upon the gaining of access to the report by the reader. Further, the reader agrees that this report is not to be referred to or quoted, in whole or in part, in any prospectus, registration statement, offering circular, public filing, loan, other agreement or document and not to distribute the report without PwC's prior written consent.
4. This report should also be read in conjunction with the important notice and restrictions set out in our Engagement Letter.



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Hutt City Council
30 Laings Road
Lower Hutt 5040

Attention: Jenny Livschitz, Group Chief Financial Officer

30 August 2021

Three Waters Reform

We refer to our engagement letter dated 10 August 2021 (the Engagement Letter), and provide our final report to you.

Hutt City Council (HCC) has engaged PwC to support its response to the government following the release of further information by the Department of Internal Affairs (DIA) relating to the Three Waters Reform.

We draw your attention to the important notice and restrictions set out in our Engagement Letter.

Save as described in the agreement or as expressly agreed by us in writing, we accept no liability (including for negligence) to anyone else or for any other purpose in connection with this report, and it may not be provided to anyone else.

If you have any questions, please do not hesitate to contact either of us.

We look forward to discussing this report with you.

Ngā mihi nui

A handwritten signature in black ink, appearing to read 'Dan Marshall', written in a cursive style.

Dan Marshall
Partner

Introduction

Background

The government's Three Waters Reform Programme envisages the creation of multi-regional water service delivery entities. The government has recently advised that councils will have ownership, but only influence, not control of the new water service entities.

Previously, the DIA issued a Request for Information (RFI) to all councils to understand the financial and infrastructure position of each council, and is currently undertaking commercial and policy work. PwC were previously engaged by HCC to provide assistance with gathering the required data and responding to the RFI.

HCC now requires further support and assistance from PwC in responding to the ongoing requirements from the Three Waters Reform Programme.

Scope

The scope of services was to provide input and support to HCC in preparing a report that will be presented to Council to outline recommendations on what further information is required from the government in order for Council to make an informed decision on the Three Waters Reform Programme. This support includes, but is not limited to the following:

- input primarily on the financial section of the document, and where appropriate, additional support regarding the outstanding issues that the Council should convey to the government
- high level assessment and testing of the reasonableness of the assumptions (and risks) of the underlying forecasts completed by the Water Industry Commission for Scotland (WICS) for the future costs of water delivery
- analysis of the difference between HCC's final LTP compared to the information submitted in the RFI, and its impact on the analysis at hand (DIA dashboard and WICS' future costs of water delivery analysis)
- broader input and identification of risks around the Three Waters Reform that Council should consider
- calculate the portion of HCC's debt that can be attributed to three waters (based on funding impact statement debt movements) in order to support HCC's negotiation with the government over debt transfer to the new water service entity.

We note that the scope item to calculate the portion of HCC's debt that can be attributed to three waters was agreed to be removed from scope as further consideration is required.

Approach

This presentation summarises the following key areas:

- WICS modelling – consideration of peer reviews undertaken by Farrierwier and Beca and review of outputs generated for HCC
- Local Authority Indicative Financial Impact Tool – review of the inputs to confirm HCC data is up-to-date and accurate
- Further consideration - Outline of any remaining gaps in the information and considerations for HCC.

WICS Modelling of average household cost



WICS Modelling

DIA’s estimated average cost per household in FY51 is not unreasonable, particularly given the higher level of capital investment forecast in the WICS modelling.

Background

DIA commissioned WICS - a specialist economic, financial, regulatory and technical overseas entity - to support the Three Waters Reform Programme and inform policy advice to ministers.

WICS has assessed the potential benefits from amalgamating three waters infrastructure and delivery for the 67 councils across New Zealand into a limited number of independent water service entities.

WICS completed a first stage of evidence on the potential economic benefits of the reform using publicly accessible council information (2018 LTPs) and benchmarked this against those benefits realised through reforms in the United Kingdom. This report was released in December 2020. WICS estimated that \$120 billion to \$185 billion of future investment is required over the next 30 years.

Between October 2020 and February 2021 a nationwide RFI took place across all 67 councils. This data has been used to inform several workstreams including the second phase of economic analysis by WICS. The WICS Phase 2 report outputs have now been released to councils (through the ‘council dashboard’ and supporting reports) and has been updated to better reflect, and be more informed by, the RFI submissions.

Household Costs per Annum under reform versus no reform scenarios

An extract of HCC’s council dashboard is to the right and outlines the WICS modelled average household cost per annum in FY21 and FY51, under both the reform and no reform scenarios.

For comparison, HCC’s final 2021-31 Long Term Plan (2021 LTP) (and assumed number of connections) forecasts average household cost per annum by FY31 of **\$1,767** (uninflated basis). If this amount is extrapolated out to FY51 (using DIA’s compounded annual growth rate over FY32 - FY51), average household cost is **\$1,861**. A comparison of the WICS Modelling to HCC’s 2021 LTP is discussed later in the report.

Three Waters Reform – Hutt City Council
PwC

A key factor in realising the benefits achieved through the amalgamated entity (reform) are achieved through increased levels of borrowings. Entity C, which HCC is proposed to be part of, has debt to revenue of 645% by FY51. The use of significantly higher leverage combined with forecast cost efficiencies are key contributors to the lower forecast average household cost per annum under the reform.

WICS modelling of average household costs per annum for HCC



Source: Department of Internal Affairs PowerBi Council Dashboard

WICS Modelling – Peer Reviews

The peer reviews completed on the WICS modelling support the direction of the Three Waters Reform, but, it is evident that there remains uncertainty in the outcomes of the reform. What is certain is that significant investment in three waters is required, which will lead to increased cost to manage three waters infrastructure.

Peer Reviews

Peer reviews prepared for DIA of the WICS model have been completed by Farrier Swier Consulting Pty Limited (2 May 2021) and Beca Limited (2 June 2021).

These review papers are available at <https://www.dia.govt.nz/Three-Waters-Reform-Programme>.

The focus on each of the peer reviews is as follows:

- **Farrierswier** undertook a peer review of the WICS modelling that focused on the methodology and underpinning assumptions applied by WICS and the extent to which this is reasonable to inform policy advice, including the following:
 - the extent to which the efficiency assumptions included in the WICS study of the economic benefits of aggregation (and associated reform) are reasonable for the purpose of providing advice to ministers
 - the extent to which the assumptions relating to the financial and commercial position of the new entities are reasonable
 - the WICS methodology and its appropriateness for developing advice on the potential benefits of the proposed reform package
 - the potential that exists for efficiency gains or losses (dynamic, productive and allocative) in New Zealand and the ways in which these could be realised.
- **Beca** undertook a peer review focused on the standards and practices in the United Kingdom and the relevance to New Zealand (given WICS used United Kingdom data and benchmarks as part of its analysis).

Outcome of peer reviews

The opinion of the **Farrierwier** peer review was that “the overall approach adopted by WICS to modelling the potential impact that amalgamation of water entities and associated reforms could have on projected expenditure, financing costs, revenue and prices of water service providers should give reasonable estimates in terms of direction and order of magnitude”.

The conclusion of the **Beca** peer review is provided as appendix B.

We note that the above summarised conclusions of the peer reviews of the WICS model undertaken by Farrierwier and Beca should be read in conjunction with the respective full reports and the limitations outlined in those reports.

HCC Comparisons

WICS made a number of assumptions for HCC in forecasting average household costs in a no reform scenario. PwC have prepared a high level comparison of the assumptions and data used by WICS and the HCC’s final 2021 LTP. This is presented on the following pages.

WICS Modelling – Comparison of data inputs (No reform)

Item	WICS Assumption	WICS amount	HCC's final 2021 LTP	PwC comment
Capital expenditure	<p>Growth</p> <ul style="list-style-type: none"> Assumed to be the same as disclosed in HCC's RFI. As forecasts were not provided for 2031-2051, the average annual growth investment over 2022-2031 is assumed to continue. <p>Level of service enhancement</p> <ul style="list-style-type: none"> Calculated on a standardised basis across all councils based on population, land area and density. <p>Renewal investment</p> <ul style="list-style-type: none"> Assumed to be 100% of economic depreciation of assets. WICS has calculated asset useful lives using an average of NZ councils with a +/- 20% cap and collar. Furthermore, WICS has used NZ council averages for the split between short and long life assets. 	Cumulative capital expenditure 2022-2031 (Uninflated): \$932m	Cumulative capital expenditure 2022-2031 (Uninflated): \$489m	<p>WICS has forecast \$443m additional capital expenditure than HCC includes in its final 2021 LTP.</p> <p>WICS has taken a more aggressive approach on the required capital investment for three waters infrastructure.</p>
Operating expenditure	<ul style="list-style-type: none"> Base operating expenditure is calculated as operating expenditure in 2021 as provided in the RFI, multiplied by forecast growth in connections. Assumed additional operating expenditure is forecast to increase by 3% for additional capital expenditure for growth and service improvement. 	Cumulative operating expenditure 2022-2031 (Uninflated): \$373m	Cumulative operating expenditure 2022-2031 (Uninflated): \$436m	<p>HCC has forecast lower operating expenditure in its final 2021 LTP than the data submitted in the RFI (that used draft 2021 LTP).</p> <p>This has the impact of the WICS model <i>understating</i> three waters operating expenditure, which will reduce forecast average household cost (offsetting a greater increase that is driven by the higher capital investment in the WICS modelling).</p>

WICS Modelling – Comparison of data inputs (No reform)

Item	WICS Assumption	WICS amount	HCC's 2021 Final LTP	PwC comment
Debt	<ul style="list-style-type: none"> Debt / borrowings as at FY21 is the figure provided in HCC's RFI New borrowings is calculated based on the required capital and operating investment, while ensuring debt to revenue is kept at 250% or less over the forecast period. 	Debt in 2031 (Uninflated): \$358m	Debt in 2031 (Uninflated) calculated as an average of revenue, asset, and interest allocation methods: \$187m	<p>Debt is significantly higher in WICS model due to the increased forecast capital investment that is funded by debt.</p> <p>The 250% debt to revenue limit that WICS applied in its model is identical to HCC's internal borrowing limit (while the LGFA limit is 280%)</p>
Revenue	<ul style="list-style-type: none"> Revenue is calculated as the amount councils need to collect to maintain a Three Waters debt to revenue ratio of 250% or less Revenue from households is calculated using an assumed 70% of revenue from households, which is based on the observed split in Great Britain. 	<p>Cumulative total revenue 2022-2031 (Uninflated): \$1.1b</p> <p>Average revenue attributable to households 2022-2031: 70%</p>	<p>Cumulative total revenue 2022-2031 (Uninflated): \$817m</p> <p>Average revenue attributable to households 2022-2031: 79%</p>	<p>The combination of significantly higher investment forecast in the WICS model, and a debt to revenue cap of 250% for Three Waters results in higher revenue in the WICS model.</p> <p>However, this increased cost is slightly offset by WICS assuming a lower portion of revenue is attributable to households (70% versus 79%).</p>
Connections	<ul style="list-style-type: none"> Connections in 2021 is calculated from HCC's water connected population, as provided in the RFI, divided by the average occupancy rate across New Zealand Growth in connections is assumed equal to the average growth rate in councils. 	Connections in 2031: 46,278	Connections in 2031: 45,672 (Source: HCC's RFI and average council growth in connections)	This would not change under both the reform and no reform scenarios, however, the increased customer numbers forecast by WICS would have the impact of decreasing the average household cost in FY31.
Average household costs per annum	<ul style="list-style-type: none"> Average household costs are calculated by taking the total revenue and dividing by the number of connections 	Average cost per household per annum in FY31 (Uninflated): \$2,165	Average cost per household per annum in FY31 (Uninflated): \$1,767	WICS cost per household is higher in FY31 than HCC forecasts, primarily due to significantly higher capital expenditure. WICS assumptions and corresponding forecasts of average household costs do not appear unreasonable.



Local Authority Indicative Financial Impact Tool

The financial impact tool is indicative only and the output is not a true reflection of debt associated with three waters investment (as RFI estimations are used). The financial impact tool has not been publicly released.

In support of the reform process, DIA has developed a high-level financial impact tool (released 17 August 2021) to provide councils with an indication of how the proposed transfer of water-related debt, assets and revenues may affect the financial position, credit ratings and/or financial covenants of each council.

The financial impact tool (in respect of HCC) primarily uses the data submitted in HCC's final 2021 LTP, with an opening balance for three waters debt from HCC's RFI (2021 LTP does not have balance sheet data at a three waters level). The output of the financial impact tool is as at 30 June 2024, the proposed transfer date.

We outline HCC's revenue and debt position with and without transfer of assets and debt to the Water Service Entity (WSE) as outlined in the financial impact tool.

We make the following observations:

Revenue

Revenue is taken directly from the Funding Impact Statement for each of the three waters. We note that HCC has a significant portion of revenue allocated to three waters (c.30% of total revenue compared to c.20% for councils across the Wellington region).

Revenue transferred includes general rates allocated to three waters. However, the allocation of general rates in the 2021 LTP is done on the basis to manage deficits, rather than being associated with the specific council activities. HCC will need to consider this position in further discussion with DIA if the reforms proceed.

We note that development contributions and subsidies for capital expenditure are currently not forecast to transfer to the WSE. HCC will need to understand this position in further discussion with DIA if the reforms proceed.

Debt

Debt is forecast based on the debt amounts for three waters supplied by HCC in the RFI, and then forecast out based on the movement in debt in the Funding Impact Statements for each of the three waters to FY24.

HCC does not allocate loans / borrowings to individual council activities, such as three waters. HCC has a portfolio approach and allocates net interest costs of council borrowings to specific activities based on a formula of the average capital spend over the financial year and previous five (5) years to arrive at a percentage proportion.

The RFI (that was used as a basis for the transfer of debt to the WSE) data for three waters debt was based on an interest allocation approach (i.e. three waters interest / total interest x total debt) and was noted to be a "proxy for debt" and is therefore not an accurate reflection of three waters debt. This approach calculated three waters debt submitted in the RFI of \$49.8m for FY20.

The table below outlines the forecast debt and asset transfer to the WSE, and HCC's corresponding debt to revenue, as per the financial impact tool.

Summary of metrics using DIA's Financial Impact Tool (Base Calculations)

Metric	Without Transfer	Transfer	With Transfer
Revenue	\$216m	\$71m	\$145m
Debt	\$416m	\$109m	\$307m
Debt to Revenue	192%		212%

Source: DIA's Local Authority Indicative Financial Impact Tool

Local Authority Indicative Financial Impact Tool

The opening debt balances in the financial impact tool have been updated to better reflect HCC's actuals. This has the impact of decreasing the debt to revenue ratios from 192% to 186% (without transfer) and 212% to 206% (with transfer).

Adjusted Calculation

We note the financial impact tool incorrectly uses the FY21 forecast debt balance for three waters and then takes into account the movement in debt for the FY21 financial year (essentially doubling up the movements in the FY21 year for all councils).

We have updated the opening debt figure in the financial impact tool to be FY20 (as submitted in the RFI). Refer to page 11 for detailed commentary around the allocation of HCC debt to three waters.

The result of this updated data is that the level of debt allocated to three waters in the financial impact tool (the indicative transfer of debt to the new WSE) decreases from \$109m to \$104m.

In addition, the tool used gross borrowings instead of net borrowings. This has also been updated in the financial impact tool.

The impact of these two adjustments is that HCC's debt to revenue ratio improves (i.e. reduces) as outlined on the table opposite.

The quantification of HCC's three waters related debt is yet to be finalised and, as such, we will provide further advice in relation to the reasonableness of the estimated debt transfer generated from the financial impact tool.

Should the reforms proceed as proposed, DIA has advised councils that a thorough due diligence process will be undertaken to assess the actual assets, debt and revenues at the point of transfer on 1 July 2024.

Summary of metrics using adjusted calculations

Metric	Without Transfer	Transfer	With Transfer
Revenue	\$216m	\$71m	\$145m
Debt	\$402m	\$104m	\$298m
Debt to Revenue	186%		206%

Source: DIA's Local Authority Indicative Financial Impact Tool

Local Authority Indicative Financial Impact Tool

The financial impact tool indicates that \$68m (in addition to any debt transfer) may be available to HCC as part of the government financial support of the Three Waters Reform. We note that this is an indicative figure and should the reforms proceed as proposed, a thorough due diligence process will be undertaken.

The government has committed to ensuring that councils are "better off" and "no worse" from the three waters reform. The financial impact tool is used to assist Council in assessing the potential financial contribution that may be available as a result of this commitment. The financial impact tool has four outputs in respect of government support:

1) Debt Headroom (FY24)

The change in debt required to maintain a council's debt to revenue ratio.

2) Financial sustainability

The financial support provided for a reduction in debt headroom to ensure debt to revenue ratios are not affected.

3) Better off package

The initial allocation from the \$2 billion announced by the government in July 2021 and calculated based on population, deprivation and land area.

4) Stranded cost

The financial support provided based on a nationwide estimate of two years unavoidable stranded costs. This amount is allocated on a per capita basis and scaled to recognise that smaller councils face greater potential stranded costs.

The table opposite outlines government support available to HCC (as per the financial impact tool) on a "DIA base calculation" basis and an "Adjusted calculation" basis, however, we note the following:

- On 15 July 2021, government announced a \$2b support package allocated across all councils based on population, deprivation and land area. HCC's allocation of this is \$39m under both calculations.

- The financial impact tool indicates that any council with a reduction in debt headroom will receive a payment equal to the loss in debt headroom to ensure debt to revenue ratios are not affected. The financial impact tool indicates that HCC will receive \$28m (DIA's base calculation) and \$29m (Adjusted calculation), which ensures HCC's debt to revenue ratio remains identical to the "without transfer" position.
- While the financial impact tool does not indicate any government support for stranded cost (as the assumption is made by DIA that expenditure sits with Wellington Water Limited (WWL)), HCC does have corporate support costs relating to three waters. HCC will need to consider this position in further discussion with DIA if the reforms proceed.

Indicative government support using DIA's Financial Impact Tool

Metric	DIA base calculation	Adjusted calculation
Financial Sustainability (indicative allocation)	\$28m	\$29m
Better off package	\$39m	\$39m
Stranded cost (indicative allocation)	-	-
Total (indicative)	\$67m	\$68m

Source: DIA's Local Authority Indicative Financial Impact Tool

Further Considerations

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Further Considerations

It is our view that the Council should seek further clarification to be better informed as it is evident that a number of aspects of the three waters reform process are not clear and remain uncertain.

Further considerations for HCC are as follows:

- It is still unclear the actual amount of debt that will ultimately be transferred to the WSE. The Local Authority Indicative Financial Impact Tool has an indicative figure, however, should the reforms proceed as proposed, a thorough due diligence process will be undertaken to assess debt at the point of transfer on 1 July 2024.
- It is unclear how financial derivatives (interest rate swaps and loan break fees) will be treated and accounted for upon the transfer of debt. A liability may exist for HCC when it "closes out" financial derivatives following the transfer of debt to the new water service entities, however, this is being managed currently to mitigate liability.
- Forecast amounts are ultimately that, forecasts. There is no guarantee that cost savings through increased efficiencies will be achieved by the WSE. Any shortfall will be ultimately passed to the ratepayers by way of water charges.
- HCC are the owners of the WSE, but has no control. HCC may still be seen as responsible in ratepayers eyes.
- Prioritisation of three waters investment by WSE for the HCC local region may be challenging when its "voice" can only influence. This includes alignment with growth planning.
- HCC's decisions around being part of the reform process or opting out could be influenced by the position taken by other councils in Entity C. i.e. if some choose to opt-out, the efficiency savings may not be achieved and then the benefit to HCC ratepayers from amalgamation may be reduced.
- Further clarification is required around the general rates that are allocated to three waters. HCC uses general rates allocation to council activities to manage deficits, however, the financial impact tool shows the general rates allocated to three waters being transferred to the WSE. Further, development contributions and subsidies for capital expenditure are currently not transferred in the financial impact tool. Transferral of these will further impact the council's debt to revenue position.
- While HCC is a shareholder council of WWL, removing three waters from HCC operationally has its complexities that will need to be managed and understood from an operational perspective.

Thank you

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Appendix A) WICS Modelling – Peer Reviews (Beca)

The **Beca** review outlined a number of high-level differences between the three waters sector in the United Kingdom and New Zealand. Any consequences for the outcomes and conclusions arising from the WICS modelling of the status quo and different aggregation scenarios as per the Beca review are summarised as follows:

Area of Difference	Degree of Difference (Scotland vs New Zealand)	Consequences of Differences
Governance and Co-governance/lwi arrangements	Major – single entities vs multiple entities Major – significant involvement of lwi in kaitiaki and Tiriti relationships at national and local government levels	Some – timeframes for implementation of new governance models may take longer than anticipated because of different current state of assets and hence cast doubt on modelling outcomes. May make it difficult for efficiencies to be realised within the timeframe set out in current delivery arrangements. Estimation and comparison of upgrade costs for three waters needs to take lwi goals/aspirations into account.
Size and Population	Some – similar size but differences in population density, more urban, higher level of connection	Minor – WICS assumptions about efficiency gains by WSEs may not be delivered due to low connections OR there will be higher costs as WSEs increase rates of connection
Standards	Major – prescriptive but clear, NZ facing major changes in environmental legislation [see also lwi/Co-Governance comments above]	Major – Council estimated LTP costs on which WICS modelling is based do not reflect higher environmental standards nor performance standards expected by new legislation and by different lwi across NZ
Three Waters Systems	Some – different materials and service lives, similar proportion of underground/aboveground assets, lower seismic risk, lower risk of other natural hazards	Some – WICS modelling uses NZ sourced data on assets for renewals predictions but these could over-estimate asset lives and hence under-estimate renewals budgets. WICS assumes NZ capital cost estimates which should include for seismic and resilience upgrading
Funding Arrangements	Major – harmonised charges, clear funding regime	Some – although WICS Phase 2 modelling assumes harmonised charges for the new WSEs, these are based on council's predicted renewals and capital works so quantum of charges may be too low if these Council estimates are incorrect due to inconsistent condition assessment methodologies and setting of renewals budgets, and/or underpredict improvements/upgrades required in next 30 years.
Levels of Service	Major – robust LoS regime	Some – could take some years for assumed LoS within WSE regions to be achieved so modelled efficiencies may take longer to be delivered to consumers
Workforce – capacity and capability	Major/Some – lacking qualification structure for water services, lack of resources and skills	Some – Scotland can rely on tapping into a larger workforce market due to its location close to larger economies. NZ has issues with lack of skills and resources which is exacerbated with the fragmented and incomplete qualification pathway qualifications and ongoing professional development in the water sector. Result – slower timeframe for implementation of change and delivery of anticipated improvements

Appendix B) Glossary of terms and abbreviations

Term	Definition
2021 LTP	2021-31 Long Term Plan
Beca	Beca Limited
Debt Headroom	The debt headroom is calculated as: Revenue after transfer (i.e. excluding revenue related to three water assets) times the debt to revenue ratio before transfer less debt after transfer (i.e. excluding debt related to three water assets)
Farrierswier	Farrier Swier Consulting Pty Limited
HCC or the Council	Hutt City Council
PwC	PricewaterhouseCoopers
RFI	Request for information
DIA	Department of Internal Affairs
WICS	Water Industry Commission for Scotland
WWL	Wellington Water Limited
WSE	Water Service Entity