

Committee: Council

Date: 13 December 2016

Report Name: Waikato Waters Study -
Consideration of Direction

Author: Stephen Halliwell

Report Status	<i>Open</i>
Strategy, Policy or Plan context	<i>2015-25 Long Term Plan – Review of Service Delivery</i>
Financial status	<i>Council has spent a total of \$500,000 since 2014 on this project (50% share), funded from existing budgets.</i>
Assessment of significance	<i>Having regard to the decision making provisions in the LGA 2002 and Council's Significance Policy, a decision in accordance with the recommendations is not considered to have a high degree of significance</i>

1. Purpose of the Report

2. To consider Council's position on forming an asset owning water and wastewater CCO for Hamilton City and Waipa and Waikato District Councils (asset owning CCO) either by confirming the previous decision to adopt of the Record of Agreement, or determine any additional information Council requires before making a decision on the most effective service delivery system for waters services.

3. Executive Summary

4. In the past few years Council has made steps towards forming an asset owning CCO with Waipa and Waikato Districts. Following the 2016 Local Body Elections each council is considering their options and either confirming the path set by previous elected members or considering other options.
5. As the recommendations offer an either/or recommendation option Council must choose a preferred direction. This direction could be influenced by the decisions of Waipa and Waikato who have met on 5 and 6 December to confirm their position. At the time of finalising this report these meetings had not been held; their officer recommendations are included as are web links to the reports on their agenda.
6. The first recommendation option provides for Council to confirm its preference to proceed to an asset owning CCO with an amendment to the decision making framework. Since the adoption of the draft Record of Agreement there has been discussion on the appropriateness of the water meters decision making framework outlined in the agreement. The report asks Council to confirm that its position has changed and that it wishes the agreement to be amended.
7. The second recommendation option provides for Council to seek further information prior to selecting a preferred direction. A decision to choose this option will result in a report in 2017 for Council to determine its preferred direction for the delivery of water and wastewater services.

8. The report reminds Council of the options previously considered and informs Council of new options that could be further considered. These new options have been derived from advice Waipa have received from their consultant Morrison Low (Attachment 3). Council could choose to seek more information on any of these, although the existing options have been comprehensively considered in the Cranleigh report.
9. The report also provides information on the challenges and obstacles of establishing an asset owning CCO and risks as they relate to the process of forming an asset owning CCO.

Recommendation/s from Management

- a) That the report be received

AND EITHER

- b) That Council amend the draft Record of Agreement for the decision to implement water metering as follows:

Decision	Decision-maker			Type of Shareholder Decision
	CCO Board/ Management	Shareholders Jointly	Individual Shareholders	
Implementing water metering			✓	

- c) And that the Council confirm its decision of July 2016 to adopt a draft Record of Agreement (with the above amendment) in relation to the potential formation of a sub-regional water and wastewater CCO.

OR

- d) That Council request further advice on options previously considered, or new options:

either /and

- (i) Asset owning CCO;
- (ii) Enhanced shared services;
- (iii) Non-asset owning CCO;
- (iv) Transitional Model: Non-asset owning CCO to an asset owning CCO;
- (v) Two council asset owning CCO.

AND

- e) That the Chief Executive be delegated responsibility to progress the project including discussions with Waipa and Waikato District Councils and advisors; to identify practicable options for working together; seeking further advice and modelling and to work with the Waters Governance Group as necessary.
- f) That the Chief Executive report back to Council on the findings of any additional advice received, and the preferred direction of each Council for the service delivery option for Waters Services.

10. Attachments

11. Attachment 1 - Sub-regional Waters Study - Resolutions of Hamilton City Council
12. Attachment 2 - Record of Agreement
13. Attachment 3 - Morrison Low - Waipa District Council - Waikato Sub-Regional Waters CCO - November 2016
14. Attachment 4 - Pros and Cons of Options assessed by Cranleigh
15. Attachment 5 - Extract from Cranleigh Report - Summary of Options

16. Web Links

17. <http://www.waterstudywaikato.org.nz/> the link to the full Waikato Waters Study website containing information, technical reports, consultants reports (commissioned both individually and collectively), media releases, council reports and FAQs.
18. The following links take you directly to these documents on the water study web site.
 - [Full Cranleigh report](#)
 - [Waikato District Council - 5 Dec Report to Council](#)
 - [Waipa District Council - 6 Dec - Report to Strategic Planning & Policy Committee](#)

19. Background

20. Since 2012 multiple independent reports have advised that councils working together in the sub-region for the provision of water and wastewater activities would deliver significant financial and non-financial advantages for ratepayers and communities. In addition, many of New Zealand's relevant professional bodies (Industry New Zealand, IPENZ, Waters NZ, Ingenium, NIU...) also support the benefits of scale in the reticulation of water services.
21. On 26 June 2014 Council resolved to "... undertake a detailed business case examination of a Council Controlled Organisation for water and wastewater activities as a joint project between Hamilton City Council, Waikato District Council and Waipa District Council." and "The detailed business case includes an enhanced shared services model as part of the review". This started the process for which this reports recommendations relate (full resolution, see Attachment 1).
22. On 30 October 2014 Council confirmed the appointment of the Cranleigh consortium following a competitive procurement process and established a Waters Governance Group with 2 members from each council with oversight over the business case development. Councillors Mallet and Pascoe represented Council.
23. The Cranleigh business case was a comprehensive piece of work which looked at the case for change, examined three options in detail identifying the financial and non-financial benefits of these options and recommending the preferred option.
24. Council resolved on 30 July 2015, "That Council receive the Business Case for Water Services – Delivery Options ("Cranleigh Report")" and "Council supports in principle the formation of a Waters CCO for the Hamilton City, Waikato and Waipa District Councils..." (full resolution, see Attachment 1)

25. On 29 October 2015 a new Waters Governance Group was established to address issues to be resolved prior to public consultation on forming an asset owning CCO. This resulted in the draft Record of Agreement which was developed via a series of independently facilitated workshops with members of a representative Waters Governance Group with three members from each council. The previous Mayor Hardaker along with Councillors Gallagher and Mallet represented Council. (Full Record of Agreement, see Attachment 2)
26. Council resolved on 14 July 2016, *“That Council adopt the attached Record of Agreement and supporting documentation relating to the potential formation of a water and wastewater CCO for Hamilton City and Waipa and Waikato Districts Councils.”* related to the formation of a CCO with Waipa and Waikato District Councils (full resolution, see attachment 1).
27. Supporting the draft Record of Agreement did not mean a decision to form a CCO had been made. The formation of an asset owning CCO could not progress until:
 - All three Councils formally proposed forming a CCO following the 2016 Local Government Elections,
 - Formal public consultation had been carried out.
28. On 5 and 6 December 2016, Waikato and Waipa District Councils consider their positions on forming an asset owning CCO. This report was finalised before they met. The final resolutions of their meetings will be advised at the council meeting. Waikato are expected to confirm their position of moving towards an asset owning CCO. As part of Waipa’s considerations they commissioned Morrison Low to consider a new option not considered by Cranleigh and the Waters Governance Group (full Morrison Low report Attachment 3). Waipa are expected to take a more prudent approach to developing a waters CCO in line with the Morrison Low report.
29. Council must now formally consider whether to either confirm its support for an asset owning CCO formed on the basis of the attached draft Record of Agreement or whether it requires more information in order to be able to make a decision on the most cost effective service delivery option for waters services.

30. Options Previously Considered for Delivery of Water Services

31. On 30 October 2014 Council appointed the Cranleigh consortium to undertake a business case and resolved *“That the scope of works for the detailed business case [Cranleigh report] as outlined in Appendix 1 of the staff report are approved”* (full resolution and appendix 1, see Attachment 1).
32. The scope specified that the business case would investigate 3 options:
 - The status quo
 - Enhanced shared services (ESS)
 - An asset owning Council Controlled Organisation (CCO)
33. Brief description of each option:
 - Status Quo:

Each council employs and supports asset managers and engineers to plan, manage and maintain the waters activities. Each Council owns all the assets, debt and consents, fees and charges and holds all risks. Some collaboration may occur.
 - Enhanced Shared Services (ESS):

Councils pool most of their waters teams into one unit to manage and maintain waters activities. One council is the employer. Each Council owns all the assets, debt and consents, fees & rates and holds the risks associated with their assets and consents. Collaboration will occur subject to each council approving scope and funding.

- Asset-owning Council Controlled Organisation (CCO)

An entity in which each Council is a shareholder, which owns, manages, maintains and finances the waters assets and usage. The entity would be governed by a Board appointed by the shareholder and follow the shareholders instructions. It would carry the risk of asset ownership and operation. It would be self funding and be responsible to the customer.

34. The process of developing and reporting on the business case was overseen by the Waters Governance Group (WGG) who met regularly with representatives of the Cranleigh consortium. During this process the WGG agreed assumptions, pros and cons and participated in the assessment of options.
35. The pros and cons of each option were formulated and are attached (Attachment 4). The report recommends an asset owning CCO as the preferred option as; *“It meets all the agreed investment objectives well, is lower risk and offers substantial financial benefits. Key advantages include:*
 - *Water services are an activity with substantial economies of scale. The CCO option is the only one which offers scale across all key areas including staffing, systems, operations, network ownership and funding.*
 - *A CCO structure is also the only option which brings a full Waikato sub-regional view and solution supported by a robust and responsive governance structure. ESS goes some way towards this, but lacks strong governance and a single unified network.*
 - *Major cost savings for water customers and councils due to opex and capex savings and the optimisation of funding structures made possible by a specialist, asset owning entity. Cost savings are supported by evidence from similar amalgamations overseas and in New Zealand as identified in the Mott MacDonald’s engineering report.”* (extract from Cranleigh Report, see Attachment 5)
36. The final Cranleigh report, agreed by the Waters Governance Group was discussed with Council at a workshop on 12 May 2015 and then received by Council on 30 July 2015. Council then resolved to support in principle the formation of an asset owning CCO (full resolution, see Attachment 1).
37. Attachment 5 contains the full text of Cranleigh’s Summary Options Assessment. The table below summarises the ranking of the options considering the multi-criteria scoring, financial savings potential and risk.

Decision Factor	Status Quo	ESS	CCO
Multi – Criteria Score	58%	60%	82%
Combined Savings (10 years)	NA	\$27m	\$107m
Combined Savings (28 years)	NA	\$104m	\$468m
PV of Capex & Opex Savings	NA	\$35m	\$91m
Risk Rating	Medium	High	Low
Overall Ranking	2nd	3rd	1st

38. Challenges of Forming an Asset Owning CCO

39. Since Council adopted the draft Record of Agreement in July 2016, staff have been progressing toward the next stage of establishing an asset owning CCO.
40. During the same period the Government proposed an amendment to the Local Government Act 2002 that could have made the establishment of the proposed CCO easier. Further to that, Council submitted on other matters that would further remove obstacles to forming an asset owning CCO.
41. The establishment of a new asset owning CCO in a very regulated environment and involving multiple councils is challenging. As the project moves forward to each decision point more detailed consideration of matters is required. For example – Development Contributions:
 - The Cranleigh Report assumed that development contribution charges would be replaced by an infrastructure growth charge (Cranleigh p48). This appeared an appropriate assumption as it is the mechanism used by Watercare. This assumption was reflected in the draft Record of Agreement.
 - In June 2016 the Government’s proposed Local Government Act amendment contained very different provisions for development contributions which required Council’s to collect these on behalf of a waters CCO. Council submitted for this to be changed.
 - Furthermore our legal advisors and auditors (following consideration of many alternatives) concluded a full LTP amendment is required. A consequence of which is, the removal of capital projects critical to charging development contributions from the period each council adopted the LTP amendment and resolves to form an asset owning CCO to the time the CCO is operational with its policies in place. The consequence of this would be a period of significant undercharging of water and wastewater DC levies.
42. Many of the challenges staff are identifying have also been identified by Morrison Low and are listed on pages 4 and 5 of their report to Waipa (Attachment 3). While each of these challenges is surmountable, they all add to the time, complexity and risk of establishing an asset owning CCO. Many of the largest and most challenging issues are more easily resolved in the Transitional Model discussed below.
43. We have heard from those involved in the establishment of other CCOs that we should expect multiple challenges to appear as we move to establishing the CCO and that it will be necessary to find pragmatic solutions so that the big gains can be achieved. They advised that many of the issues weren’t project critical and can be resolved after the CCO is established. Should the implementation plan seek to be overly prudent and seek to have an answer to every issue, the CCO will never be established nor achieve the potential benefits the business case has outlined.

44. Amendment to Record of Agreement

45. The current draft Record of Agreement outlines the matters on which the councils have agreed in principle. It represents how an asset-owning CCO would function, if formed.
46. Since the elections informal discussions have been held between the councils and further matters discussed. In these discussions HCC outlined a preference that should a CCO be formed the decision to install water meters in the city, should meters be needed in the future, must be solely a decision of Hamilton City Council. This is slightly different to what is outlined in the existing draft Record of Agreement.
47. Council need to confirm that it is its preference to move the decision in the Record of Agreement Table 1, as shown below:

Decision	Decision-maker			Type of Shareholder Decision
	CCO Board/ Management	Shareholders Jointly	Individual Shareholders	
Implementing water metering	✓	Establish principles		Significant

Changed to:

Implementing water metering			✓	
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48. The Cranleigh report did not assume that water meters would be installed in Hamilton. Council's 30-year Infrastructure Strategy estimates this decision is towards the end of the 30 year period).
49. The report to Waikato District Council contemplates that HCC may seek to change the decision making process on water meters as follows: *"this proposed change to the RoA would have no material effect on the benefits outlined in the report. It is recommended that, if this request is formally made by HCC, Waikato District Council support such an amendment."*
50. Other minor amendments may need to be made to the draft Record of Agreement following further consideration by each Council. These can be considered by the CEOs of each Council or through the Waters Governance Group (delegated through Council to be His Worship the Mayor, the Chair and Deputy Chair of the Strategy & Finance Committee.)
51. It should be noted that the draft Record of Agreement agreed to by all three Councils in June and July of this year represents the basis of the formation of an asset-owning Water CCO. If any Council wished to fundamentally change any of the base assumptions underpinning the agreement, a new agreement would need to be developed. This would likely add significant further costs to the project and delay moving towards public consultation.

52. Potential New Options for Delivery of Water Services

53. Since the councils resolved to adopt the draft Record of Agreement in June/July 2016, further consideration of the proposal has been undertaken. Specifically Waipa District Council independently sought additional advice on the advantages and disadvantages of a non-asset owning CCO and transitional approach to implementing a CCO from Morrison and Low (see Attachment 3).
54. The report proposes a "prudent transition" to an asset owning CCO which has three parts to it. A non-asset owning CCO, transitioned to a self funding CCO which could then be transitioned to an asset owning CCO.

55. These options have been given various names in the Waipa report, a Waipa press release and the Morrison Low report, including Mixed Model, Mixed Model of management and operation, Council Funded CCO and Self Funded CCO.
56. It appears Waipa is wishing to pursue a transitional approach to establishing a Waters CCO. This leaves HCC and Waikato the option to either join with Waipa to transition to a asset owning CCO, acknowledging that Waipa have indicated a strong preference not to take the final step (i.e. transition from a self-funding CCO to asset owning CCO), or for HCC to work with Waikato alone and investigate a new 2 council asset owning CCO, or for HCC to consider other options.
57. For the purpose of this report we have identified three potential new options that have not been considered. They are not exactly the same but incorporate the essence of the Morrison Low report.
58. Brief description of each option:
- **Non-asset Owning CCO**

This option is much like the Enhanced Share Service option except with a governance structure that could possibly mitigate Cranleigh's assessment of high risk. A non-asset owning CCO could be established more quickly and easily than the asset owning CCO. The Morrison Low report documents two steps within this option where in the first step the CCO operates as a provider of asset management services and a second step where the CCO could become self funding from user charges.
 - **Transitional Model**

This option starts with the establishment of a non-asset owning CCO which at a prescribed point in time and subject to certain conditions would recommend to its shareholders the transfer of the waters assets to the CCO. This is an important end point to achieving all the benefits identified in the Cranleigh report. This option could possibly start sooner than an asset owning CCO and provide time and resources to address potential obstacles for an asset owning CCO.
 - **2 Council Asset Owning CCO**

This option joins Waikato and Hamilton as the likely remaining council's (assuming that Waipa resolves to support the Morrison Low proposal). It is assumed that this would look very similar to the agreements already made however no analysis has been done to assess how this might work and whether this is a reasonably practicable option.
59. From an HCC perspective none of these options have been assessed against the business case (Cranleigh). It is not possible to assess whether these options are reasonably practicable or more or less cost effective without further work. Also it is not possible without further analysis to conclude the extent to which the benefits of the asset owning CCO will be achieved under each of these options and what the associated risk of achievement is.
60. If Council were to consider that the information in the Cranleigh report was not sufficient to proceed and that one or more of these options merited consideration, then staff recommend that any selected option be assessed by Cranleigh (and if necessary other advisors) against the assessment criteria used already. This will enable a proper determination of the most suitable option.

61. Recommendations to Waikato and Waipa District Councils

62. On 5 and 6 December 2016 Waipa and Waikato Councils met and discussed the following recommendations. Unfortunately this was after this report was finalised. We will update Council on the final resolutions at the meeting.

63. Waikato District Council

- Council meeting on Monday 5 December 2016 to consider the following recommendations:

THAT the report from the General Manager Service Delivery -Sub Regional Water CCO- be received;

AND THAT Council formally support the formation of an Asset Owning Three Council Water CCO:

AND FURTHER THAT Council adopt the attached draft Record of Agreement, incorporating any necessary amendment in relation to any decision on water meters for Hamilton City being made by that Council alone as the basis of the formation of a three council asset-owning Water CCO:

AND FURTHER THAT Council request staff to develop the plan to undertake the next stage of the project, including a full public consultative process and delegate the approval of this plan to the members of the Waters Governance Group.

64. Having considered this report and advice from officers we interpret this to mean that Waikato District Council has a strong preference to proceed with an asset owning CCO.

65. Waipa District Council

- Council meeting on Tuesday 6 December 2016 to consider the following recommendations:

“That

a) The report of David Hall, Group Manager Planning and Community Relations, be received;

b) The Strategic Planning and Policy Committee resolve to request that Hamilton City Council and Waikato District Council consider amending the “Transition and Establishment Processes Options” section of the Record of Agreement and other consequential amendments;

c) The Strategic Planning and Policy Committee recommend to Council the reformation of the Waters Governance Group to allow discussion with Hamilton City Council and Waikato District Council about amendments to the Record of Agreement and a coordinated approach to public consultation.”

66. Having considered this report, a press release regarding the report and advice from officers we interpret this to mean Waipa District Council has a preference to not proceed directly to an asset owning CCO and to take the more prudent approach as outlined in the Morrison Low report. This is a significant amendment to the draft Record of Agreement.

67. Financial and Resourcing Implications

68. On 30 October 2014 Council approved a budget of \$650,000 shared with Waikato and Waipa.

69. Further more on 29 October 2015 Council approved \$350,000 shared with Waikato and Waipa.

70. The budgets have been managed by the joint staff water project group and costs have been shared HCC 50% and Waipa and Waikato 25% each.
71. At 31 December 2016 all approved budgets will have been spent on external costs. No estimate of staff time has been made.
72. Further reports will require further funding provision. No prices have been obtained for this work. If Council requested analysis, analysis of each option could cost \$50,000 - \$100,000 each. No agreement on cost sharing has been made and it is likely that not all partners would be willing to contribute to each option. Given this uncertainty it is difficult to determine a final cost to HCC. As such it is recommended the Chief Executive be given discretion to get quotes, fund from variations to the budget and seek partner funding as he sees appropriate so that any additional work can be expedited. The Chief Executive will report any budget impact to the Finance Committee.

73. Risk

74. Challenges and obstacles. This report and the Morrison Low report discuss challenges and obstacles that have been identified and would require resolution when forming an asset owning CCO.
 - These will create delays (see below)
 - An amendment to the Local Government Act 2002 could significantly assist with some of the larger challenges.
 - Mitigation: We believe that each issue can be resolved however the more complex the issue the greater likelihood of delays and increased risk. An essential element in mitigating risk is extending implementation timeframes.
 - The current tentative timetable gives six months for consultation and decision making; six months to establish the company and appoint interim directors, and for them to appoint a chief executive and 12 months to start operations.
 - The Transitional Model proposes more time to address some of the obstacles associated with the formation of an asset owning CCO.
75. There are further delays in confirming the preferred delivery option.
 - The start date is presently 1 July 2019. Delays in confirming the delivery option affect each Council's ability to employ qualified staff. The effects of this are already being seen particularly at Waipa and Waikato and to a limited extent at HCC.
 - Delays mean that data relied upon for decision-making is getting out of date and may need re-assessing.
 - Delays mean that benefits are not being realised.
 - Mitigation: Significant progress was made in the last term of council and there has been a hiatus in progress due to necessary democratic processes. Progress in 2017 will be determined by the decisions of the councils this month, and how quickly a consensus on the delivery model can be achieved.
76. The business case contains errors or is out of date
 - The business case is based on draft 2015-25 10-Year Plan data and changes have been made to operations of each Council since then (particularly to respond to growth). In addition, Waikato has identified potentially significant new capital works to maintain wastewater systems (report to Waikato Council 5 December 2016).

- Mitigation: As the Cranleigh business case data will be two years old and is based on a different start date it would be prudent to update the report closer to the consultation and decision-making time.

77. Conclusion

78. It remains the staff view that from all the expert evidence presented to us that an asset owning CCO is the most cost effective option for the delivery of waters services. We have identified a number of obstacles and challenges that make implementing this in a reasonable timeframe difficult. The transitional model proposed by Morrison Low (which needs much more analysis) could possibly provide a path to a quicker start and a more effective transition to the asset owning solution.

Signatory

Authoriser	Blair Bowcott, Executive Director Special Projects
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