Waikato Sub-Regional Waters CCO

November 2016

Introduction

A number of independent reports have consistently concluded that Hamilton City (HCC), Waikato (WDC) and Waipa District (WPDC) Councils could manage water, wastewater and stormwater infrastructure more efficiently and cost-effectively by forming a joint Council controlled organisation (CCO). Those reports have also indicated there would be substantial non-financial benefits in forming a CCO, including:

- improved and greater consistency in engineering standards
- improved risk identification and management
- greater resilience in the operation of the network
- improvements in procurement practices
- improved focus on and enhanced responsiveness to customers
- improved demand management ability
- improved ability to attract and retain specialist professional engineering staff.

The formation of an asset-owning CCO is a substantial decision. It involves the transfer of more than $1.3bn of assets into a yet-to-be-established entity, charged with providing an essential public service. To compound this, the legal and political environment in which these decisions are being considered is complex.

Prior to recent local government elections, the Record of Agreement (RoA), which was developed around the formation of an asset-owning CCO, was adopted by all three Councils and commitments were made to carry out the necessary public consultation. This still remains the last official point of agreement, although as this report describes, agreement has not yet been reached on several complicated issues and significant logistical challenges have been identified with an asset-owning CCO.

Until the issues outlined in this paper are resolved, it would not be prudent to commit to entering an asset-owning CCO. While each issue is surmountable, combined they present a risk of stalling or preventing the formation of any kind of waters CCO in the sub-region.

Purpose

The purpose of this paper is to examine an alternative approach which is intended to reduce the risks and uncertainties inherent in forming an asset-owning CCO, while allowing each Council to enjoy most of the benefits identified in the Cranleigh Business Case (CBC) released in May 2015.

Specifically, it is proposed to begin by establishing a CCO that performs strategic asset management and operational activities for the sub-region.

The three key activities of tariff setting, ownership of risk, and decision-making authority are inextricably linked. The transfer of these to the CCO defines two distinct modes of operation. Namely, a Council-funded CCO, where Council controls tariffs and approves works programmes, and a self-funded CCO where the CCO determines its own works programmes and sets tariffs sufficient to cover them. Logically, the CCO would start as Council-funded and progress to self-funded.

Once the self-funded CCO has developed, in tandem with the Councils, all resources, systems and processes that would be required in an asset-owning CCO, the transition to an asset-owning CCO can be initiated by any one or any two Councils that perceives an additional benefit in doing so, without obligating other Councils to also transfer infrastructure assets.

There is nothing to prevent the CCO from continuing indefinitely either as a self-funded CCO, asset-owning CCO or a combination of each with the different Councils involved. Relative shareholdings can be adjusted if a Council chooses to sell their assets to the CCO, which would afford Councils who choose to transfer assets greater influence over significant decisions and proportional liability for any debt raised by the CCO.

The ability of the Councils to strategically align with each other remains paramount. Efficiency gains from a self-funded CCO will be similar to those forecast for the asset-owning CCO if agreement can be reached on regional asset management plans and a regional development plan. For maximum benefits to be realised, amalgamation of these plans would be required under either a self-funded or an asset-owning CCO.

Background

The original CBC produced in May 2015 investigated the potential financial and non-financial benefits of water governance options for the sub-region. The options considered included the status quo, an enhanced shared services model, and an asset-owning CCO. From these options, it was recommended that an asset-owning CCO was the most beneficial.

The Waikato Waters Governance Group (WWGG) and Waters Project Group (WPG) have been working together to identify and resolve issues associated with forming a CCO and negotiations have proceeded on a 'nothing is agreed until everything is agreed' basis.

The RoA contains all decisions unanimously reached by the Councils through the WWGG, including agreement on fair consideration to be paid to each Council. The RoA was adopted by all three Councils and still stands as the last official point of agreement.

The recommendations made in this paper are a further development based on the desire to reduce risks around implementation and to ensure that optimal solutions are obtained for significant issues, which require time and process to develop.

Also relevant to any discussion about a water CCO in the Waikato sub-region, is the report recently published by Mott McDonald titled *"Analysis of 3 Waters in the Wellington Region, June 2016"* regarding Wellington Water. In particular, the following learnings from the Wellington Water CCO structure would equally apply to a Council-funded or self-funded waters CCO in the Waikato sub-region, with or without the goal of transitioning to an asset-owning CCO:

- the five Councils' objectives, reporting requirements, priorities and procurement strategies are all different, and the CCO caters to each of them, diminishing the efficiency savings
- the CCO needs to develop a regional 10 year plan that all the Councils agree on and commit to funding
- the CCO needs a common asset management strategy and IT system for integration across the Councils
- the Councils need to agree on a common level of service to be provided by the CCO
- the CCO should develop a stronger relationship directly with the customers.

Obstacles Identified in Forming an Asset-Owning CCO

The following obstacles have been identified by the WPG and these issues require solutions before an asset-owning CCO is considered a viable option. Each of these issues requires the unhurried attention of the Councils as they will shape the future operation of any asset-owning CCO.

Legal

For the CCO to perform the same utility provider function as the Councils currently do, amendments to legalisation are required. Some of these changes are included in the *Local Government Act 2002 Amendment Bill (No 2) 2016*, currently before the Local Government and Environment Select Committee. Further changes are described in detail in Hamilton City Council's submission on the Bill. The changes are extensive and as a brief summary, they include:

- availability of the Rates Rebate Scheme to customers of the CCO
- uncertainty around the treatment of vested assets and development contributions (DCs)
- removal of the requirement for the CCO to pay income tax – while not preventing the formation of the asset-owning CCO, the likely savings to customers are reduced if the CCO is required to pay income tax.

Political

The WWGG and WPG have worked together to reach agreement in many areas, however there are unresolved matters that require further discussion and negotiation. These include:

- Lack of agreement on tariff harmonisation, including:
  - inconsistent attitudes towards water meter installation within the sub-region,
  - a lack of willingness by HCC for the decision to install meters to be transferred to the CCO along with the assets, and
  - difficulty in determining a fair methodology for the establishment of a unified tariff.
- The impaired accuracy of the financial model in predicting future savings, due to any potential historical underinvestment in infrastructure, particularly in compliance, as a result of trade-offs between the needs and desires of a wide range of activities and elected member's assessment of what is affordable for their communities. Preparation of a sub-regional asset management plan will allow each Council to better understand the position of the sub-regional waters network.
- The above point will also resolve any queries about the asset condition information that was used to determine relative levels of consideration in the RoA
- The role of each Council in the development of growth priorities for the sub-region
- Changing current established practices to meet the challenge of achieving unanimous alignment on asset management practices and levels of service
- Waipa Councillors' reluctance to move directly to an untested asset-owning CCO
- Potential public palatability of Council not owning essential infrastructure directly, including concerns around the potential for future privatisation.

Operational

While not requiring the same degree of negotiation as the political challenges, these issues require time and cooperation to be worked through to completion, before an asset-owning CCO can be considered.

- Each Council's Long Term Plan (LTP) will need to be rewritten to authorise the transfer of water assets to the proposed CCO. It is possible to do this at any time by way of an amendment, or it could be undertaken as part of the regular three-yearly review, which would delay a decision concerning the vesting of assets until June 2018 at the earliest. The disadvantages of transferring assets by way of an LTP amendment are:
    - It would be a significant, and costly, exercise. The water and waste water activities form a substantial part of each Council's LTP and are not easily removed. In addition to the staff time involved, each Council will require approval from the Office of the Auditor General. The level of detail required to satisfy audit requirements is unlikely to assist the consultation process and would be wasted if the proposal did not proceed.
    - Future capital expenditure projects cannot immediately be removed from each Council's LTP, irrespective of the proposal to establish the CCO. This is because Councils can only charge development contributions for scheduled projects. The inability to charge for future growth infrastructure would have significant financial consequences. However, if an LTP amendment were only required after the CCO was established this problem would be avoided.
    - Any proposal that commits the future transfer of assets will require a full Special Consultative Process. The establishment of a CCO still requires public consultation, however if infrastructure assets are not included this can occur under Section 82 of the Local Government Act, which gives Councils much greater flexibility about how they consult.
- An accurate and consistent assessment of asset condition is vital to ensure there are no surprises in the infrastructure transferred to an asset-owning CCO. This impacts:
    - the degree of consideration each Council receives for their assets
    - the relative Council shareholdings
    - the required future expenditure of an asset-owning CCO
    - the realisation of the potential savings.

  An accurate condition assessment will be an essential element of work as part of a sub-regional Strategic Asset Management Plan. It would seem prudent to allow this work to undertaken by the CCO prior to each Council committing the transfer of their assets.

Advantages of a Prudent Transition

- Taking a considered approach to the establishment of a CCO through a Council-funded and self-funded CCO, eliminates all but one of the issues with the asset-owning CCO discussed in the previous section. The only issue remaining is the Councils' ability to work together to align asset management plans and practices, which is still necessary for maximum efficiency benefits to be realised. Issues eliminated are:
    - tariff and rating system harmonisation, as the CCO will initially be Council-funded
    - water meters, for the reasons listed above
    - competing priorities between different Councils and the CCO will be resolved because work programmes will continue to be approved by individual Councils until the CCO is authorised to self-fund. It is however important that this provision does not restrict or discourage sub-regional planning on growth and growth related priorities.
    - gaps in knowledge about asset condition, as existing infrastructure issues will remain the responsibility of the Council to whom they belong until, at the earliest, a Regional Asset Management Plan is approved
    - fair consideration being paid for water assets
    - LTP amendment requirements for the transfer of assets
    - the relative debt of individual Councils, because debt will be funded by each individual Council (unless a separate arrangement is agreed).
- The CCO is able to earn status as Trusted Advisor and become familiar with networks and risks, while Councils still retain control as a precaution against over or under spending during the learning and establishment phase
- During the Council-funded phase, each Council retains control of the capital projects and operational works programmes undertaken within its local area and has the ability to introduce and fund projects strategically important to them, or to choose not to carry out projects recommended by the CCO
- It allows the CCO to demonstrate that efficiencies are available. Savings predicted in the original CBC should still be realised from:
    - increased strategic planning and asset management ability (capital and network savings)
    - operational savings and savings in asset delivery, in part from economies of scale as well as greater capability and experience
    - admin savings, including procurement practices and overheads.
- The timing of the savings is also likely to follow a similar timeline, as an asset-owning CCO would still require time to align AMPs and would be using existing Council plans initially
- Operations and maintenance requirements would be aligned and crews would service the whole sub-region as one network, allowing programming and resourcing efficiencies that will lower costs overall, giving consistency in strategy and approach to maintenance
- It enables a consistent and more accurate determination of asset condition across all councils and it enables the CCO to work through each Council's current AMPs to provide certainty that there are no 'hidden costs' and that growth costs are being adequately managed by each Council. This also means that in the event of a transfer of water assets in the future, a fair amount of consideration can be paid.
- Council still having direct ownership of the infrastructure assets eliminates the possibility of future privatisation and therefore makes the CCO more likely to be accepted by the public

- Each Council keeps physical assets on their balance sheet, rather than un-saleable shares and interest free shareholder loans
- The CCO would be more flexible without the infrastructure assets involved and therefore quicker and easier to:
    - implement initially (especially setting up the organisation)
    - dismantle if necessary
    - offer services to other Councils
    - extend ownership to include other Councils in the future.
- The CCO would not require any legislation changes before implementing, so it is not dependent on the passage of the LGA Amendment Bill
- Each Council retains the responsibility for their funding mechanisms for water until key targets have been achieved and the CCO becomes self-funded. The transition to a self-funded CCO does not pre-suppose or necessitate the approval of tariff harmonisation.
- This approach would allow directors the opportunity to become familiar with the networks and associated issues before taking complete responsibility for them. This is likely to attract a higher calibre of directors than the alternative, which requires the directors to assume full responsibility from the very beginning
- It gives the three Councils experience in working together, to provide a basis for determining whether a transition to an asset-owning CCO is likely to be successful
- Working together will improve trust between the Councils, which will reduce the perceived risk of vesting greater responsibility in the CCO, and therefore make it more palatable
- Because very little capital would be involved, it makes the ownership/governance decision a lot simpler to resolve.

Suggested Transition Path

Each of the obstacles previously identified carry the risk of negatively affecting the long-term performance of the final CCO if solutions are less than ideal, or face the very real prospect of the CCO not proceeding at all if negotiations on these matters are not encouraged to continue. To enable the issues to be dealt with in a proper manner, the following transition pathway is recommended.

Transition from a Council-funded to a self-funded CCO will proceed based on the achievement of certain defined targets. A self-funded CCO does not necessitate tariff harmonisation. The movement from a self-funded CCO to an asset-owning CCO would be at the discretion of each Council. If any Council chooses not to proceed, or requires more time before proceeding, the other two Council can progress uninhibited. The relative shareholdings in the CCO may need to be adjusted to reflect the different levels of responsibility and risk carried by the CCO on behalf of each Council, when or if any infrastructure asset transfers take place.

1. Reinstatement of the Waikato Waters Governance Group
   Target: Develop a business case for the establishment of a CCO, and continue to seek resolution of the larger issues
2. Establishment of Council-funded CCO
   Target: CCO operating as stand-alone entity with clear responsibilities, stable workforce, office and depot in place, IT systems functioning.
3. Strategic alignment between Councils
   Target: Aligned AMPs, agreed Levels of Service, Regional Development plan approved by all Councils. CCO would be instrumental in developing infrastructure options for this.
4. Proven savings from CCO recorded
   Target: Tangible savings from operations and maintenance displayed
5. Agreed process for setting of water rates
   Target: Agreement between Councils/shareholders and CCO on tariff setting principles
6. Tariff setting transferred to CCO, creating a Self-funded CCO
7. Tariff harmonisation (if desired)
8. Successful removal of legal obstacles
   Target: Passing of LGA Amendment Bill 2016
9. Transfer of assets into CCO, at each Council's discretion.

The Appendix shows a schematic of these phases, with greater detail about the Council and CCO roles in each phase, and minimum requirements for transitioning to a self-funded CCO, and an asset-owning CCO if desired.

Description of a Council-Funded and Self-Funded CCO

Function

- The CCO would aim to develop a single set of strategic Asset Management Plans and a combined infrastructure delivery programme for implementation across the sub-region. This would be done by first reviewing all current AMPs, converting them to a common and consistent basis, then consolidating them into a sub-regional plan.
- The CCO would plan and deliver all capital and operational works within the sub-region.
- Accountability for overall performance of the networks would lie with the CCO, except where a Council has chosen not to proceed with the CCO's recommendations. This is discussed in greater detail further on in this paper.
- The CCO would have sub-regional strategic oversight of network management, including capacity management, identifying opportunities to share capacity between networks, and implement asset management strategies which are uneconomical for each Council to introduce individually.
- Optionally, the CCO could prepare and distribute bills on behalf of a Council, but until a decision is made by the Council to transfer funding authority to the CCO, the payee for the bill would remain the relevant Council.

Operation

- The CCO would operate as a separate legal entity external to all three Councils, with its own administration support, procurement strategies, and operational equipment.
- The CCO would be run from a single office, housing all management, administration, asset management, planning and project management staff, and the coordination of the maintenance crews.
- Any physical works staff would be accommodated either at treatment plants or in a centralised depot which would also provide storage for parts, stores and equipment if required. It would be ideal to have the management office and the depot relatively close to each other.
- The CCO would have its own IT arrangements, and a single asset management system would be introduced. Each Council would be able to view in real time, but not update, their data and the status of work orders relating to their area, along with any other reporting required (within reason).
- Operational plant, equipment and vehicles would be sold to the CCO by each Council at valuation. Funding for purchasing this equipment, along with sufficient reserves for working capital and to ensure equipment can be replaced, would be included in the initial capital provided to the CCO equally by all three Councils. Typically, the operational funding requirement is related to the expenditure over the first six weeks to two months' trading.
- Operations and maintenance costs would be coded for costing through logging of work orders (within the systems adopted by the CCO) to each Council's network and asset identifiers, to enable cost recovery from the relevant Council. The CCO would consolidate materials and consumables across the sub regional networks to develop economies of scale. (If no bulk electricity agreement exists between the three councils then the CCO would undertake this, for example).
- However, as the CCO is not intended to make a profit, it ought to be able to maintain lower rates than other external businesses. This could be monitored by periodically comparing the rates charged by the CCO with rates for similar services from relevant companies in the marketplace e.g. contracting

companies.

- To produce the maximum opportunity to provide enhanced services, the CCO organisation structure will be finalised at the establishment planning stage to ensure there is increased capacity and capability in the CCO, and not simply the sum of the relevant parts of the Councils. There may be different positions required than currently exist across the combined councils, but it is expected that the total management and operational staff costs will be no more than the current group totals. Costs associated with meeting any redundancy obligations of any existing Council staff could either lie with each individual Council or be paid by the CCO (but this would require extra funding).

Council-funded CCO

- The Council-funded CCO would produce a list of capital works (including renewals) for each Council annually in advance, along with drivers for each project. Each Council would have the opportunity to approve or change the works planned for their area, including the ability to add projects that have become significant for Council. Similarly, the CCO will be transparent about its maintenance plans (including intervention strategies) which would be derived from the AMPs.
- Once approved, the Council would then have responsibility for funding the agreed list of works to be undertaken by the CCO or others. The utilisation of different funding mechanisms would be at the discretion of each Council.
- Although Councils have existing time frames for determining rating requirements, earlier time frames may need to be introduced for reaching agreement between the CCO and each Council, similar to that afforded large contractor works at present, in order for the CCO to be able to operate efficiently.
- Costs billed to each Council would be on a fee for service basis for asset management, a schedule of payments or other agreed payment terms for network operational costs and probably a lump sum basis for capital works. It is recommended that operation and maintenance of treatment plants and pumping stations be under a reducing lump sum payment schedule to drive efficient operational performance including usage of chemicals, electricity and other ongoing activities. Invoiced costs would include the CCO's governance, management, operational and delivery costs.
- Having approved the maintenance plans as part of the AMP, Councils would be aware if significant changes to existing funding levels are expected.

Self-funded CCO

- Once key milestones have been met by the CCO, the Council would delegate the necessary tariff-setting and decision-making authority to create a Self-funded CCO.
- The Self-funded CCO would carry the full responsibility for operation and compliance across the networks and would not require Council approval of capital or maintenance plans. Council would still provide direction and KPIs to the CCO through the Letter of Intent as a Shareholder, but not have direct control of projects.
- The Self-funded CCO would set tariffs necessary to fund the programmes they develop, guided by principles agreed with the shareholders.

Public Interfaces

- Initially, each Council would remain the interface for all billing and water related issues. Customer management would remain the responsibility of each Council. By agreement between the Council and the CCO, this activity could be transitioned to the CCO. The customer service operation is possibly one of the first functions that may be transferred, although there is no requirement for all Councils to transfer customer service at the same time.

- As a Council-funded CCO, vested infrastructure assets and development contributions would continue to be received by the relevant Council. As the infrastructure became required, the contributed funds would be paid to the CCO as part of the capital delivery programme.

Governance

- The CCO will initially have three shares, with each Council subscribing for one share. Each Council need only be compensated for the operational plant purchased by the CCO. There is no advantage in holding more or less shares, as the CCO is not structured to make profits and requires local Council funding and approval to deliver local projects, while it is Council-funded. The relative shareholdings can be adjusted with a further issue of shares when any Council chooses to transfer their infrastructure assets.
- While the CCO is providing similar services to all shareholders, voting is carried out on a one vote per council basis, requiring a simple majority to pass, except where it has been previously agreed that voting ought to be unanimous, in line with the current Record of Agreement. At the point where one or more Councils transfer their assets to the CCO, the relative shareholdings and impact on decision making would need to be reviewed.
- The CCO would be run by an independent board consisting of at least three members. All board members must be approved by all shareholders. Board members would be appointed impartially based on their experience and expertise, not to represent a specific Council. The Chair should be appointed separately by the shareholders.
- The Shareholders' Forum described in the Record of Agreement would still be appointed to be the main liaison between the CCO and each Council. Authority would be delegated to the shareholders' group as agreed by all Councils.
- Initial capital will be provided by the Councils equally and will be based on the assets required and sufficient operational funding to allow the CCO to pay its costs and remain solvent. Ongoing support payments will not be necessary as the CCO will be able to generate a secure source of funds through its activities.
- It is common to expect the CCO to raise some of its required funding through third party financiers using its revenue base as the prime security offering. The board will determine the scope of external funding requirements.
- It would be possible for one Council to fund a project in another Council's area, assuming there was sufficient benefit to be gained and the host Council was agreeable. Such arrangements would need to be negotiated between the Councils concerned, outside the CCO, and clear direction passed on to the CCO.

Comparison of Council / Self-Funding CCO to Asset-Owning CCO

	Council-Funded and Self-Funded CCO	Asset-Owning CCO
Asset Management Plans	Initially, a Council-funded CCO would develop a single set of strategic asset management plans and a combined delivery programme for implementation across the sub-region. Each Council would still be required to adopt a water, wastewater and stormwater plan as part of their Long Term Plan, but these would be heavily based on the sub-regional plans developed by the CCO. When the CCO became self-funding it would no longer be necessary to develop individual plans for each territory.	An asset-owning CCO (and a self-funded CCO) would develop a single set of strategic asset management plans and a combined delivery programme across the sub-region.
Growth Planning	Growth planning and sequencing would remain the prerogative of the individual Councils. The CCO would be charged with ensuring that waters infrastructure met each Council's growth objectives in the most efficient and effective manner.	Growth planning and sequencing would remain the prerogative of the individual Councils. The CCO would be charged with ensuring that waters infrastructure met each Council's growth objectives in the most efficient and effective manner.
Demand Management	A decision to introduce universal water metering would remain with the Councils, most other decisions (e.g. restricted water season) would stay with CCO.	A decision to introduce universal water metering would transfer to the CCO, although this would be subject to principles established by shareholders, as outlined in the RoA.
Development Engineering	Transfers to the CCO, although Development Agreements, because of the funding implications, may require adoption by the individual Councils.	Transfers to CCO.
Compliance and Consenting	Accountability and liability would remain with Council while it was Council-funded, but would transfer to a self-funded CCO. Council would still hold some responsibility as asset owners. Liaison with the Regional Council, applications and reporting would transfer to the CCO.	The CCO would hold legal accountability for compliance.
Statutory Planning	While the CCO is Council-funded each Council would be required to include water and waste water services in Annual Plans, LTPs, AMPs, Infrastructure Strategies, development contribution policies etc. The development of these documents would be undertaken by the CCO.	The CCO (and a self-funding CCO) would be required to produce an annual Statement of Intent.
Resilience Planning	Transfer to the CCO, but ultimately subject to Council decisions on funding for implementation until responsibility is delegated.	Transfer to the CCO.
Project Delivery	Transfer to the CCO.	Transfer to the CCO.
Project Management	Transfer to the CCO.	Transfer to the CCO.
Renewals	Transfer to the CCO.	Transfer to the CCO.
Procurement	Transfer to the CCO.	Transfer to the CCO.
Network Operations	Transfer to the CCO.	Transfer to the CCO.
Plant Operations	Transfer to the CCO.	Transfer to the CCO.

	Council-Funded and Self-Funded CCO	Asset-Owning CCO
Maintenance and Planning	Transfer to the CCO.	Transfer to the CCO.
Laboratory Services	Transfer to the CCO.	Transfer to the CCO.
Trade Waste	Transfer to the CCO.	Transfer to the CCO.
Communications	Migrate to the CCO.	Transfer to the CCO.
Customer Services	Migrate to the CCO.	Transfer to the CCO.
Iwi Engagement	Migrate to the CCO.	Transfer to the CCO.
Water Education	Transfer to the CCO.	Transfer to the CCO.
Finance	The CCO, as a stand-alone entity, will require a finance team. The Councils will also require waters finance staff until the CCO becomes self-funding. It may be possible to transfer some finance people to the Council-funded CCO while leaving sufficient to manage a smaller water asset workload related to finance.	The CCO would be direct funded, and therefore Council finance staff would transfer to the CCO.
Meter Reading	Transfer to the CCO. Could also undertake billing on behalf of the Councils.	Transfer to the CCO.
Revenue	Councils would set rates / tariffs to gather revenue for a Council-funded CCO, based on agreed capex and opex plans. Once self-funded, the CCO would set tariffs based on principles established by the shareholders.	CCO would set tariffs, based on principles established by the shareholders, as per the Record of Agreement.

Disadvantages of a Council-Funded or Self-Funded CCO

The challenges of the Council-funded or self-funded CCO are more easily overcome than the challenges associated with an asset-owning CCO (or in fact in getting agreement on the establishment of an asset-owning CCO in a single step), but would need to be approached differently by the Councils and a CCO:

- Savings from debt optimisation

  The original CBC predicted savings from optimising the water-related debt across all three councils. With each Council retaining their assets, they would also retain their debt. To achieve the savings from debt optimisation across the region, an alternate debt structure could be utilised which may be completely separate from the CCO. It would be possible to combine all relevant Council borrowings and effectively guarantee each other's water debts using the combined water infrastructure, which is essentially what would happen if all debt was transferred to an asset-owning CCO.

- Council control of CCO practices

  This is both an advantage and a disadvantage. As a Council-funded CCO, each Council would control and adopt the AMP policy for the management of their own assets and have direct input into renewals and upgrade programmes carried out in their area, which alleviates the concerns about competing priorities across the region. However, the CCO will function optimally when practices and standards are aligned between Councils. To achieve this, the CCO would be likely to change some well-established existing work practices. This means that each Council's ability to direct the workings of the CCO within their area, should not be overly prescriptive or so inflexible that they impair the CCO's ability to create uniform asset management plans, standards and practices.

  This could possibly be achieved by having accepted common levels of service across the region as part of the CCO KPIs, and by the shareholders' group engaging independent assurance from time-to-time to confirm processes and practices of the CCO.

- Stranded costs

  Stranded costs will still exist and each Council will need to determine how these are to be funded, reduced or eliminated within its own capabilities. There would not be a period where stranded costs are reimbursed by the CCO, originally proposed by the CBC, as this would only increase the cost of the CCO's services. Each Council would be responsible for managing and minimising their own stranded costs (which we are still concerned may be understated in the original CBC).

Areas for Further Consideration

- A clear level of risk intended to be borne by a Council-funded CCO would need to be agreed and clearly communicated in the Letter of Expectation to the board. This includes under what circumstances each Council could defer recommended works. Any fines incurred by the CCO as a result of a Council's decision to defer works, or any other cause beyond the CCO's control, would be assumed to be recovered from that Council. However, it would be equally undesirable for the CCO to make recommendations that were overly cautious in order to reduce it's own risk.
- The organisation structure and optimal level of staffing for the CCO, particularly around the ability to deliver capital and operational works internally or to engage contractors for the majority of the projects and have the CCO focus on the project management aspects of the delivery.

Implementation of a Council-Funded CCO

The suggested steps for establishing a Council-funded CCO are:

1. Complete a business case to examine feasibility
2. If feasible, develop an initial Proposal for initial approvals of Councils
3. If approved, finalise Proposal jointly and undertake public consultation
4. Develop a Letter of Expectation from the combined shareholders, detailing specific directives, required service levels and KPIs for the CCO
5. Develop position descriptions for CEO and board members, seek to conditionally appoint those positions and develop the CCO Statement of Intent
6. Develop structure of CCO, including preparation of an organisational chart detailing the number and type of positions, position descriptions, and any specialised skill sets required
7. Each Council develops its owner/client/smart buyer function
8. Final approval to implement from all Councils
9. Fill positions through advertising and complying with all Councils' employment policies. Existing staff from all three councils may apply, and any external applicants if appropriate
10. Start-up costs and an agreed amount of working capital transferred by all three Councils
11. All operational assets (not infrastructure) be transferred at valuation eg. utes, equipment and computers
12. Systems and processes implemented
13. All staff successful in obtaining positions be offered new positions and employed
14. All infrastructure assets and water related debts remain with the Councils
15. As existing contracts come up for renewal, they are evaluated and either discontinued or transferred to the CCO.

Recommendation

We suggest establishing a self-funded CCO, after transitioning through an initial phase of a Council-funded CCO, is in the best interests of all the Councils, whether as an interim step towards an asset-owning CCO, or as a destination in it's own right.

A Council-funded CCO is the first step on the pathway to an asset-owning CCO, notwithstanding that the final decision to vest assets will be at the discretion of each Council. It does not require full agreement on all issues or any changes to current legislation, yet enables some of the potential benefits to be realised. Transition into a self-funded CCO would follow the successful completion of clearly defined pre-requisites. Following that, the transition, at the discretion of each Council, to an asset-owning CCO can proceed on a Council-by-Council basis, as both the Council and the CCO agree that there are benefits to be gained by doing so.

The proposed approach of establishing a transitional Council-funded CCO offers many advantages, including:

- It will test the ability of the potential infrastructure savings identified in the CBC to be realised
- It will give confidence in Councils' ability to work together
- It can be implemented quickly and easily
- It removes many of the issues encountered with establishing an asset-owning CCO.

After transitioning to a self-funded CCO, further advantages are expected:

- Maximum efficiency gains can be achieved, resulting in savings to the sub-region
- The complex issues described in this report, such as tariff harmonisation, still do not need to be resolved before the savings can be achieved.

The next steps towards implementing the CCO are:

1. Reinstating the Water Governance Group to enable development to continue
    a. Establish whether support continues for the Record of Agreement or not
    b. Obtain in-principle support for the Council / self-funded CCO option.
2. Prepare a business case that includes the pre-requisites for transition to a self-funded CCO, which can be reported back to each of the Councils for consideration.

Waipa DISTRICT COUNCIL

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Appendix

Status Quo

Council owns assets

Council provides all services

Council produces local plans for capital and maintenance

Council determines funding source and sets tariffs

Council bills, collects water revenue and manages customer interface

Council-Funded CCO

Form Strategic Asset Management and Operational CCO

CCO: Evaluate current AMPs across the region and align based on common ground to produce regional AMPs

CCO: Produce capital delivery programme for each Council

CCO: Develop regional capital delivery plan

CCO: Carry out operations and maintenance across the sub-region

Council: Approve AMPs, work together with CCO to plan transition to regional AMPs

Council: Approve capital delivery plan

Council: Fund approved CCO works, either by water rates or borrowings

Goal – normalisation of asset data, valuations and LOS. Development of regional AMPs and Regional Capital Plan approved by all Councils. Take initial steps for efficiencies.

Relationship – the "consultant" model and earning trusted advisor status

Self-Funded CCO

Transfer funding, billing and decision-making authority to CCO

CCO: Accepts responsibility for funding operations, based on ability to bill and raise revenue from customers

CCO: Accepts responsibility for network performance and compliance

CCO: Approves tariff setting principles and any tariff increases

Council: Specifies tariff setting principles and required level of service

Goal – operating sub-regionally to maximise savings (short of debt optimisation). Assumption of majority of operational risk.

Relationship – high level of trust. Strategic in terms of planning and delivery; specifying and monitoring of performance through a Statement of Intent and the Joint Shareholders Group; assets remain in Council ownership. CCO as trusted advisor.

Asset-Owning CCO

Assets are vested to CCO

Consideration based on thorough understanding of asset condition and risk

CCO assumes full responsibility for services

Requires – Tariff harmonisation across sub-region; and conclusion on consideration

Relationship – full asset owning or mixed model of some ownership and self funded

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