Three waters reform proposal

Feedback to government

Decisions about how our district's three waters services – water supply, wastewater, and stormwater – are managed and delivered in the future are a big deal. We agree that the Government's Three Waters Reform programme presents a once-in-a-generation opportunity to rethink how New Zealand Inc. delivers safe and reliable water services at less cost for all.

However, there are questions over the proposed model. For context, our response includes below some of the information that we have provided to our community.

The "at less cost" promise

From the outset, funding and affordability was acknowledged as the main issue that the country faced. The government is not proposing any new funding tools to solve this issue. Instead, the Government's Three Waters Reform proposal is based on the premise that larger water service entities (WSEs) will be able to deliver water services at significantly lower costs than local councils, due to 'economies of scale' and their ability to borrow more. This is how they intend to keep costs as affordable as possible.

Currently, everyone pays for their water services through rates. These are a mix of volumetric (water meters, pay for what you use) and fixed charges (everyone pays a standard amount). There's more behind it, but the key point is this would not change under the proposed new model. The difference will be that the WSEs will be charging these rates, not your local council.

This has not solved the affordability issue. No new funding source has been proposed.

The model

The Government has taken advice from the Scottish regulator, the Water Industry Commission for Scotland (WICS), including the development of a model that estimates costs for each council over the next 30 years. It is based on a set of standard assumptions, which shows the estimated cost per connection if councils go it alone, versus the estimated costs under the four WSE proposal.

For Kāpiti, the WICS cost per connection in 2051, before adjusting for inflation, is estimated to be $2,627 if we go it alone, and $1,255 if we are part of Entity C. Our Long-term Plan forecasts our cost per connection in 2051 to be $884 before adjusting for inflation. Accepting some variation is likely, this says our costs would have to be 300% higher than we have in our Long-term Plan. How does WICS reach such a different number?

Asset values

WICS' starting position for Kāpiti is overstated. WICS has used national averages to estimate the value of Kāpiti's water assets at $940 million, but the actual replacement value of our assets is $548 million – only 58 percent of the WICS number. WICS estimates the useful life of our water assets to be around 80 years, but say it should be much lower, at 59 years. In reality, our water assets have an average life of 68 years. Our assets are revalued by external experts every 2–3 years, so we're confident the asset values and useful lives are accurate and current. This is important when it comes to depreciating our assets (what we should spend on replacing worn out pipe and plant items), as reducing the useful life increases our depreciation expense. For example, if we were to use WICS modelling as a yardstick, depreciation on our water assets would be $12 million per annum but should increase to $16 million. Our actual depreciation is $8 million per year.

Capital expenditure

WICS has assumed Kāpiti will have capital expenditure (capex) spending of $12 million per year on asset renewals, plus $17 million per year on growth and improving the level of service. After adjusting for the consumers' price index (CPI), that adds up to $1.5 billion over 20 years. Our Long-term Plan (LTP) includes $1.1 billion for the same period – about $400 million less. The renewal expenditure would be funded by depreciation, in effect; but the balance is assumed to be fully funded by debt. It appears WICS has not accounted for development and financial contributions, which councils use to fund growth capex. Using the conservative growth assumption of 0.8 percent per annum in the model, this potentially overstates required debt by a further $125 million over the 30-year period.

Debt

The biggest influence on water bills is the assumed borrowing capacity. In the WICS model Kāpiti, like all councils, is assumed to have a maximum debt capacity of 250 percent debt to revenue (in fact our Long-term Plan forecasts our debt to be well under 200 percent of revenue). However, the WSEs essentially have unlimited borrowing capacity due to the government underwriting their debt. As modelled, Entity C is expected to get up to 645 percent debt to revenue.

If the council reaches its borrowing limit, the assumption is that further capex will have to be paid for out of rates, rather than borrowing. This is the main driver of increased rates revenue according to the model.

Operating expenditure

The WICS model forecasts just over 60 percent gains in operating expenditure (opex) efficiency. This equates to 2 percent per annum, every year. For Kāpiti, this is considered unlikely, because our operating costs are already very low.

WICS has highlighted Watercare as an efficient operating model, with the scale equivalent to that suggested in the four WSE proposal. However, Castalia states that Kapiti's costs are **lower** than those achieved by Watercare in Auckland - they calculate our combined opex costs for water and wastewater are $489 per connected property per year, while for Watercare customers the costs are $534.

That said, we all expect that there should be gains from a larger entity. The government is using the reported savings achieved in Scotland between 2002 and 2020 as real-world evidence. The problem is we're not comparing apples with apples, as our population is spread over a much wider area, largely concentrated in urban areas. To put this in context, Entity C will cover almost 500 kilometres, from Gisborne to Nelson, whereas 80 percent of the Scottish population lives within 70 kilometres, between Edinburgh and Glasgow. What this means is that there won't be significant joining up of our water infrastructure and the benefits this would bring. The WICS modelling also assumes individual councils won't generate any efficiency improvements. This seems improbable; the sector should expect to share benefits as they're identified, including through the expertise provided from the two regulators. There should be some, albeit smaller, efficiency gains even for smaller organisations.

Assumptions vs the Kāpiti reality

The main argument behind the case for change is that the proposal will be cheaper for everyone. The WICS model provides the main support for this "less cost for all" argument. Analysis provided for us by Castalia, along with our own interrogation of the model, has demonstrated that the model does not accurately represent the Kapiti Coast situation. This casts doubt over the validity of the findings, and by virtue of the standardised assumptions may also translate to inaccuracies for other councils.

From a Kapiti perspective, we acknowledge that this is just a model. Rather than having a debate about this model, we would prefer to see effort put into developing a better model, drawing on the rich data that was provided by councils early this year. The 3-waters proposal is a big deal – it's an estimated $54 billion worth of assets that we're talking about, across the country, and everyone wants to see the best outcome achieved. Therefore, it deserves the time and effort to get the details represented as accurately as possible.

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Controlling the flow

Other issues to consider with the 3-waters reform

The Government's Three Waters Reform proposal is a complex beast and there are a range of considerations, including the financial model that underpins the case for change and the time and effort it will take to transition to the proposed four Water Service Entity (WSE) model, that warrant further discussion

Need more time

Many councils are calling for more time to assess the proposal, to inform and gather feedback from their communities, and to work through the implications of change. We've heard the Minister say that this conversation has been on the table for four years. While at one level this is true, it is not accurate for most of the country.

The Government, through the Department of Internal Affairs, has been examining the three waters issue for four years, and for the last two of those it has worked with a steering group, comprising of local government representatives, to work through issues, options, and solutions on behalf of us all. While good in theory, this approach has effectively denied most councils the opportunity to look at all the options, and work through a process of narrowing them down.

We've just been given eight weeks to do this but, in the absence of understanding or having access to all of the details that have helped shape the current proposal. The window we have been afforded to evaluate and provide feedback on the proposed WSE model is at odds with the normal, statutorily prescribed consultation processes that councils and their communities are used to.

Information shared to date leaves many unanswered questions, including next steps. There is no clarity about the intended process for community consultation or if the government will support 67 councils around the country to do this well/effectively. It is important that the government fronts, and funds, their proposal if it proceeds. An earlier commitment to provide guidance about community consultation hasn't been fulfilled, which leads some to the conclusion that the reform will be made mandatory.

A related concern is the proposed timeframe for another piece of work that is looking at the future for local government. This work could result in a fundamental reshaping of the role local government plays in our communities, and most people believe that this work should precede any decisions about the three waters – it's a bit like putting the cart before the horse.

Governance structure

A professional, competency-based board is proposed to govern each WSE. This acknowledges the increasing complexity of managing the three waters, particularly in large-scale operations. Watercare and Wellington Water already have similar governing boards.

The unwieldy parts of the governance design stem from the desire to retain councils and mana whenua involvement, but without the powers to control. If councils were to retain effective control, for example they are appointed to WSE governing boards, then balance sheet separation would not occur. This would prevent WSEs from overcoming the debt restrictions that exist with many councils, and would undermine one of the reform's key objectives.

So, the proposal sees councils and mana whenua nominate members for a Regional Representative Group who will then appoint an Independent Selection Panel to appoint and monitor the board.

It is hard to see this working effectively, and if it fails it would beg the question of who appoints the boards? Who has effective control?

This governance proposal is complicated and will be ineffective.

Ownership

Another curious element to the proposal is the assertion that councils will continue to own the assets, even though they are to be removed from council balance sheets and transferred to WSEs. The primary purpose for this appears to be as a form of reassurance that the WSEs will not be privatised. As owners, councils would resist any move to privatise the three waters.

If water assets are transferred at the deeply discounted rate currently proposed (i.e., paying an estimated $7.7 billion for $54 billion worth of assets), then WSEs would be highly attractive targets for privatisation due to this low gearing.

This government has repeatedly assured local government that privatisation is off the agenda, but it remains theoretically possible. In the same way that the current proposal could be mandated by government, it is not difficult for a future government to change the rules in a similar fashion to the energy reforms in the late 1990s.

The 'ownership' interest of councils will not in any sense be real. Councils will not have any control of the assets or of the expenditure on them.

Iwi involvement

There is a consensus around the country that iwi have not been afforded sufficient opportunities to effectively participate in the proposed reform. Councils would prefer to be working alongside their local iwi to evaluate the proposal, not separately.

There are unfortunate misconceptions about the role of mana whenua in the proposed WSEs. A lot of debate has centred around mana whenua 'ownership', but this is not what is being proposed. As far as we are aware, iwi involvement will be limited to the ability to make appointments to the Regional Representative Group – the same role as councils will have.

Councils currently work with their local iwi in slightly differing ways across the country. In Kāpiti, our three iwi - Ngāti Toa Rangatira, Te Ātiawa ki Whakarongotai and Ngā Hapū o Ōtaki – are involved in our planning and delivery, as partners. Our aspirations, and our roles as kaitiaki, are completely aligned, and there is much that we gain from sharing our knowledge. Mana whenua need to be involved in the new entities, but will have the same concerns as councils, that only a subset of each region's iwi would be appointed to the Regional Representative Group.

Local voice

One of the key issues in the three waters debate is the need to retain our 'local voice'. There is a long-standing principle of "no taxation without representation", and this reform would break that link. Elected representatives currently have the challenge of making balanced decisions between all of a council's competing needs – for example water, roads, libraries, and parks. The community has direct access to their mayor and councillors and can express their views on how well those decisions are being made.

There are two things to consider when thinking about local voice: strategic prioritisation, and service response.

All councils want assurance that their priority investments, such as infrastructure to enable growth, will be delivered. There is concern that a WSE, when faced with the competing demands of 22 councils, will prioritise work in ways that will hold back some districts. We've already seen this play out with some Regional Land Transport Committee decisions, where smaller councils feel their voice is lost at times.

For Kāpiti, the way in which WSEs prioritise investment is a very real concern as we could find ourselves in a situation where, as a result of doing a good job in maintaining our assets over the years, we are pushed well down the pecking order so others can effectively 'catch up' at the expense of our ratepayers.

In response to this the government suggests that the WSE would be a direction-taking entity, not direction-making – the question is how this works in practice.

At the other end of the spectrum is concern that local service levels could deteriorate to an entity 'average'. As an example, in the 2019/20 year, the average resolution time for urgent water faults in Kāpiti was 1 hour, but for a nearby council it was 5 hours. Our non-urgent average resolution time was 22 hours, for the comparator council it was seven days. It is unlikely that WSEs will look favourably at differing levels of service, as this would have an impact on cost efficiency.

Delivery

There are a range of positives when considering operational delivery. The new WSEs would have deeper resources, and yet can still be expected to ensure local suppliers are involved in water services.

As an example, our Council does not carry in-house expertise for maintaining large diameter pipes, largely because we have so few of them. A larger entity would carry those skills.

The Government has committed to retaining all current jobs, in the same locations. They have stated that the extra investment that will be required over time, is expected to create up to 9,000 new jobs, which will be spread across the country. The water sector needs to ramp up recruitment and training and this should be easier to achieve through the proposal, along with more career path options.

So, what do we suggest?

Everyone wants to ensure good outcomes for our communities – safe drinking water and an enhanced freshwater environment at an affordable cost. Perhaps though, when faced with options, we should favour the simple over the complex.

Improve funding

Over the last two years the Government has provided over $1 billion to councils to be spent on three waters related work. That amount of money is a good starting point for addressing the needed improvements across the country however, it doesn't go far enough to address the inequality.

We suggest an ongoing $500 million a year is provided by government and is allocated to councils using an equivalent model to the Waka Kotahi financial assistance rate (FAR). This assistance needs to be shared on an equity basis – with more going to councils that have a demonstrated affordability problem. This is no more than the government is already contributing, so it should not be a funding concern.

We don't see a need for balance sheet support in most cases. However, we believe that the government could incentivise any councils that want to opt-in to a larger scale, shared delivery model, by agreeing to provide a government guarantee to those entities. Initially we suggest this includes Watercare, and potentially Wellington Water if it assumes asset ownership. That will allow the higher borrowing limits that are needed by some.

Improve governance

We've noted that decision-making in the infrastructure area is increasingly complex and councils could benefit from competency-based appointments. Our existing legislation allows for a range of structures that can contribute this, while retaining democratic oversight.

The simplest option is for councils to appoint an advisory board, similar to that of our independent Economic Development Kotahitanga Board comprising of a range of iwi and local business expertise who work closely with council staff, and provide input to council decision-making. This Board has brought an external perspective, as well as energy and networks, that add value to our economic development programme and a similar approach could be applied to governance of three waters.

Alternatively, councils could, individually or in groups, look to establish joint committees that includes external appointees and have wide-ranging decision-making powers. A working example of this is the Wellington Regional Leadership Committee involving 10 councils. Taking an in-between approach and noting the region's four metropolitan councils already have Wellington Water, we could for example set up a joint committee between the Kāpiti Coast and Horowhenua district councils, where we can share the costs and benefits of external expertise.

Improve the regulatory regime

Most of the initiatives needed in this space are already occurring and are well supported. Our wero to government though, is to pick up the pace. In the four years that water reform has been considered, some of the most basic opportunities have not been addressed. Kāpiti Coast residents and our environment continue to benefit from water metering, and we believe issues such as water meters and water treatment should be required, not encouraged.

Establishing an economic regulator will still have benefits in our proposal. It will closely monitor the costs and performance of all councils, and it could identify an affordability cap for each. Where costs are unavoidably higher than what is affordable, the funding support via FAR can kick in. Overall, this will be cheaper and less contentious than cross-subsidies between districts.

Improve best practice for infrastructure

Recently the Infrastructure Commission, Te Waihanga, was established. A core function is to prepare research and best practice guidance on major infrastructure procurement and delivery. Te Waihanga does work with councils, but it's mandate in the local government sector could be enhanced.

Alternatively, just as the local government sector has benefitted from the establishment of the Local Government Funding Agency, a sector-led organisation could be set up.

The role of this entity would be to provide leadership in best practice asset management, innovation, and procurement. It could provide horsepower to smaller councils in times of need, and it would be the forum for all councils to contribute to and learn from each other.

Improve training pathways

The water sector already has a training organisation, but we don't have enough new people in the pipeline. We need to put what we have on steroids. This should be a highly attractive career option, and the Water Industries Operations Group, a sector training organisation, should work with councils on recruitment drives across colleges.

Career development in terms of training, qualifications, secondments and identifying pathways for individuals, are all achievable with more resources and greater emphasis. An advertising campaign with green water coming out of the taps is unhelpful. The same amount of effort into promoting career opportunities in the water sector would be well received.

Final words

A lot of emphasis has been on the loss of control that would result from transferring all responsibility from councils to the proposed WSEs. However, through this process what has become even more evident is the potential for loss of connection.

This week our council held a blessing at our Waikanae Water Treatment Plant to clear the way for stage 2 of our $17 million upgrade programme. We reflected on how stage 1 included an innovative river recharge scheme, that sees 400-year old aquifer water drawn from underground to replenish our river at times when water levels are low. This was a collaboration between local iwi and council and is part of ensuring we have enough water supply for at least the next 30 years, through a process that is best for the health of our waterway.

Our staff are proud of their role in delivering water to our community – that local connection is why we work for the Council. At the blessing our Mayor spoke to this connection, and he said "Ko au te awa, ko te awa ko au" - I am the river, and the river is me.

Everyone wants the best outcomes (the 'what' and the 'why'), but we are not in agreement about the how. This should not be a contest of ideas; it should be a collaboration of partners. And, **when faced with choices, let's go for the simple option over the complex. It will deliver better results, faster.**