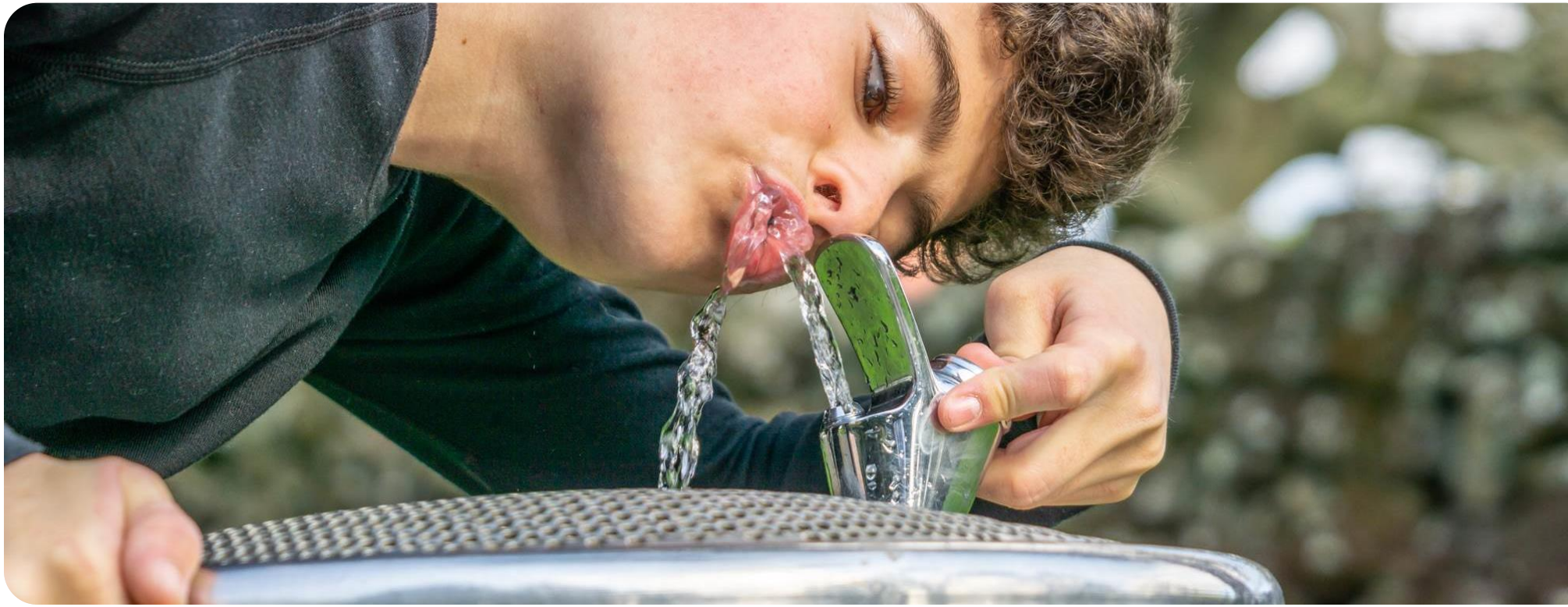

# Joint Water Services Organisation

**South Canterbury region**

23 April 2025

# Preface

*This report has been prepared for Timaru, Mackenzie, Waimate and Waitaki District Councils by MartinJenkins.*

For over 30 years MartinJenkins has been a trusted adviser to clients in the government, private, and non-profit sectors in Aotearoa New Zealand and internationally. Our services include organisational performance, employment relations, financial and economic analysis, economic development, research and evaluation, data analytics, engagement, and public policy and regulatory systems.

We are recognised as experts in the business of government. We have worked for a wide range of public-sector organisations from both central and local government, and we also advise business and non-profit clients on engaging with government.

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Established in 1993, we are a privately owned New Zealand limited liability company, with offices in Wellington and Auckland. Our firm is governed by a Board made up of Executive Partners and Independent Directors. Our Independent Directors are Sophia Gunn and Chair David Prentice. Our Executive Partners are Sarah Baddeley, Nick Carlaw, Allana Coulon, Nick Davis, and Richard Tait. Michael Mills is a non-shareholding Partner of our firm.

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This Disclaimer supplements and does not replace the Terms and Conditions of our engagement contained in the Engagement Letter for this assignment.

# Table of contents

# 01. Introduction and purpose

# Introduction and purpose

***Timaru, Mackenzie, Waimate and Waitaki District Councils engaged MartinJenkins to undertake a high-level financial assessment of a potential Joint Water Services Council Controlled Organisation (WSCCO).***

To inform the preparation of Water Services Delivery Plans required by the Local Government (Water Services Preliminary Arrangements) Act 2024, participating councils wish to understand the potential financial implications of a joint WSCCO option.

### *Local Water Done Well requires councils to demonstrate the delivery of water services is financially sustainable*

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

Councils also need to consider whether existing service delivery arrangements will continue to meet community expectations regarding levels of service, achieve compliance with future regulatory requirements, while remaining affordable for their communities.

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

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

### *A WSCCO potentially offers additional financial benefits compared to in-house delivery options*

A WSCCO has the ability to borrow from LGFA at higher gearing ratios than councils, while doing so at similar interest rates to councils. The potential economies of scale from amalgamating assets and service delivery, ability to optimise capital structure, alongside professional governance and management, mean there are likely to be operating and capital efficiencies relative to in-house delivery options.

### *This report assesses how a joint WSCCO could benefit participating councils and their communities, collectively and individually, through efficiencies and more efficient capital structures*

It presents findings for a joint WSCCO comprising all participating councils under one possible scenario, targeting a capital structure based on the midpoint of LGFA's indicative primary lending covenant (i.e. the funds from operations (FFO) to debt ratio). It provides an indicative assessment of costs to consumers if prices were to be harmonised.

### *We have relied on council inputs and an agreed set of assumptions*

In undertaking this analysis, we have relied on information provided by the participating councils and used assumptions agreed upon by them (refer Appendix A). These assumptions guide the scope of potential outcomes and inform our overall findings regarding the financial viability of the proposed joint WSCCO model. Any changes to these underlying assumptions could have a material impact on the outcomes presented in this report.

**The methodology and process undertaken to conduct this modelling and analysis is included in Appendix A.**

# Limitations

## This is a point-in-time, indicative assessment of stylised WSCCO scenarios to inform decision making.

This analysis represents a snapshot in time, based on the data, assumptions and information available at the date of this report. As circumstances, policies and council data evolve, this assessment, in whole or part, may become out of date and warrant re-evaluation.

## We have relied on council-provided information and have not verified its accuracy.

The modelling outputs are dependent on the accuracy and completeness of information provided by participating councils. Any errors, omissions or inconsistencies in that information may affect the reliability of the findings, and have not been independently verified by us.

## Scope of analysis is limited to indicative financial implications only.

Work focuses on the potential structure and outcomes of a joint water services council-controlled organisation. It does not examine potential flow-on effects for other parts of the councils' operations and delivery arrangements, nor does it evaluate the underlying capital delivery programme. It is high-level, indicative analysis and does not constitute a detailed business case nor provide information sufficient to support implementation planning.

## The outputs should be considered representative rather than exhaustive.

The purpose of this modelling is to provide a representative analysis based on current assumptions. It is not an exhaustive analysis or a detailed operational review. Users of this report should exercise caution when extrapolating the results beyond the specific scenarios modelled.

## Ongoing changes and updates.

Given the dynamic nature of legislative frameworks, council priorities and data quality, the inputs underpinning this analysis may change over time. Readers should refer to the most recent information and seek updated modelling if circumstances change.

## Use of sensitive information

This report relies on the provision of information that may be commercially sensitive, the disclosure of which may prejudice commercial positions or negotiations, or inhibit the future supply of such information. It is recommended that participating councils are consulted prior to the disclosure of any information or findings in this report.

# 02. Individual Council 10-year water services outlook

# Framework for financial sustainability assessment

***DIA guidance sets out key financial principles that underpin the requirement for financial sustainability.***

Under LWDW, the expectation is that operating revenues pay for operating costs with capital investment funded by capital sources (for example, borrowing and development contributions).

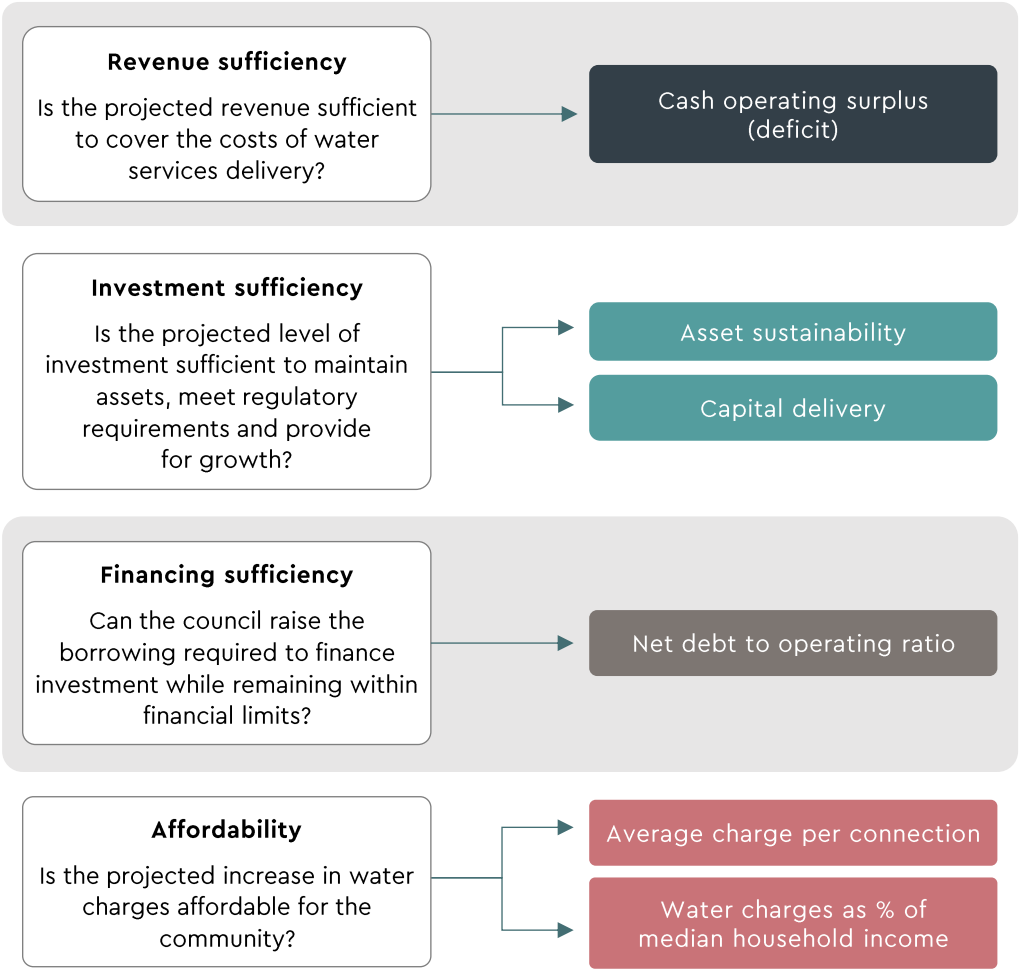
***With the exception of affordability, the measures on the right are used to test against the financial sustainability requirements under LWDW.***

We applied these measures to the data provided to us by the participating councils to create a comparable and consistent baseline for each council.

The purpose of doing so was to create a shared understanding between the councils of their individual ability to meet the financial sustainability requirements under the new legislation and their starting financial positions before analysing a combined entity.

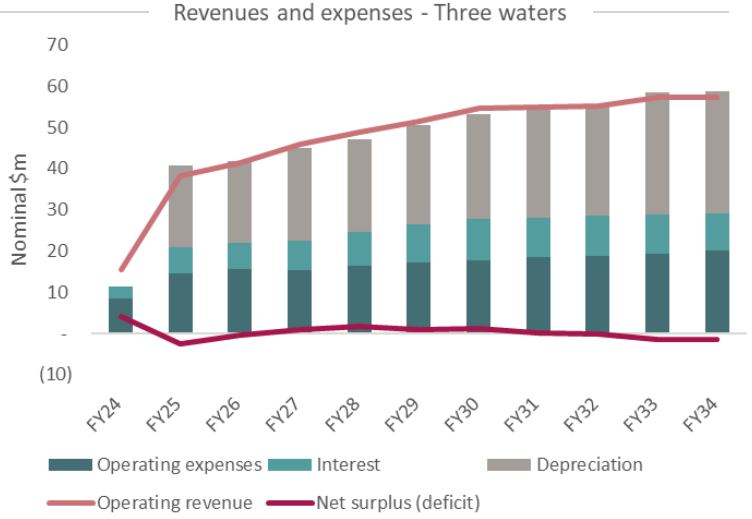
***For the purposes of this analysis, we have assumed that each council's supplied capital expenditure projections will be sufficient to meet drinking water quality assurance rules, and wastewater discharge standards and resource consent requirements.***

We have not undertaken an independent review of investment sufficiency as part of this analysis.

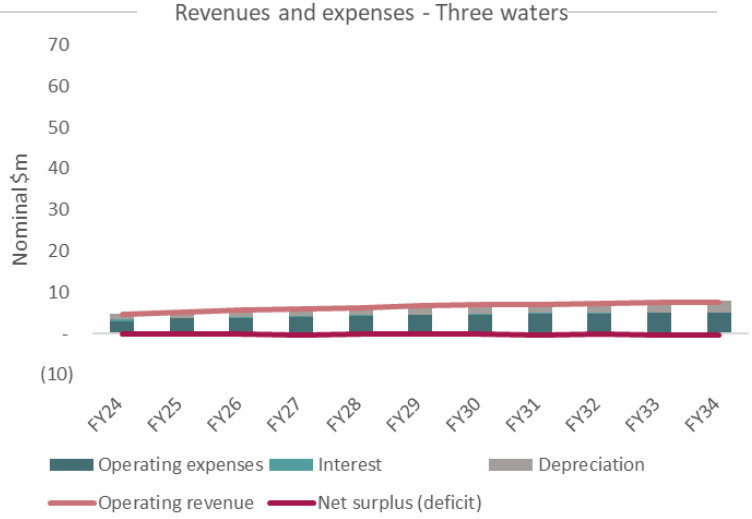


# Operating revenue and expenditure

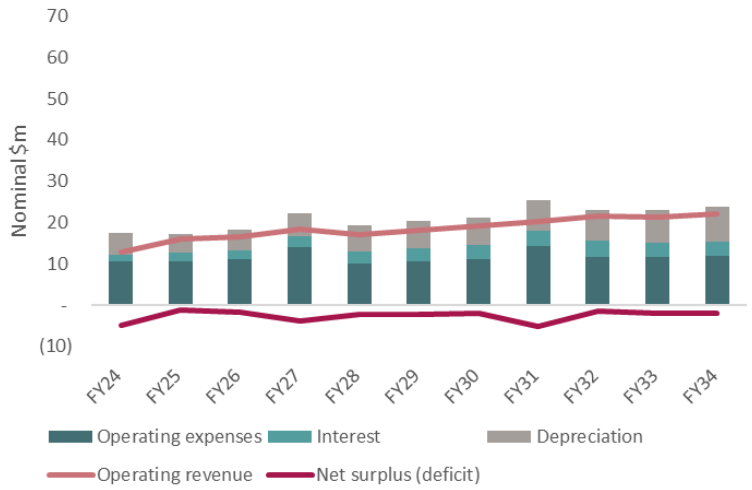
## *Timaru*



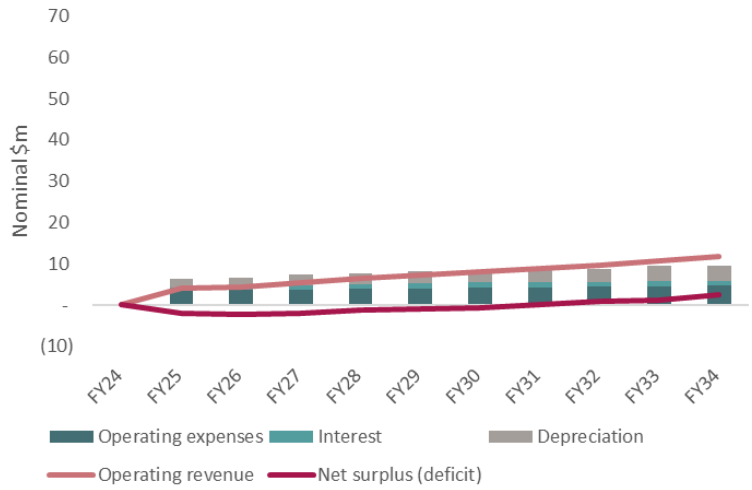

## *Waimate*




## *Waitaki*

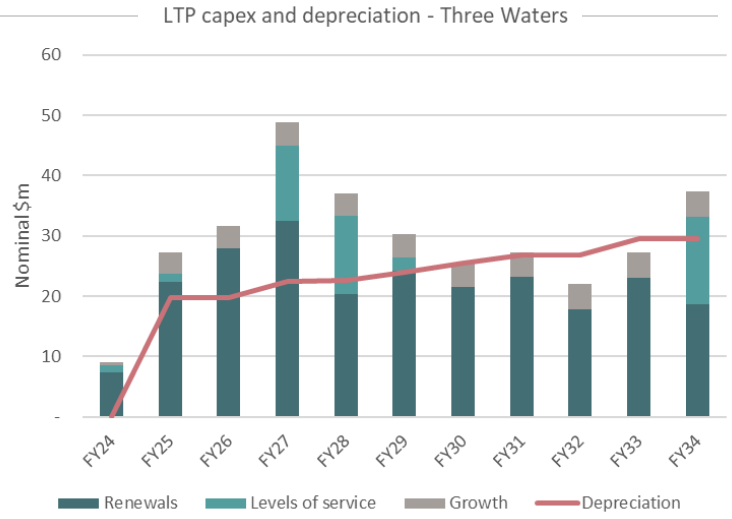



## *Mackenzie*

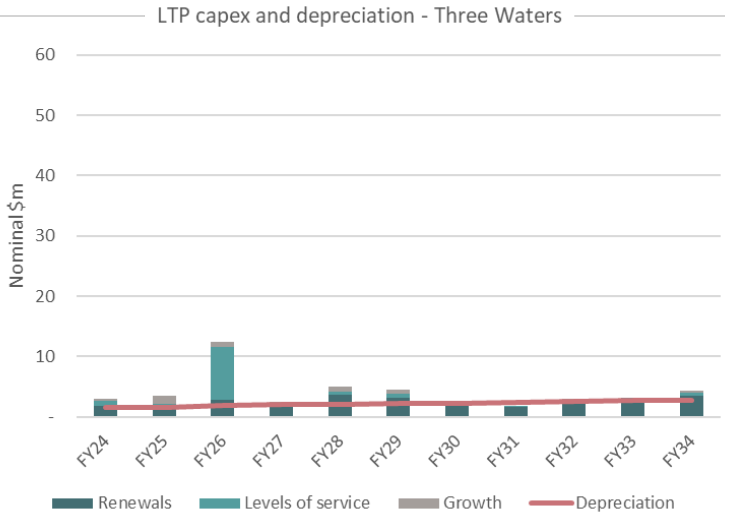


# Capital expenditure

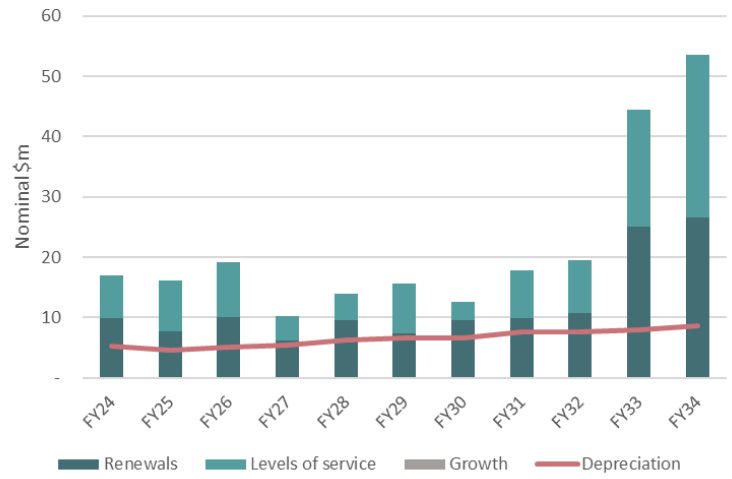
## *Timaru*



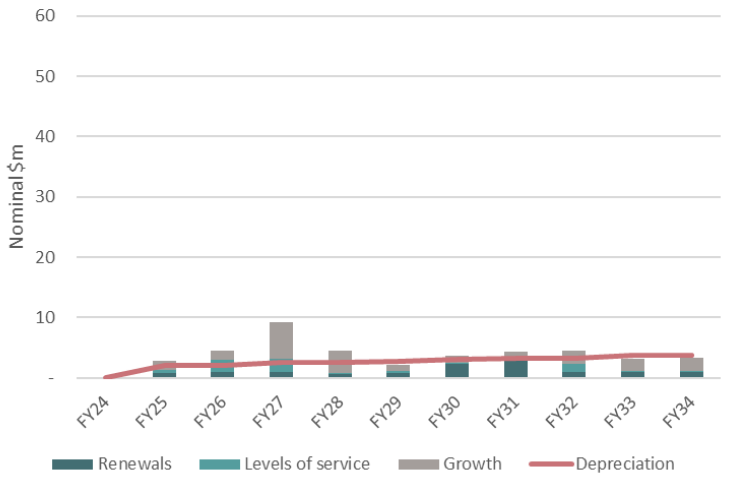

## *Waimate*




## *Waitaki*

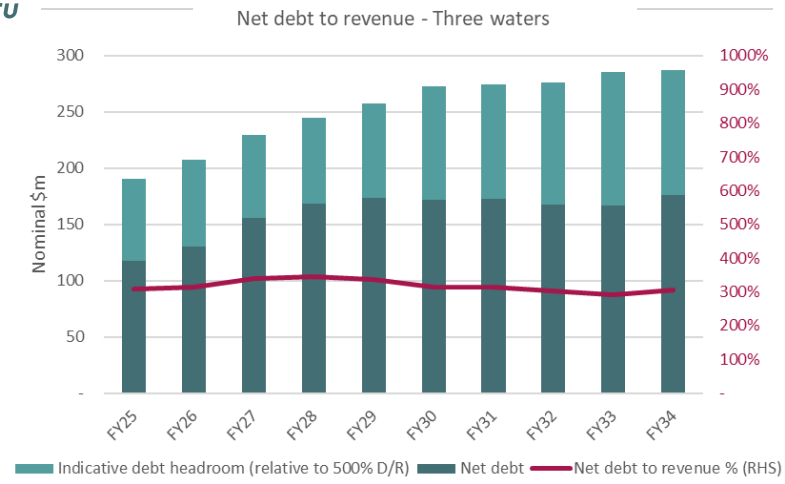



## *Mackenzie*

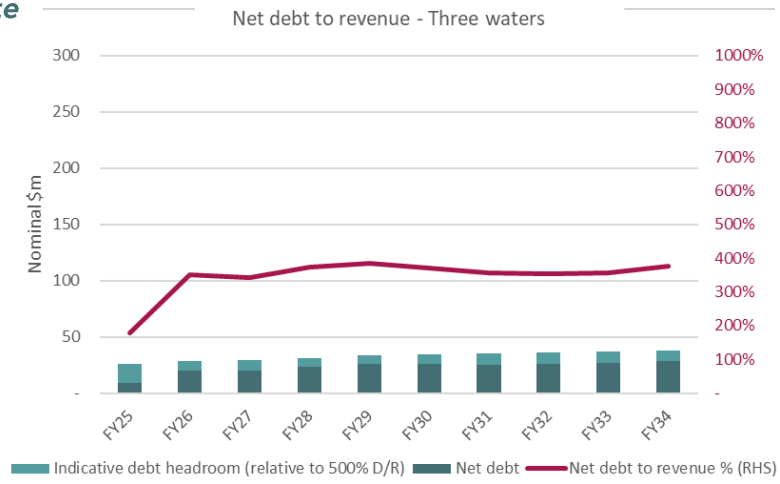


# Borrowing

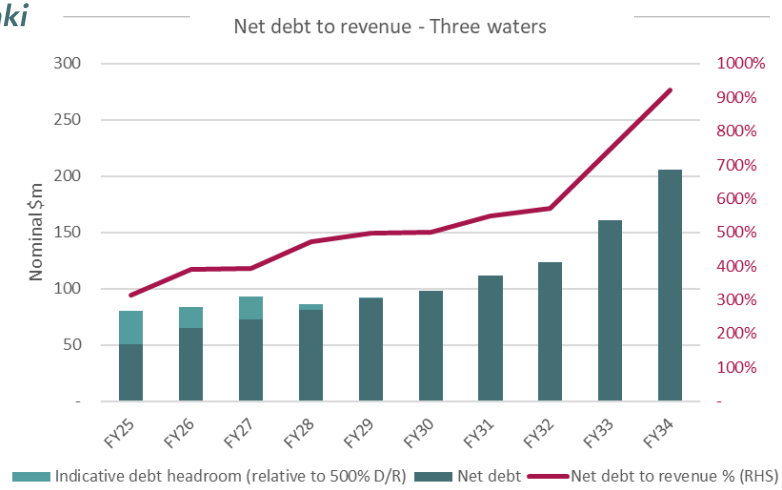
## *Timaru*



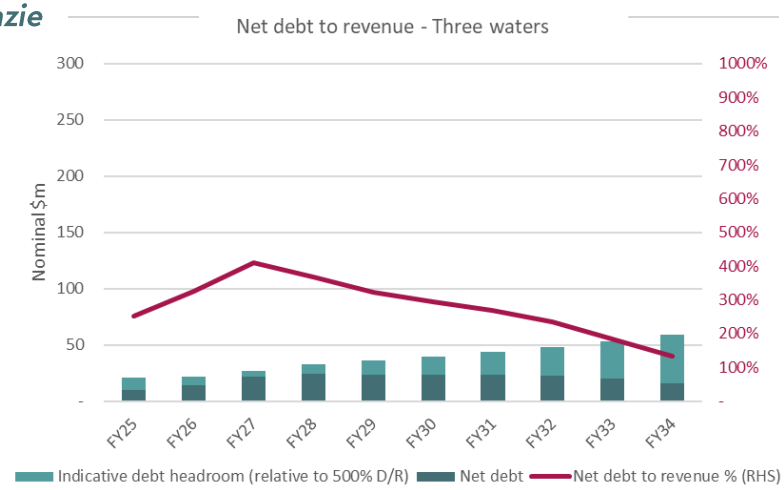

## *Waimate*




## *Waitaki*

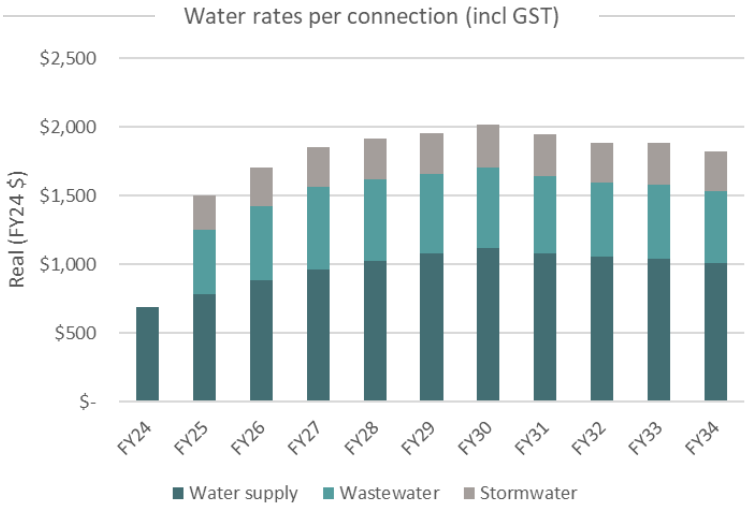



## *Mackenzie*



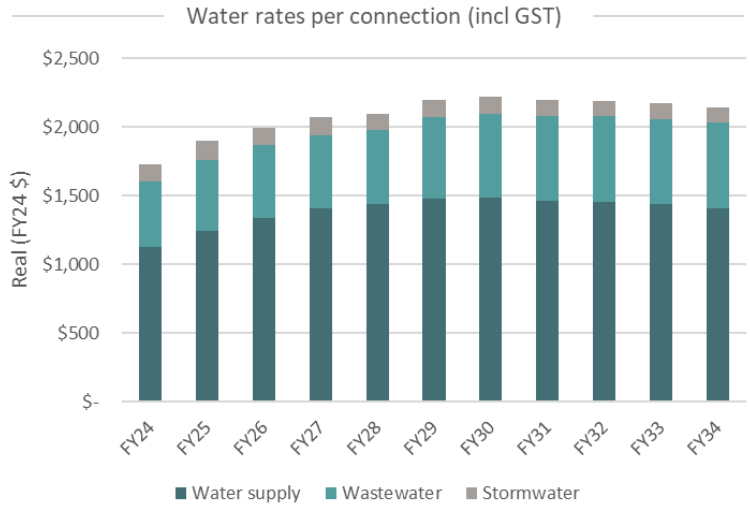
# Water revenues per connection

## *Timaru**

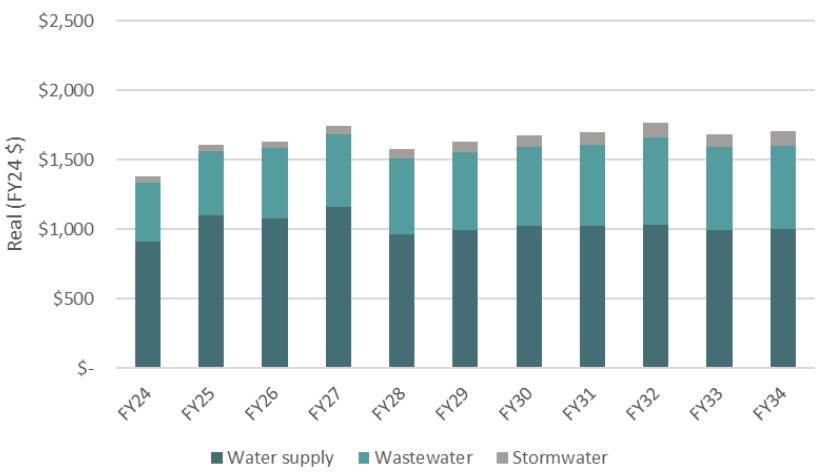



* Note, Timaru's water rates per connection excludes revenues collected under industrial metered supply and trade waste agreements.

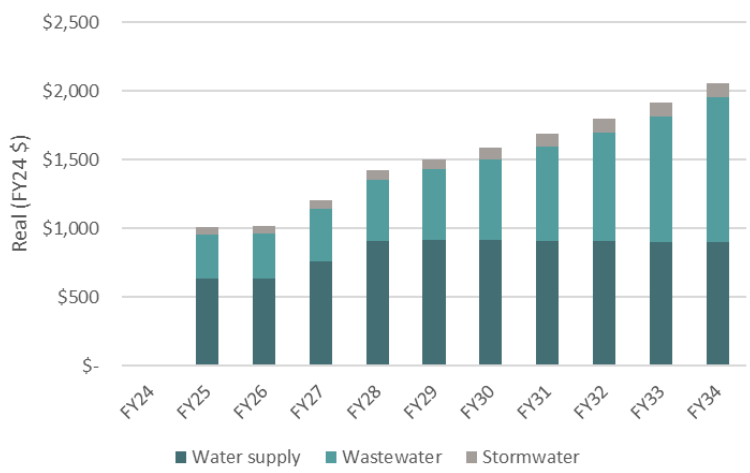
## *Waimate*




## *Waitaki*



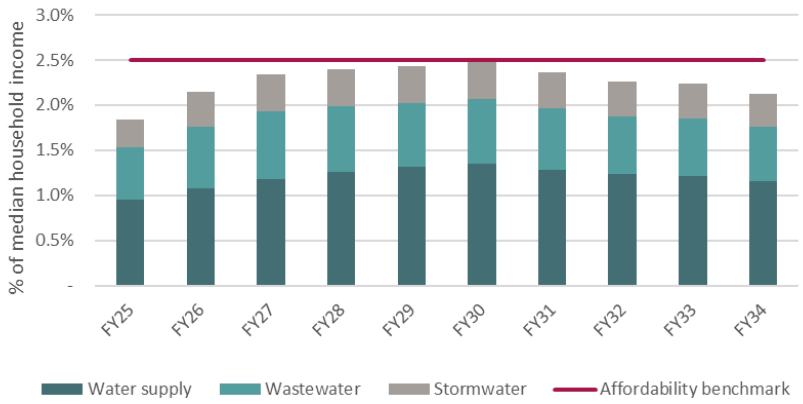

## *Mackenzie*



# Affordability

## *Timaru**

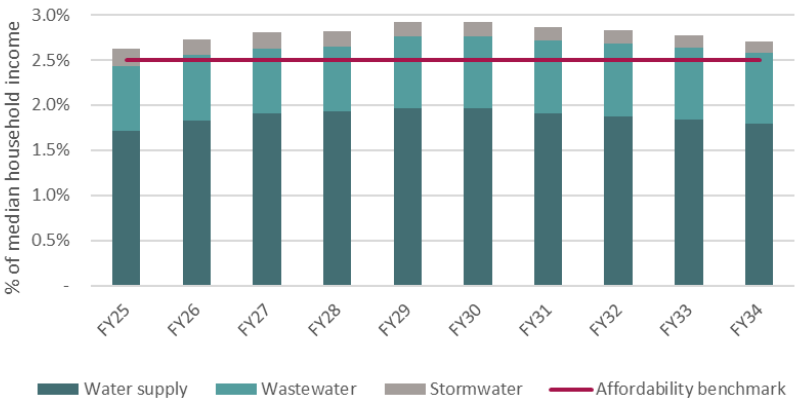
Water rates per connection (incl GST)
(% of median household income)




* Note, Timaru's water rates per connection excludes revenues collected under industrial metered supply and trade waste agreements.

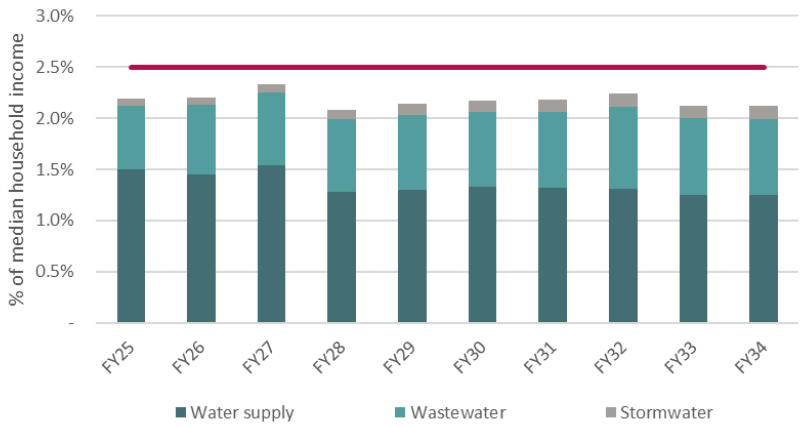
## *Waimate*

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



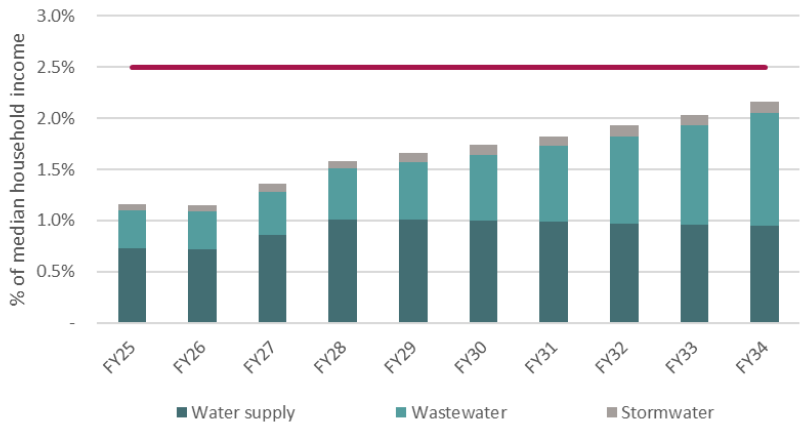

## *Waitaki*

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




## *Mackenzie*

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



# 03. Scenario overview

+ Target capital structure and key assumptions

# The modelled scenario

*Two potential WSCCO scenarios have been modelled involving:*

1. **All four councils: Timaru, Mackenzie, Waimate, and Waitaki District Councils** – this scenario is the primary focus of this report
2. **Three councils: Timaru, Waimate, and Mackenzie Councils only** – this scenario is included in an Addendum to this report

An aggregated comparison is used to compare the modelled WSCCO with a simple aggregation of each council's projections (the simple aggregation excludes capital and operating expenditure efficiencies and other WSCCO-specific assumptions).

*The modelled scenario uses additional borrowing capacity and efficiencies to lower prices while maintaining currently planned levels of investment.*

It does this by:

- Combining starting assets and debt positions and projected opex, capex and revenue (including development contributions) for each council.
- Adjusts these projections for one-off establishment costs (assumed to be debt funded initially with recovery through water revenues over time) and additional ongoing operating costs.
- Incorporating agreed efficiency improvements from changes to governance and management, economies of scale and benefits of economic regulation.
- Assumes LGFA's indicative borrowing terms for WSCCOs

*The results are used to demonstrate the potential savings and affordability benefits of the combined WSCCO model.*

By targeting an efficient capital structure, the WSCCO is assumed to optimise revenues, expenditures and debt that meet prudent credit criteria and anticipated LGFA lending covenants.

This creates opportunities to:

- increase investment while maintaining current price levels, or
- maintain investment while lowering price levels, or
- a combination of these scenarios.

LGFA has set an expectation that the FFO to debt ratio falls between 8% and 12% depending on individual circumstances for the WSCCO. See the following page for more detail. The model targets FFO to debt of 10%, the mid-point of LGFA's indicated range.

# DIA guidance on capital structure

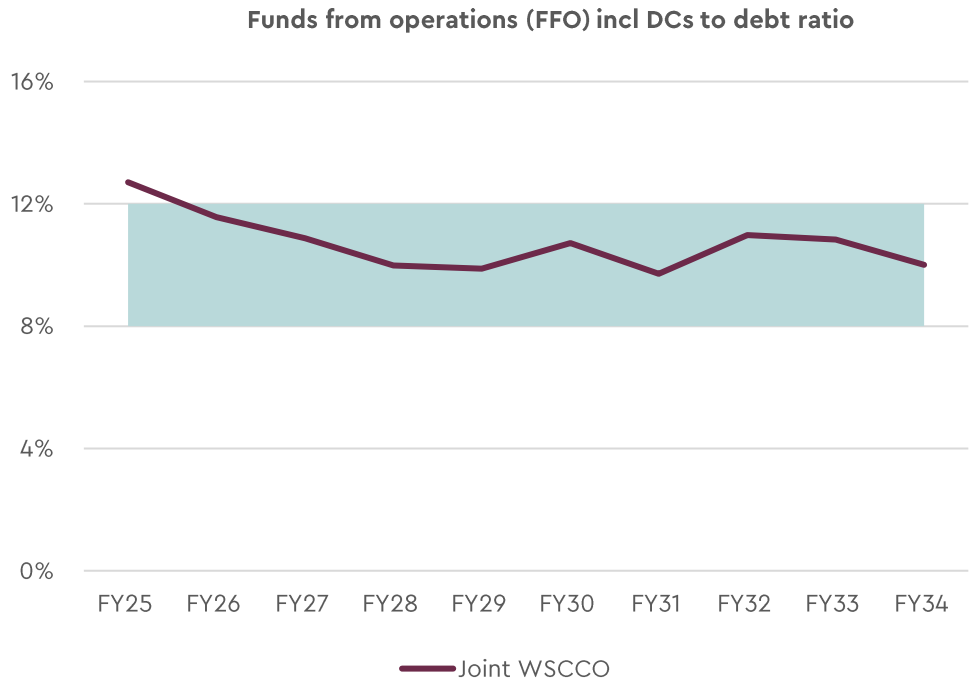
DIA guidance indicates it is inefficient to fund investment in long-lived infrastructure primarily through operating revenues. Under the LWDW framework, capital investment is expected to be funded through capital sources (i.e., borrowing and development contributions), while operating revenues must be sufficient to maintain debt repayments and ensure debt remains within LGFA lending limits* for WSCCOs.

The FFO to debt ratio is a way to assess the ability for revenues (including development contributions in certain circumstances) to meet operating costs and debt servicing requirements.

The joint WSCCO scenario targets a FFO-to-debt ratio of 10%, the mid-point of the range indicated by the LGFA*, resulting in:

- Higher average level of gearing of water activities.
- Lower long-term increases in water charges compared to in-house service delivery options.
- Increased levels of investment.

**The LGFA has signalled a minimum 'FFO-to-debt' ratio of between 8% and 12%. If LGFA approved a lower FFO-to-debt ratio for the WSCCO, then this would further increase the additional investment or further reduce prices relative to the modelled scenario.*



# Model assumptions and adjustments to council projections

The assumptions used in our model were agreed by representatives of participating councils at the following meetings/workshops:

- 12th February 2025: Waimate, Waitaki and Timaru CEOs
- 17th February 2025: Mackenzie Mayor and CEO
- 28th February 2025: Waimate, Timaru and Mackenzie Mayors, Waitaki and Mackenzie CEOs.

Further detail underpinning these assumptions in included in Appendices A and C.

## *Establishment assumptions*

- The WSCCO will include all three waters.
- Price harmonisation would be phased in from year three of the entity's establishment, achieving full price harmonisation by FY34.
- The WSCCO would be established on 1 July 2027.
- It would cost $10 million to establish, with the assumption that these costs would be capitalised (increasing borrowing) and recovered through water revenues over time.

## *Cost assumptions*

- Operating efficiencies have only been applied to core operating costs. No efficiencies have been applied to financing or depreciation costs.
- $1.5 million per annum of additional operating costs as a provision for additional management costs, board fees, audit etc.
- $458,000 additional regulatory costs associated with anticipated levies from Taumata Arowai and the Commerce Commission.

**Operating expenditure efficiencies**

- FY28-FY30 – 0.0% per annum, cumulative
- FY31-FY34 – 1.0% per annum, cumulative
- FY35-FY44 - 1.5% per annum, cumulative

**Capital expenditure efficiencies**

- FY28-FY42 – 1.0% per annum

## *Adjustments to projections*

**Finance costs:**

- Funding Impact Statements received from Waitaki Council implied an average financing rate of 3.4% p.a. for the 10 year period. An adjustment totalling $21.0 million over the FY26-FY34 years was added to raise the effective interest rate to 5.3%, in line with LGFA's long term base rate plus margin.

**Overheads:**

- Data supplied by Timaru Council showed that internal overheads equated to an average 13% of operating revenue over the 10-year period. Additional overheads totalling $20.5 million were added over the FY26-FY34 years to raise this to 17%, the sector average.
- Data supplied by Waitaki Council showed that internal overheads equated to an average 14% of operating revenue over the 10 year period. Additional overheads totalling $5.6 million were added over the FY26-FY34 years to raise this to 17%, the sector average.

**Revenue:**

- Required revenue for Waitaki Council was increased by a total of $26.6 million over the FY26-FY34 period to account for the additional expenditure detailed above.
- Required revenue for Timaru Council was increased by a total of $20.5 million over the FY26-FY34 period to account for the additional expenditure detailed above.
- In addition, for Timaru District, we excluded revenues collected under industrial metered supply and trade waste agreements for the purposes of reporting water rates per connection and affordability metrics. This revenue was included in all other WSCCO financial projections.

# 04. Key findings – Four Council scenario

Four council scenario - Timaru, Mackenzie, Waimate, and Waitaki District Councils.

# Key findings – Four council scenario

A joint WSCCO could support financially sustainable water services while reducing the average annual cost to consumers by up to $30 by FY34.

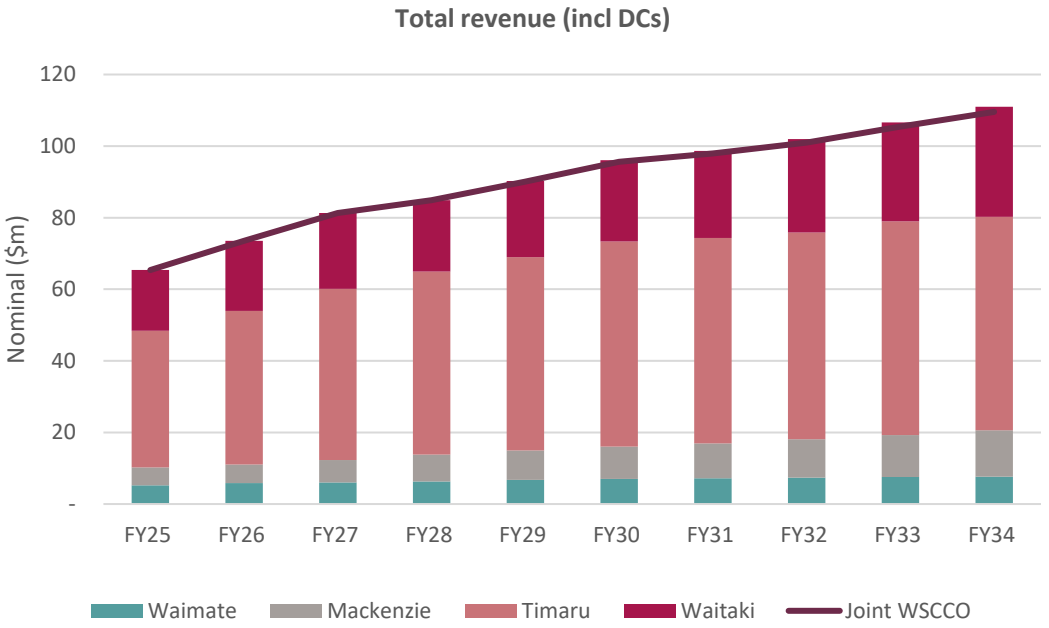
This means a joint WSCCO could deliver water services at a marginally lower cost to consumers than the aggregated councils under current operating models and capital structures.

A joint WSCCO could achieve:

- Operating efficiencies of up to $1.7 million in annual savings by FY34 and peak at 18.7% by FY45.
- Capital efficiencies will generate $6.7 million in annual savings by FY34 and peak at 13.1% by FY42.
- The current investment profile could be delivered for around $19 million less between entity establishment in FY28 and FY34.

This arises from using a more efficient capital structure and financial flexibility which provides:

- Immediate access to increased borrowing.
- Ability to Increase investment capacity.
- Ability to spread the costs of financing assets over their useful lives.



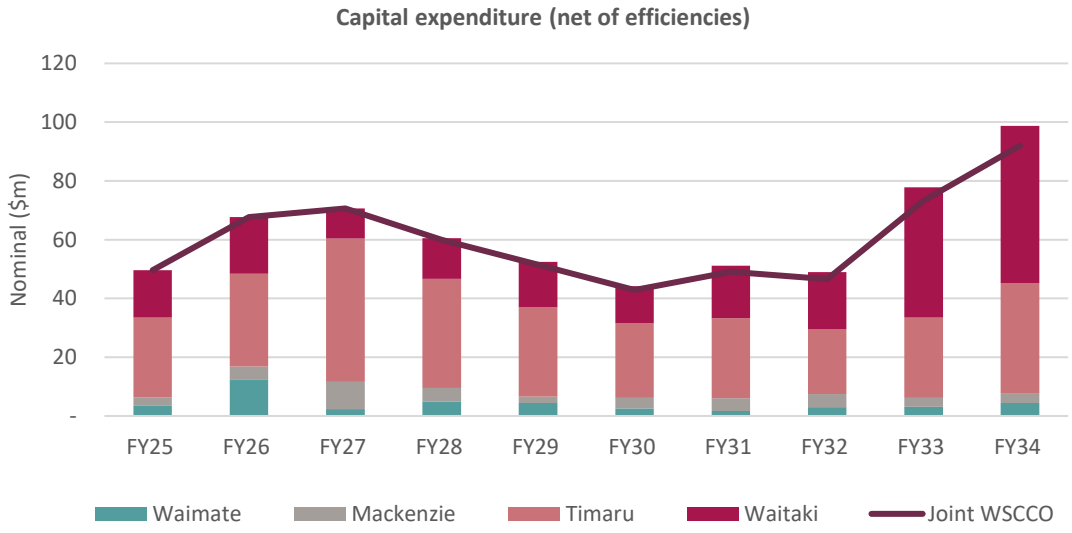

| Scenario | Cost per connection (FY25, Real FY24 $) | Cost per connection (FY34, Real FY24 $) | Total capex (FY25-FY34, $m nominal) | FFO-to-debt, incl. DCs (FY34) |
|---|---|---|---|---|
| **Joint WSCCO** | $1,570 | $2,040 | $603 | 10% |
| **Aggregated comparison** | $1,570 | $2,070 | $622 | 11% |

# Infrastructure investment

The four councils plan to invest $622 million in water infrastructure over the next ten years.

By optimising the capital structure and achieving modest efficiencies, the joint WSCCO could potentially deliver the same investment for $18.6 million less than current council arrangements by FY34.

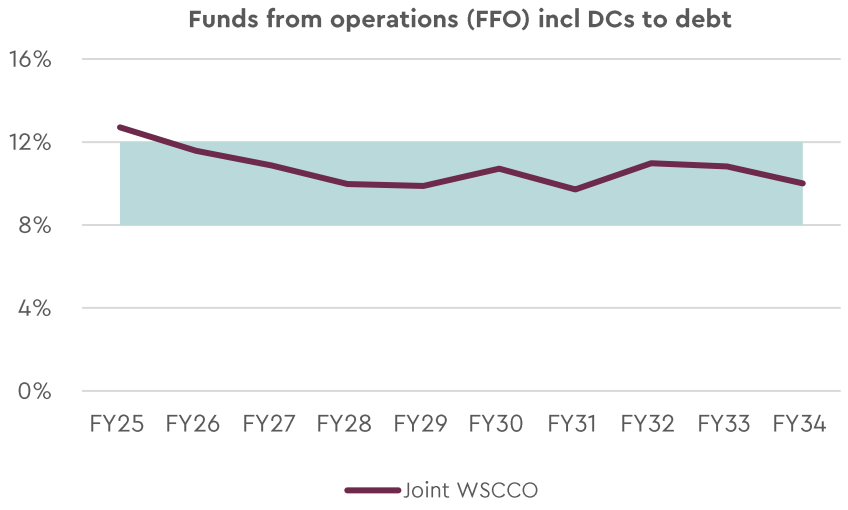
As efficiencies are phased in slowly and are permanent, benefits would continue to accumulate beyond FY34.

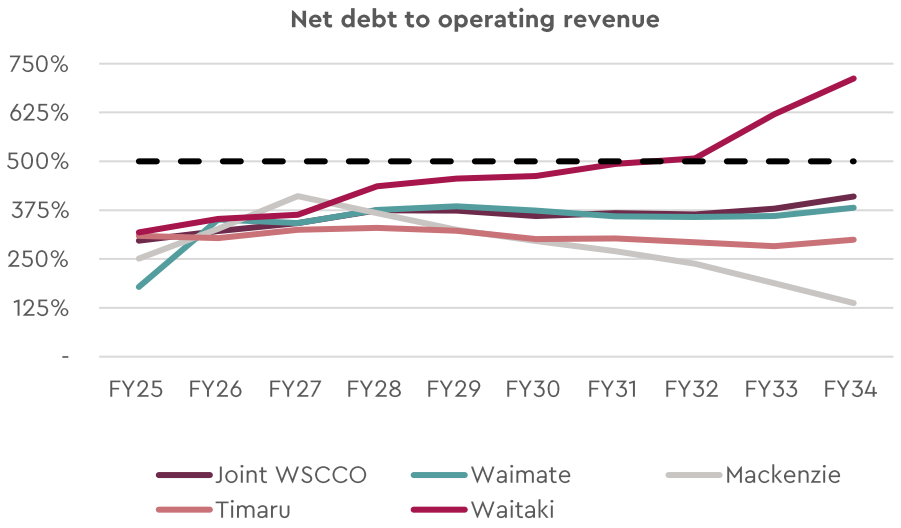



| Scenario | Joint WSCCO | Aggregated comparison | Cumulative capex efficiencies |
|---|---|---|---|
| **Total capex** (FY25-FY34, $m) | $603.0 | $621.6 | $18.6 |

| Capex efficiency | Cumulative efficiency (FY34) | Peak efficiency (FY42) |
|---|---|---|
| 1.0% p.a. | 6.8% | 13.1% |

# Debt sustainability



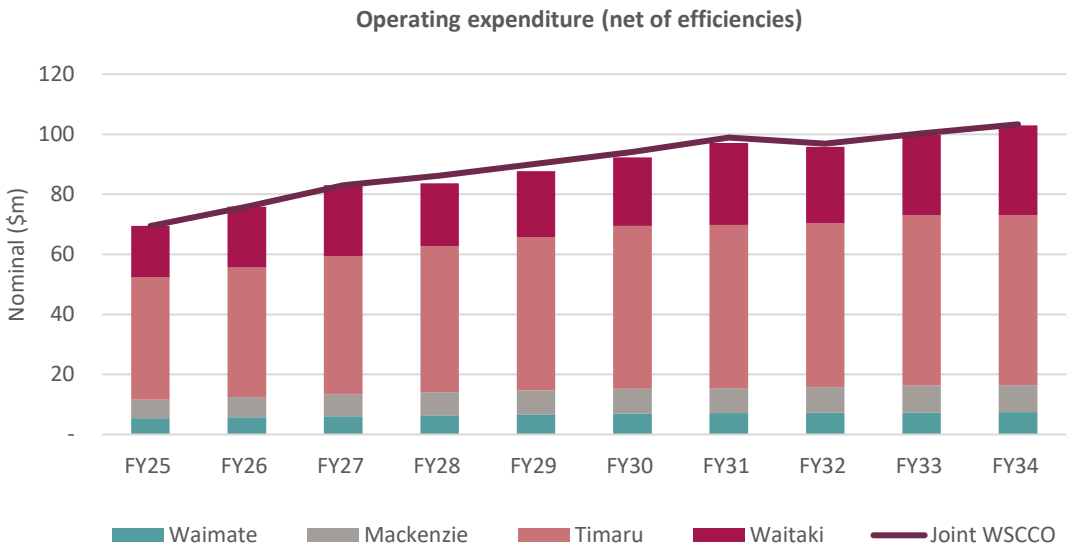

The joint WSCCO is modelled to reach the target FFO to debt ratio of 10% in FY34, when price harmonisation amongst the four councils occurs, and will then remain at that level into the future. The joint WSCCO remains within DIA's recommended FFO to debt ratio band of 8-12% over the whole period.

Net debt to operating revenue is not a metric the LGFA is considering for WSCCOs and is only presented here to illustrate that participating councils have different debt trajectories.

# Projected operating expenditure

The costs associated with operating a joint WSCCO are forecast to exceed the costs to operate the aggregated comparison over the ten-year forecast period by a total $10.4 million.

Cumulative efficiencies total $4.5 million by FY34 and are $1.2 million in FY34 alone. Efficiency gains will continue to increase over time and will begin to exceed incremental costs from FY34 onwards.




As agreed with the councils, the scenario assumes no efficiencies for the first three years following entity establishment, then 1% per annum for four years, before increasing to 1.5% from FY35.

Peak efficiency is forecast to be 18.7% in FY45.

| Scenario | Joint WSCCO | Aggregated comparison | Cumulative opex efficiencies |
|---|---|---|---|
| **Total opex** (FY25-FY34, $m) | $898.1 | $887.7 | $4.5 |

| Opex efficiency (FY31-FY34) | Opex efficiency (FY35-FY45) | Cumulative efficiency (FY34) | Peak efficiency (FY45) |
|---|---|---|---|
| 1.0% p.a. | 1.5% p.a. | 3.9% | 18.7% |

# Projected revenue requirements

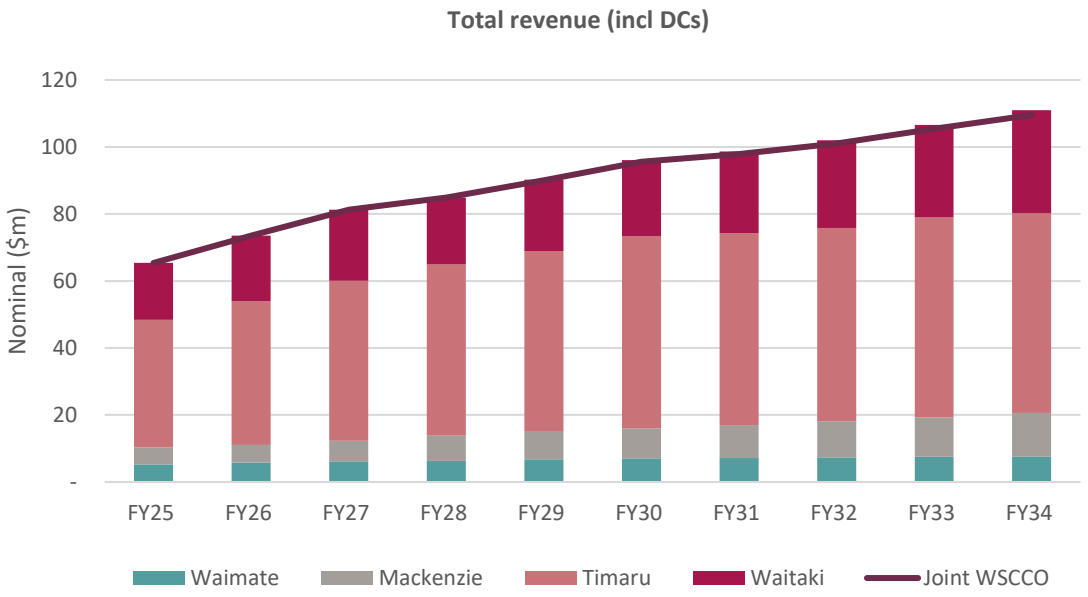
Under LWDW, the expectation is that operating revenues pay for operating costs with capital investment funded by capital sources.

This means charges for water services (operating revenue) should be set to recover all cash operating expenses plus a minimum FFO to debt requirement of 10% (as outlined in Section 3).

This approach ensures an appropriate approach to setting water charges while maintaining borrowing at a prudent level.

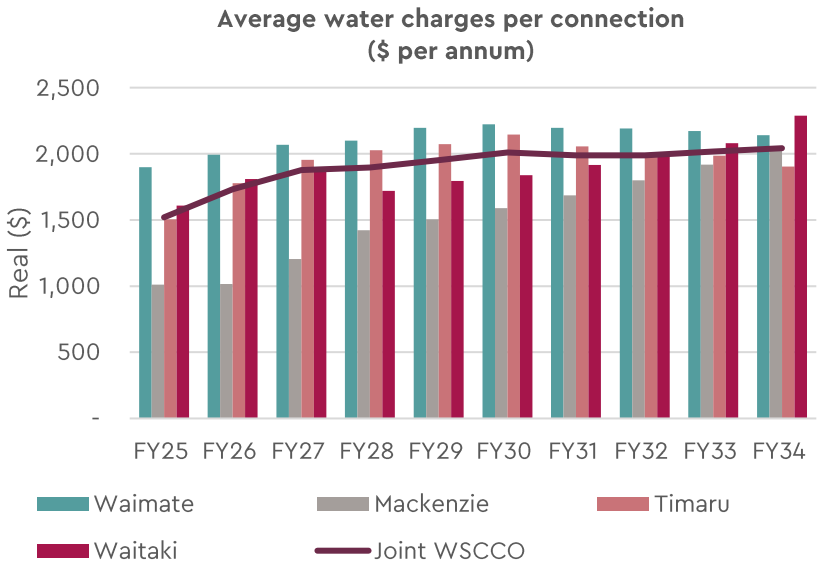
Based on this approach, water revenues can be reduced by $4.9 million over the FY34 forecast period.

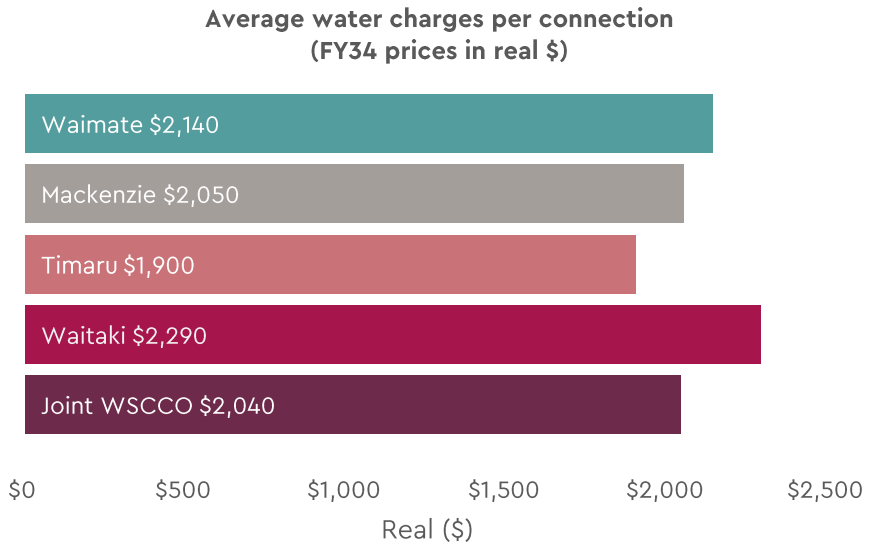
The ability to increase borrowing makes this possible despite the joint WSCCO being more expensive to operate over the FY34 forecast period than the aggregated comparison.




| Scenario | Joint WSCCO | Aggregated comparison | Cumulative reduction |
|---|---|---|---|
| **Total revenue, incl DCs** (FY25-FY34, $m) | $904.7 | $909.6 | $4.9 |
| **FFO : Debt** (FY34) | 10% | 11% | |

# WSCCO price harmonisation




Price harmonisation means that the joint WSCCO would operate a consistent tariff structure across the region served by the entity (i.e. like for like consumers would pay a like for like price irrespective of their location in the service area). This assumption enables the councils to understand the relative affordability for consumers under a joint WSCCO if prices are harmonised, noting there is no requirement for prices to be harmonised under LWDW.

Based on the price harmonisation assumption:

- By FY34, average water charges per connection in a price harmonised joint WSCCO are expected to be lower than three of the four councils are currently projecting.
- Under current council arrangements, water charges per connection are projected to range from $1,900 to $2,290 per connection annually (in today's terms).
- A joint WSCCO could achieve a charge as low as $2,040 per connection on a harmonised basis by FY34.

Note, we excluded the revenues collected by Timaru District Council under industrial metered supply and trade waste agreements due to their distortive impact on average cost per connection.

# 05. Key findings – Three council scenario

Three council scenario - Timaru, Mackenzie, and Waimate District Councils

# Key findings – Three council scenario

A joint WSCCO, consisting of Timaru, Mackenzie and Waimate District Councils, could support financially sustainable water services while reducing the average annual cost to consumers by up to $240 by FY34.

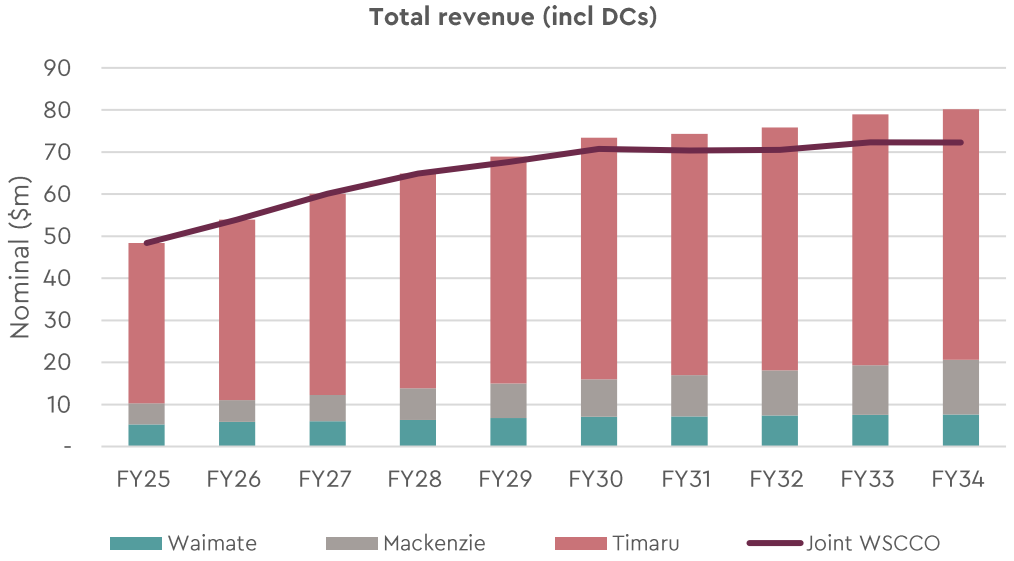
This means a joint WSCCO could deliver water services at a lower cost to consumers than the combined councils under current operating models and capital structures.

A joint WSCCO could achieve:

- Operating efficiencies - $1.2 million in annual savings by FY34 and peak at 16.5% by FY45.
- Capital efficiencies - $2.8 million in annual savings by FY34 and peak at 12.7% by FY42.
- The current investment profile could be delivered for around $8.9 million less between entity establishment and FY34.

This arises from using a more efficient capital structure and financial flexibility which provides:

- Immediate access to increased borrowing.
- Ability to Increase investment capacity.
- Ability to spread the costs of financing assets over their useful lives.




| Scenario | Average cost per connection (FY25, Real FY24 $) | Average cost per connection (FY34, Real FY24 $) | Total capex (FY25-FY34, $m nominal) | FFO-to-debt, incl. DCs (FY34) |
|---|---|---|---|---|
| **Joint WSCCO** | $1,480 | $1,740 | $390 | 10% |
| **Aggregated comparison** | $1,480 | $1,980 | $399 | 17% |
| • **Waimate DC** | $1,899 | $2,140 | $42.4 | 8% |
| • **Mackenzie DC** | $1,012 | $2,050 | $42.2 | 44% |
| • **Timaru DC** | $1,505 | $1,900 | $314.2 | 16% |

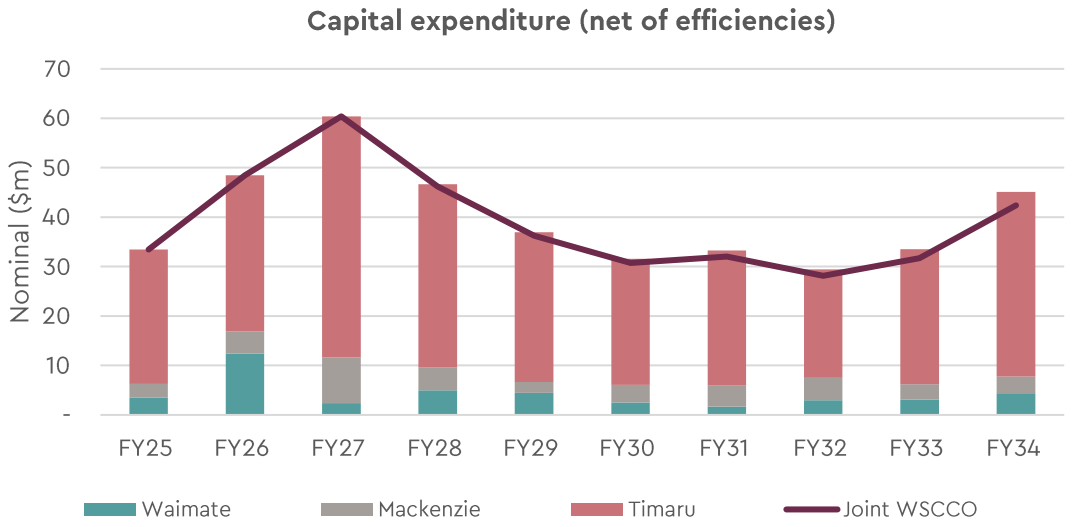
# Infrastructure investment – three council model

The three councils plan to invest $398.8 million in water infrastructure over the next ten years.

By optimising the capital structure and achieving modest efficiencies, the joint WSCCO could generate annual capital efficiencies of $2.8 million by FY34.

This would enable the delivery of the same investment for $9.0 million less than current council arrangements by FY34, while also lowering costs for consumers.

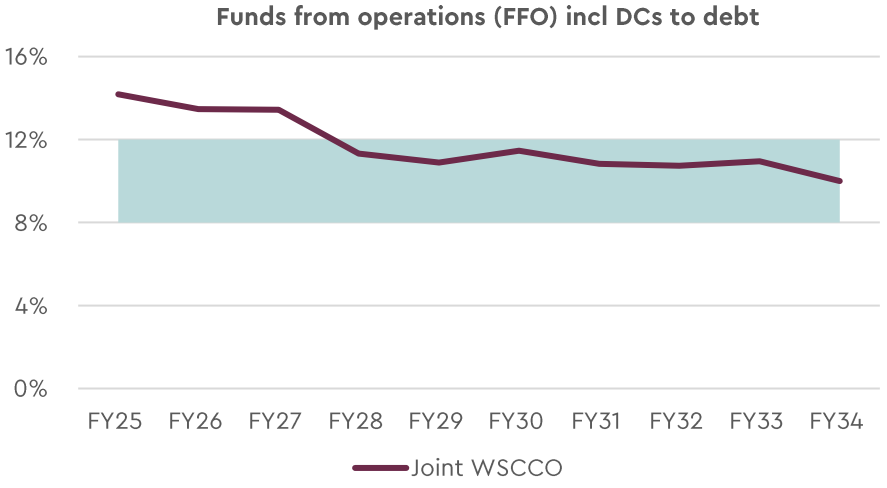
As efficiencies are phased in over time and are permanent, benefits would be larger and continue to accumulate beyond FY34.

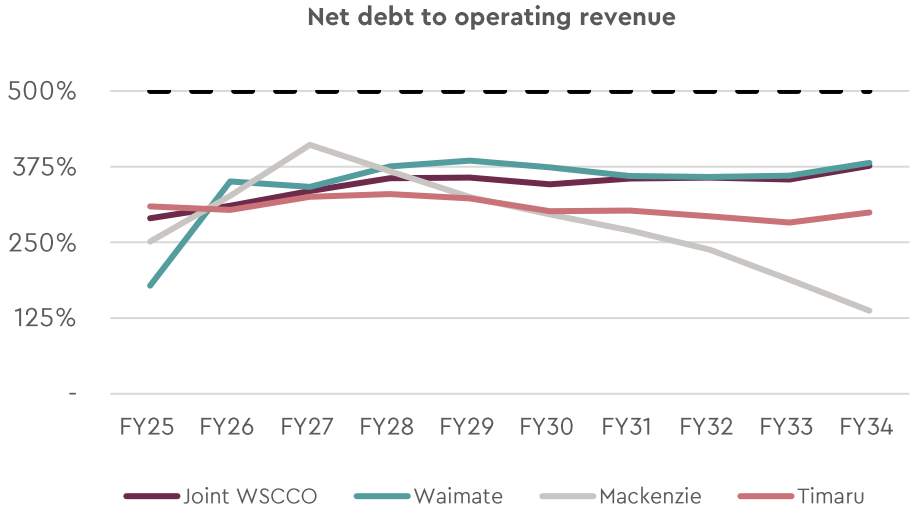



| Scenario | Joint WSCCO | Aggregated comparison | Cumulative capex efficiencies |
|---|---|---|---|
| **Total capex** (FY25-FY34, $m) | $389.8 | $398.8 | $9.0 |

| Capex efficiency | Cumulative efficiency (FY34) | Peak efficiency (FY42) |
|---|---|---|
| 0.9% | 6.1% | 12.7% |

# Debt sustainability - three council model



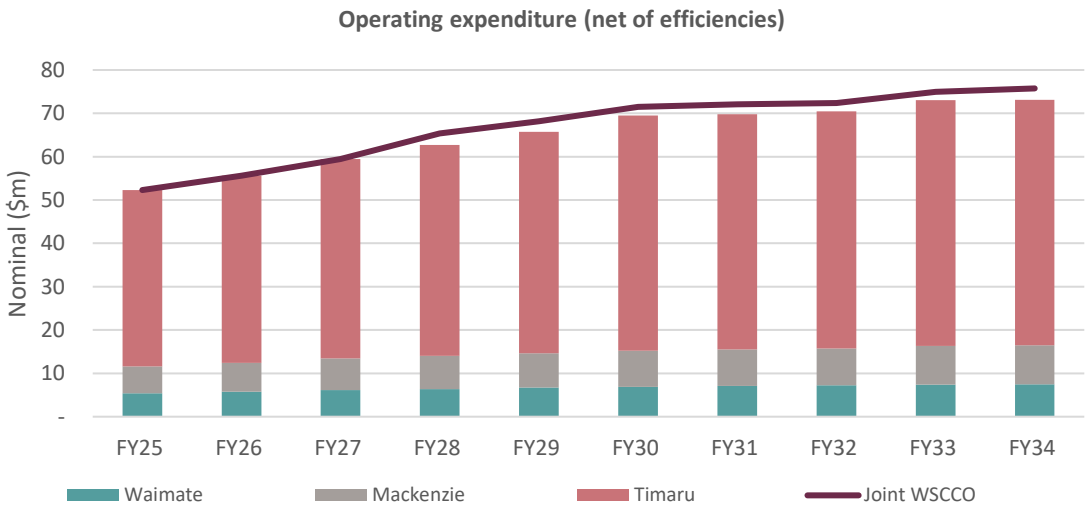

The joint WSCCO is modelled to reach the target FFO to debt ratio of 10% in FY34, when price harmonisation amongst the three councils occurs, and will then remain at that level into the future. The joint WSCCO remains within DIA's recommended FFO to debt ratio band of 8-12% over the whole period.

Net debt to operating revenue is not a metric the LGFA is considering for WSCCOs, and is only presented to show the greater gearing levels that the WSCCO could have when compared to some of the individual councils in later years due to targeting a FFO to debt ratio.

# Projected operating expenditure - three council model

The costs associated with operating a joint WSCCO are forecast to exceed the costs to operate the aggregated comparison over the ten-year forecast period by a total $2.6 million.

However, efficiency gains will continue to increase over time, reversing this post FY34.




As agreed with participating councils, the scenario assumes no efficiencies for the first three years following entity establishment, then 0.9% per annum for four years, before increasing to 1.3% from FY35.

Peak efficiency is forecast to be 16.5% in FY45.

| Scenario | Joint WSCCO | Aggregated comparison | Cumulative opex efficiencies |
|---|---|---|---|
| **Total opex** (FY25-FY34, $m) | $667.6 | $651.7 | $2.9 |

| Opex efficiency (FY31-FY34) | Opex efficiency (FY35-FY45) | Cumulative efficiency (FY34) | Peak efficiency (FY45) |
|---|---|---|---|
| 0.9% p.a. | 1.3% p.a. | 3.6% | 16.5% |

# Projected revenues - three council model

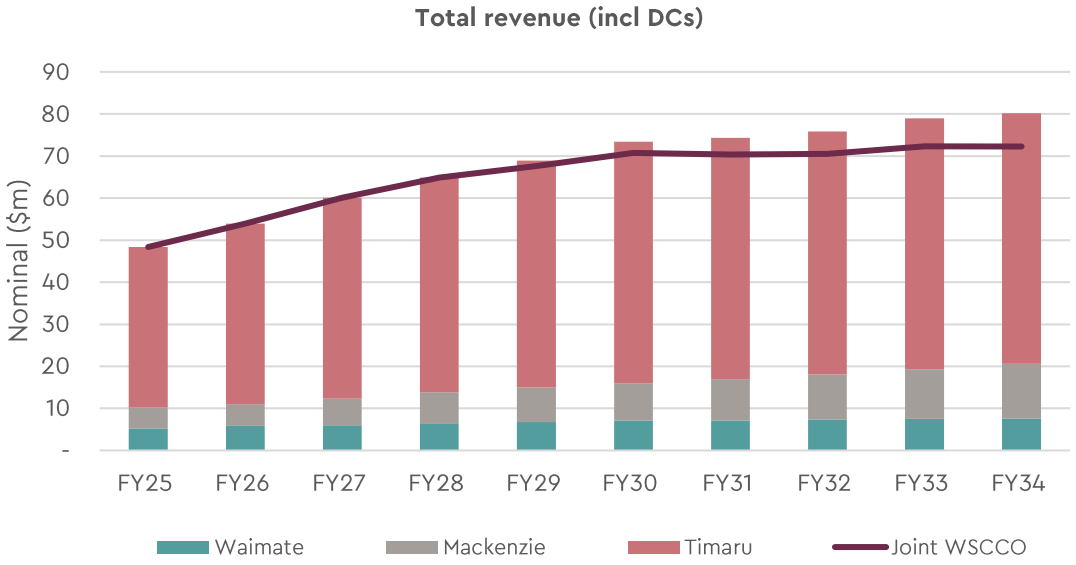
Under LWDW, the expectation is that operating revenues pay for operating costs with capital investment funded by capital sources.

This means charges for water services (operating revenue) should be set to recover all cash operating expenses plus a minimum FFO to debt requirement of 10% (as outlined in Section 3).

This approach ensures an appropriate approach to setting water charges while maintaining borrowing at a prudent level.

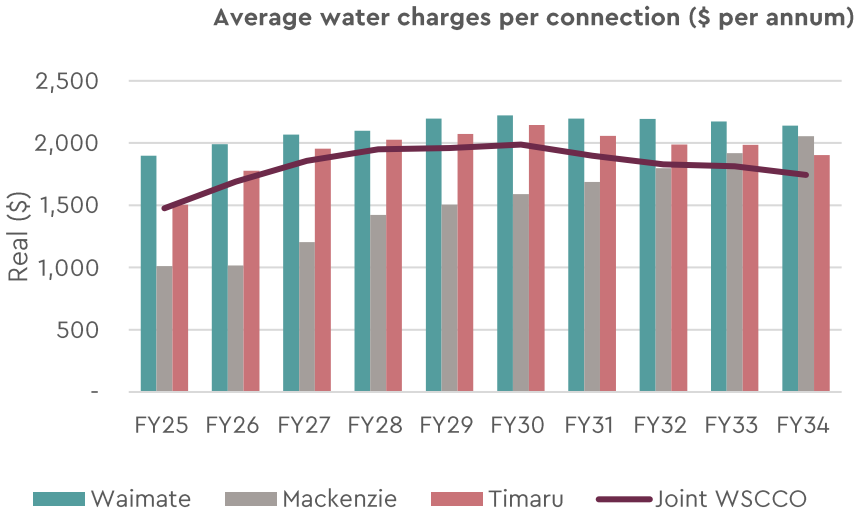
Based on this approach, water charges can be reduced by $27.9 million over the FY34 forecast period.

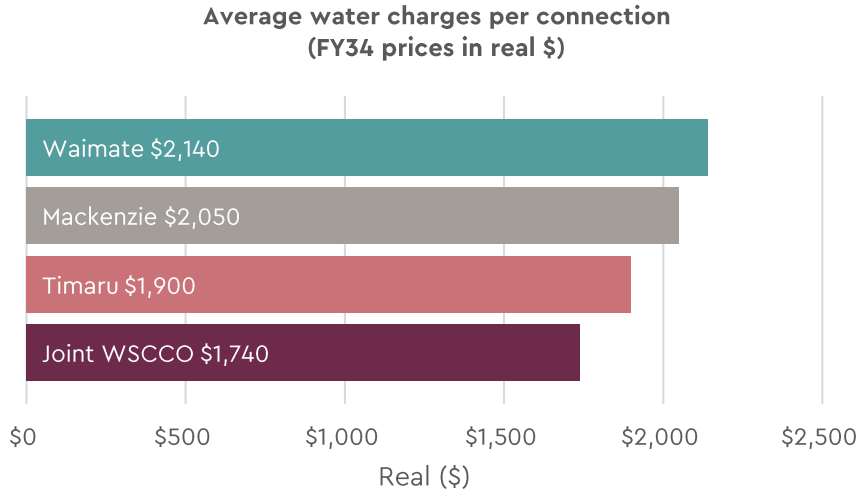
The ability to increase borrowing makes this possible despite the joint WSCCO being more expensive to operate over the FY34 forecast period than the aggregated comparison.




| Scenario | Joint WSCCO | Aggregated comparison | Cumulative reduction |
|---|---|---|---|
| **Total revenue, incl DCs** (FY25-FY34, $m) | $651.0 | $678.9 | $27.9 |
| **FFO : Debt** (FY34) | 10% | 17% | |

# WSCCO price harmonisation - three council model




Price harmonisation means that the joint WSCCO would operate a consistent tariff structure across the region served by the entity (i.e. like for like consumers would pay a like for like price irrespective of their location in the region). This assumption enables the councils to understand the relative affordability for consumers under a joint WSCCO with price harmonisation, noting there is no requirement for prices to be harmonised under LWDW.

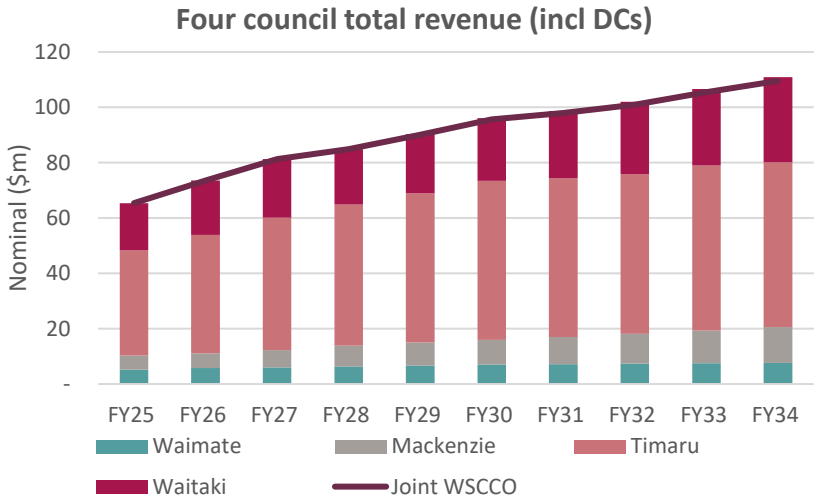
- By FY34, average water charges per connection in a price harmonised joint WSCCO are expected to be lower than all three councils are currently projecting.
- Under current council arrangements, water charges per connection are projected to range from $1,900 to $2,140 per connection annually (in today's terms).
- A joint WSCCO could achieve a charge as low as $1,740 per connection on a harmonised basis by FY34.

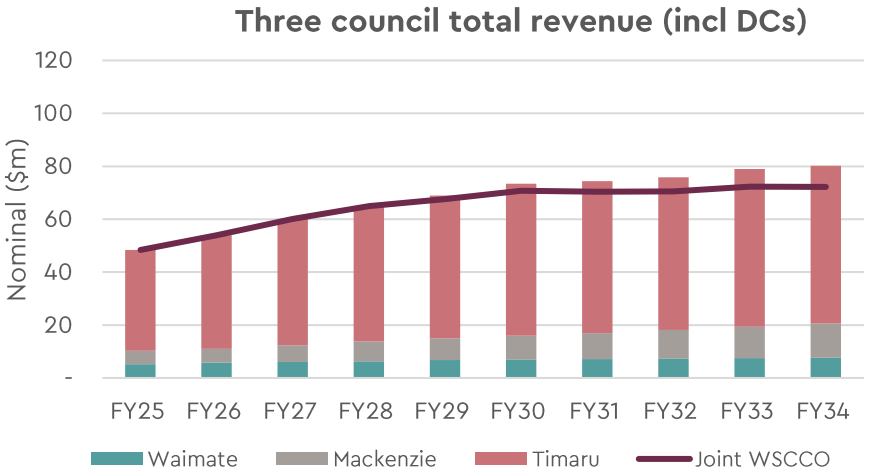
Note, we excluded the revenues collected by Timaru District Council under industrial metered supply and trade waste agreements due to their distortive impact on average cost per connection.

Based on the price harmonisation assumption:

# 06. Comparison – Four and three council WSCCO

# Summary findings




A joint WSCCO could support financially sustainable water services while **reducing the average annual cost to consumers by up to $30 by FY34.**

This means a joint WSCCO could deliver water services at a marginally lower cost to consumers than the aggregated councils under current operating models and capital structures.

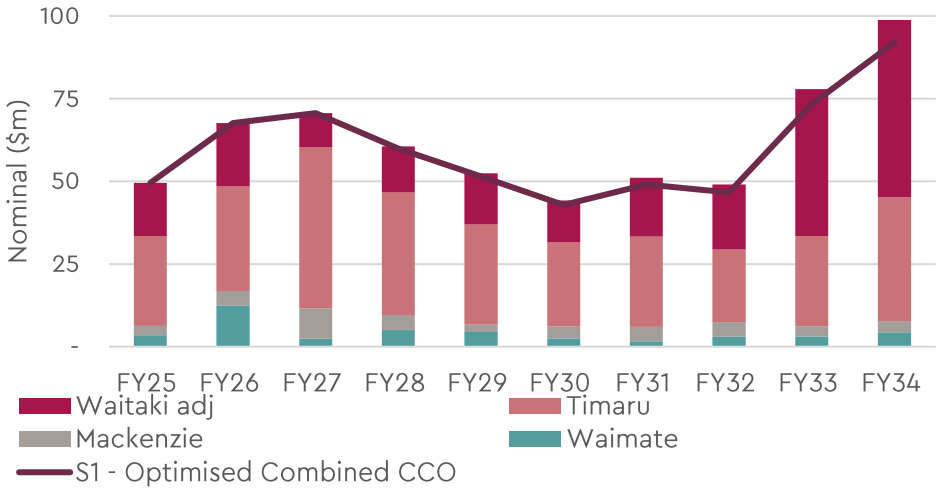
A joint WSCCO, consisting of Timaru, Mackenzie and Waimate District Councils, could support financially sustainable water services while **reducing the average annual cost to consumers by up to $240 by FY34.**

This means a joint WSCCO could deliver water services at a lower cost to consumers than the combined councils under current operating models and capital structures.

# Capital expenditure

Investment sufficiency

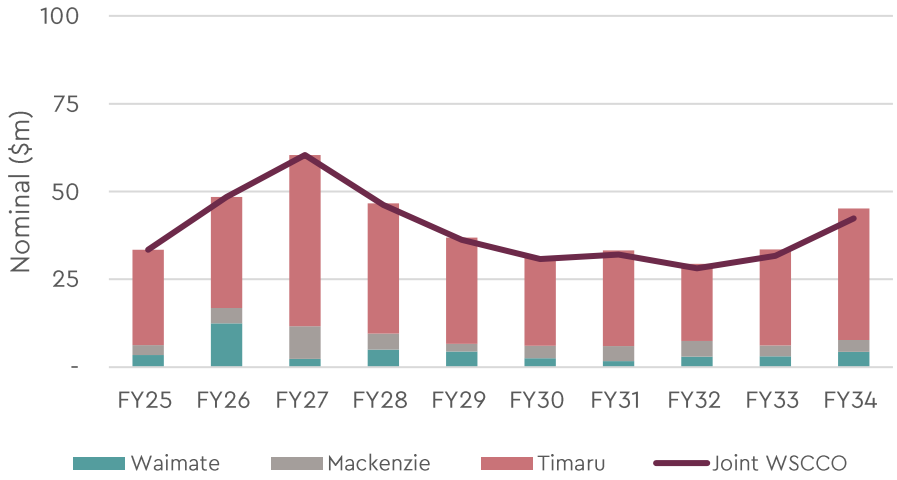
### Four council capital expenditure




| Capex efficiency | Cumulative efficiency (FY34) | Peak efficiency (FY42) |
|---|---|---|
| 1.0% p.a. | 6.8% | 14.0% |

The four Councils expect to invest $622 million over the 10 year period. By optimising the capital structure and realising modest capital efficiencies, this capital programme is expected to be able to be **delivered for $19 million less**, at $603 million.

### Three council capital expenditure

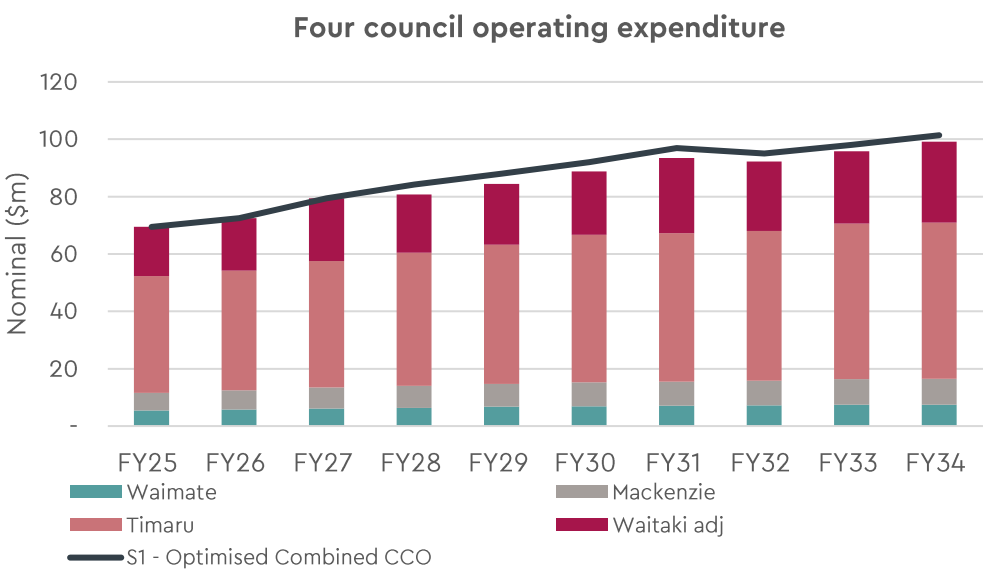


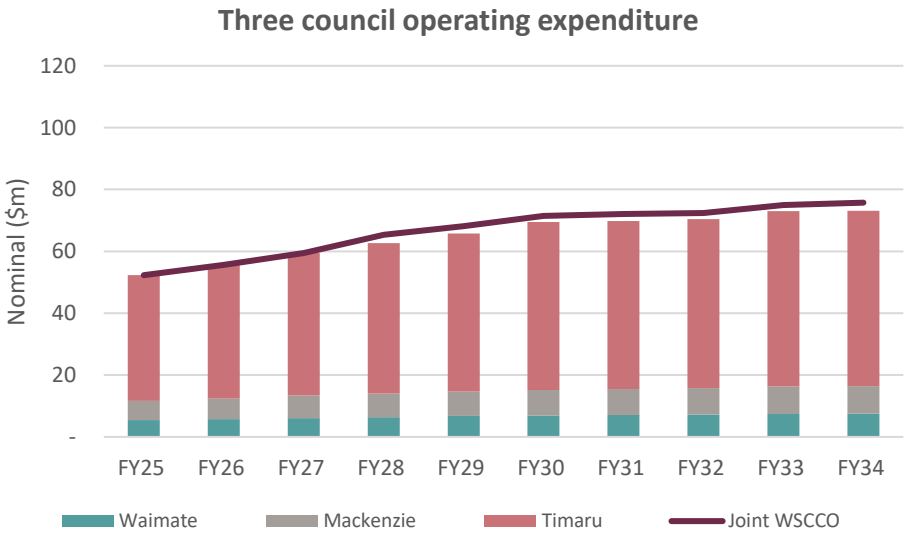

| Capex efficiency | Cumulative efficiency (FY34) | Peak efficiency (FY42) |
|---|---|---|
| 0.9% p.a. | 6.1% | 12.7% |

The three councils plan to invest $399 million over the 10 year period. By optimising the capital structure and realising modest efficiencies, this capital programme is expected to be able to be **delivered for $9.0 million less**, at $390 million.

# Operating expenditures

Revenue sufficiency



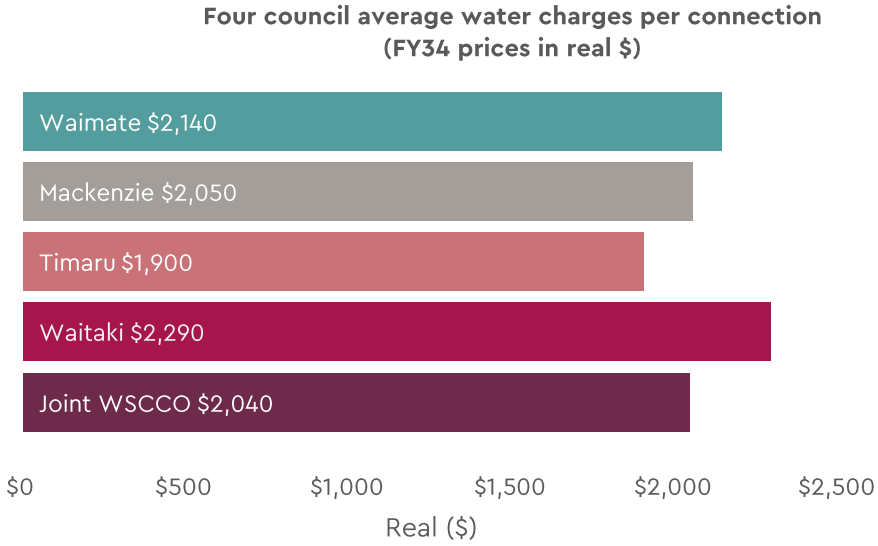

| Opex efficiency (FY31-FY34) | Opex efficiency (FY35-FY45) | Cumulative efficiency (FY34) | Peak efficiency (FY45) |
|---|---|---|---|
| 1.0% p.a. | 1.5% p.a. | 3.9% | 18.7% |

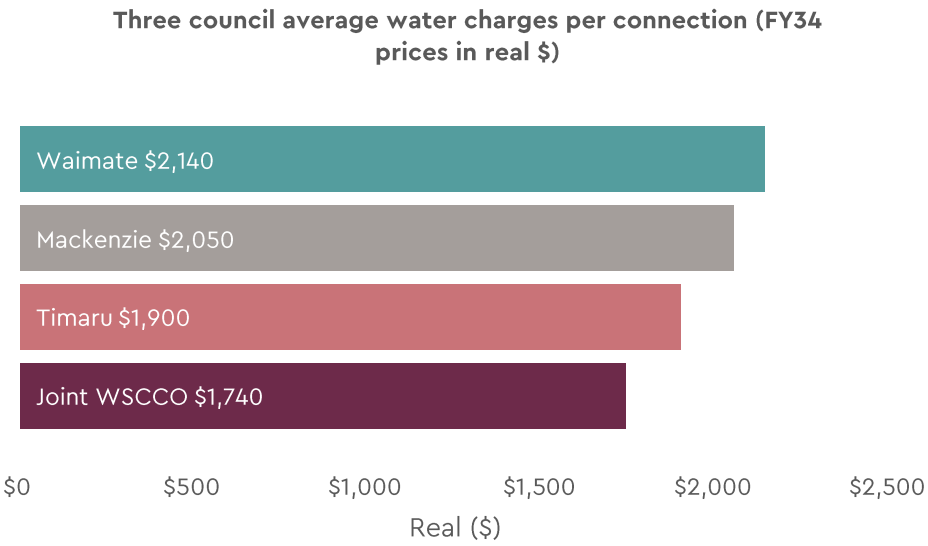
Operating efficiencies totalling $1.7 million (3.9%) are achieved in FY34, **matching the forecast additional costs from establishing a combined WSCCO.** Despite these efficiencies, the combined CCO would still incur greater costs in FY34 than the baseline combined, due to higher debt balances.

| Opex efficiency (FY31-FY34) | Opex efficiency (FY35-FY45) | Cumulative efficiency (FY34) | Peak efficiency (FY45) |
|---|---|---|---|
| 0.9% p.a. | 1.3% p.a. | 3.6% | 16.5% |

Operating efficiencies totalling $1.2 million are achieved in FY34 (or 3.6%). Despite these efficiencies, the combined CCO would still incur greater costs in FY34 than the baseline combined due to both additional costs associated with operating the entity and greater finance costs arising from higher debt levels.

# Comparison of water charges




Note, we excluded revenues collected by Timaru District under industrial metered supply and trade waste agreements due to their distortive impact on average cost per connection.

By FY34, average water charges per connection in a price harmonised joint WSCCO are expected to be **lower than three of the four councils** are currently projecting.

By FY34, average water charges per connection in a price harmonised joint WSCCO are expected to be **lower than all three councils** are currently projecting.

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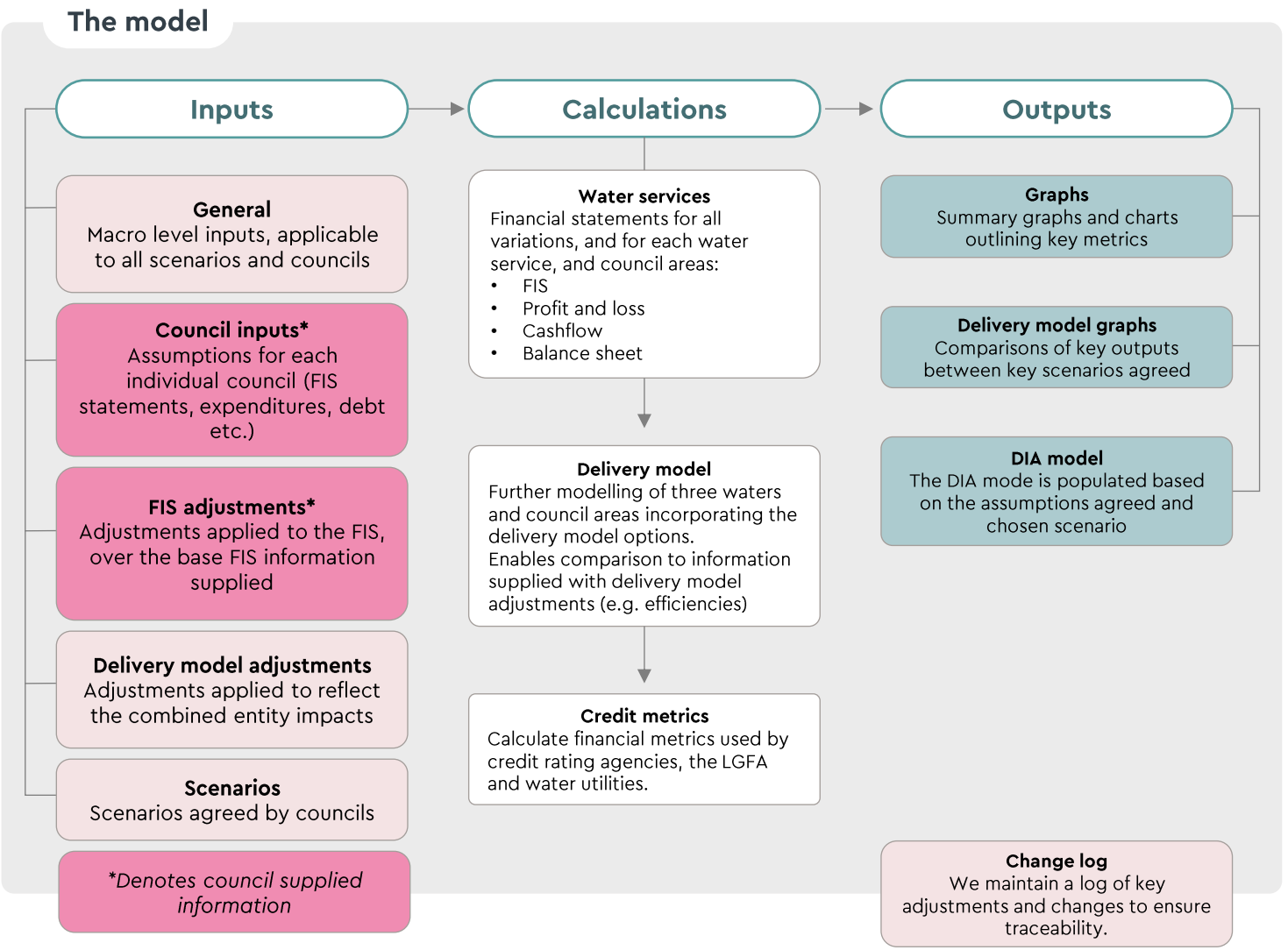
# Appendix A: Approach to modelling and assumptions

# Approach to modelling

**The model builds on the Department of Internal Affairs Water Service Delivery Plan financial template in the following ways:**

- Ability to solve for certain capital structures, financial ratios, revenue profiles and other key metrics. Testing and comparison of multiple scenarios.
- Incorporates efficiency assumptions for both capital and operating expenditure based on international benchmarks and scale of the proposed entity.
- Allows for estimated establishment costs.
- Models several key assumptions, based on evidence or information supplied by councils.

**The usefulness of the model's outputs is dependent on the robustness of inputs and assumptions.** We have relied on information supplied by councils, with adjustments documented in the assumptions.



# Base assumptions

The following table provides further detail on the assumptions set out on page 19 of the report. The breakdown of efficiency assumptions is outlined on the following page.

| Assumption | Commentary | Basis of assumption / source |
|---|---|---|
| **Financing** | LGFA has indicated that for multi-council WSCCOs the borrowing margin would be based on the weighted average borrowing margin of the participating councils. Default weighting will be based on ownership structure per LGFA guidance. | LGFA |
| **Inflation** | Each council will have created their Funding Impact Statements with potentially different inflation rates. We rely on nominal inputs and do not attempt to normalise. We will present nominal and real figures for capital and operating spend. | BERL LGCI |
| **Governance costs** | WSCCOs will have a board of directors. We have assumed that the board will be comprised of 5 members, with the following assumptions:<br>• Chair = $108,000 pa<br>• Other board members = $54,000 pa<br>• Meeting costs = $10,000 pa | Watercare Services Limited (base) |
| **Management costs** | • CEO = $400,000 pa<br>• CFO = $300,000 pa<br>• Other management costs are assumed to be captured within existing opex figures | Relative to council salaries |
| **Establishment costs (one-off)** | Establishment costs are assumed to be:<br>• $10 million for four council entity scenarios<br>• $9 million for three council entity scenarios<br>This covers transition activities, including legal, commercial and other due diligence, and fit out of premises and basic IT hardware. IT investment may not be fully captured.<br>*The model is not sensitive to this assumption.* | *Note: We assume that operating costs associated with establishment will be capitalised.* |
| **Levies** | Commerce Commission (estimated $110,000) and Taumata Arowai (estimated $349,000) levies have been included in all scenarios. | Commerce Commission and Taumata Arowai + population statistics |

# Efficiency assumptions

| Composition | Four councils:<br>Timaru + Waitaki + Mackenzie + Waimate | Three councils:<br>Timaru + Mackenzie + Waimate |
|---|---|---|
| **Characteristics** | | |
| No. of councils | 4 | 3 |
| Population (2023 census) | 84,255 | 60,873 |
| **Decided assumptions** | | |
| Opex efficiencies per annum | 1.0% from FY31-FY34, then 1.5% from FY34-FY45 | 0.9% from FY31-FY34, then 1.3% from FY34-FY45 |
| Capex efficiencies per annum | 1.0% from FY28-FY42 | 0.9% from FY28-FY42 |
| The above four-council efficiencies reflect decisions by Council officials on realistic efficiency assumptions that could be applied to support financial assessment of alternative options. The assumptions for the three-council entity have been reduced commensurately given the smaller population base. The assumption should be applied on a compound (diminishing rate) basis. Note the above estimates apply after adding incremental establishment or operating costs. | | |

# Main adjustments to data provided

### *Timaru District Council*

Adjustments to operating expenditure to align with the assumptions detailed on slide 18, with an increase in charges (revenue) to ensure a balanced Funding Impact Statement:

- Internal overheads totalled 13% of operating revenue over the 10 year period. Additional overheads totalling $20.5 million were added over the FY26-FY34 years to raise this to 17%.
- We excluded revenues collected by Timaru District Council under industrial metered supply and trade waste agreements for the purposes of reporting water rates per connection and affordability metrics. This revenue was included in all other WSCCO projections.

### *Waitaki District Council*

Adjustments to operating expenditure to align with the assumptions detailed on slide 18, with an increase in charges (revenue) to ensure a balanced Funding Impact Statement:

- Finance costs provided on the Funding Impact Statements averaged 3.4% p.a. for the 10 year period. Additional finance costs totalling $21.0 million were added over the FY26-FY34 years to raise the interest rate to 5.3%.
- Internal overheads totalled 14% of operating revenue over the 10 year period. Additional overheads totalling $5.6 million were added over the FY26-FY34 years to raise this to 17%.

### *Waimate District Council*

No adjustments were made to the data supplied.

### *Mackenzie District Council*

No adjustments were made to the data supplied.

# Appendix B: Additional information on efficiencies

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

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

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

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

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

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

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

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

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

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

**There are two plausible scenarios here:**

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

# Evidence base to support efficiency assumptions

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

**Productivity Commission**

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

**Frontier Economics**

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

Review of experience with aggregation in the water sector (dia.govt.nz)

**Water Industry Commission for Scotland (WICS)**

WICS reports that Scottish Water has been able to reduce its operating costs by over 50% since reform, while improving levels of service to customers and absorbing the new operating costs associated with its investment programme.

WICS Supporting Material 2 - scope for efficiency (dia.govt.nz)

**FarrierSwier**

In its review of WICS methodology, FarrierSwier commented on the potential that exists for efficiency gains from amalgamating water services in New Zealand and notes significant improvements are possible through aggregation and associated reforms, including improving the ability to attract and retain skilled management and staff, more effective procurement functions, asset level optimisation and reduction in corporate overheads and duplicative functions.

Farrierswier - Three Waters Reform Programme - Review of WICS methodology and assumptions underpinning economic analysis of aggregation - 2 May 2021 (dia.govt.nz)

In an independent review of the Essential Services Commission's PREMO regulatory model in Victoria, Australia, FarrierSwier found that water companies set efficiency targets through its 2018 Price Review ranging from 1.0% p.a. to 2.7% p.a. (averaging 1.8% p.a. across 15 regulated water authorities). While all but two companies delivered reductions in controllable opex per connection, the actual opex savings reported were lower than the target (ranging from 2.2% to -0.2% and average 0.9% p.a.).

Victoria's water sector: The PREMO model for economic regulation

**UK Water Trade Association**

A report for the United Kingdom Water Trade Association found that reform of the water industry in England resulted in annual productivity growth of 2.1% or 64% over 24 years when adjusted for service quality improvements.

Water-UK-Frontier-Productivity.pdf

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

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

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

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

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

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

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

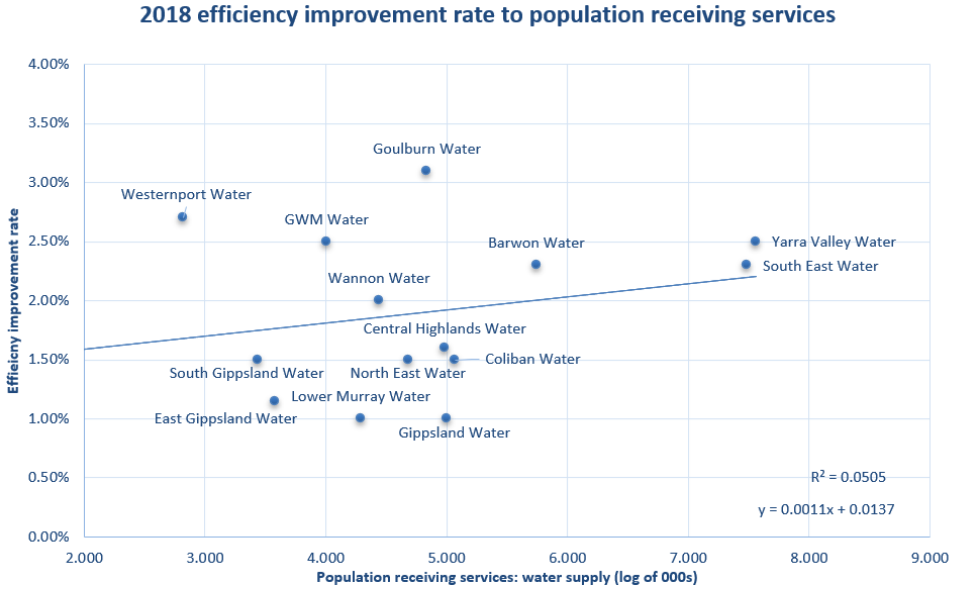
While actual performance data across Victorian utilities is limited and inconsistent (discussed overleaf), analysis of regulatory efficiency targets (hurdles) provides valuable insights into the relationship between scale and expected improvements.

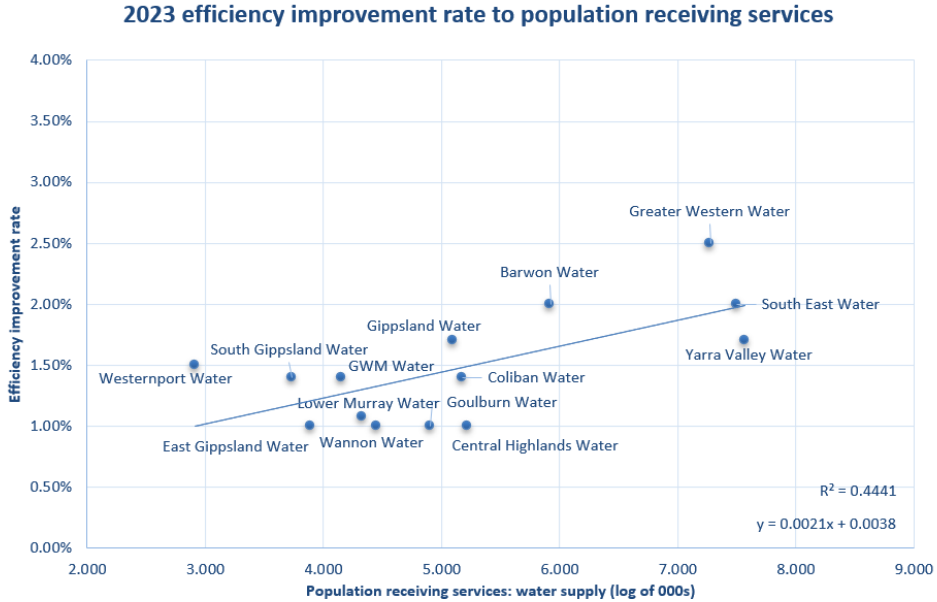
We have analysed the efficiency improvement hurdle imposed by or agreed with the Essential Services Commission in Victoria for each of the price reviews in 2018 and 2023 against scale (measured by population served).

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

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

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



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

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

## Operating costs vary significantly by utility size

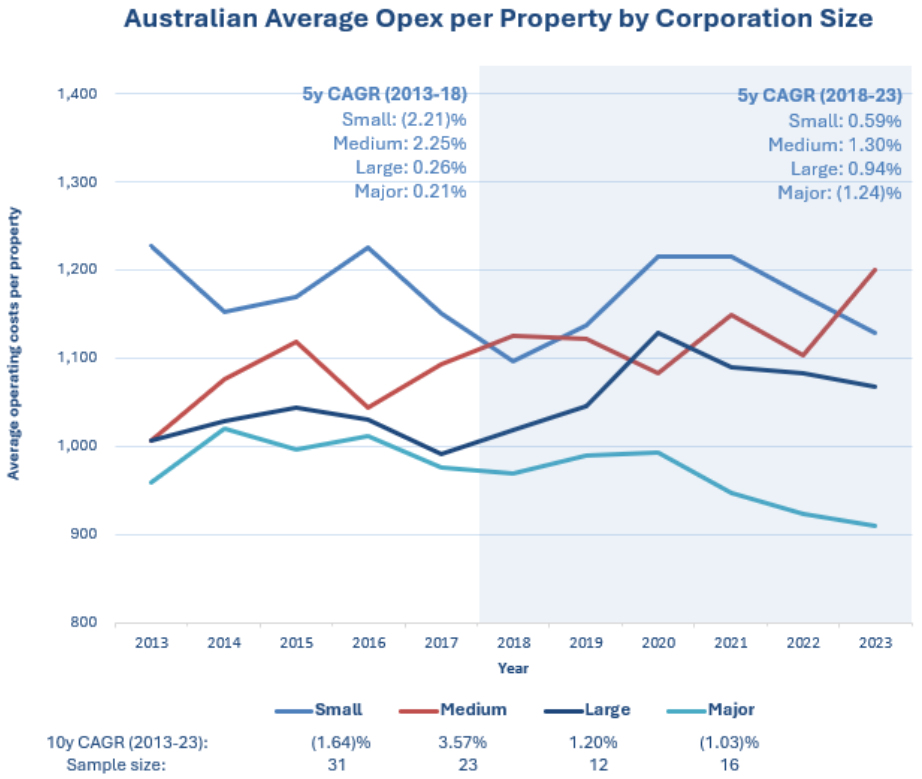
Major utilities (100,000 plus connections) consistently demonstrate the lowest operating costs per property (around $900–1,000) likely partly due to economies of scale as well as higher density.

## 10-year horizon highlights benefit of scale

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

## Dataset highlights variability over time

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




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

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

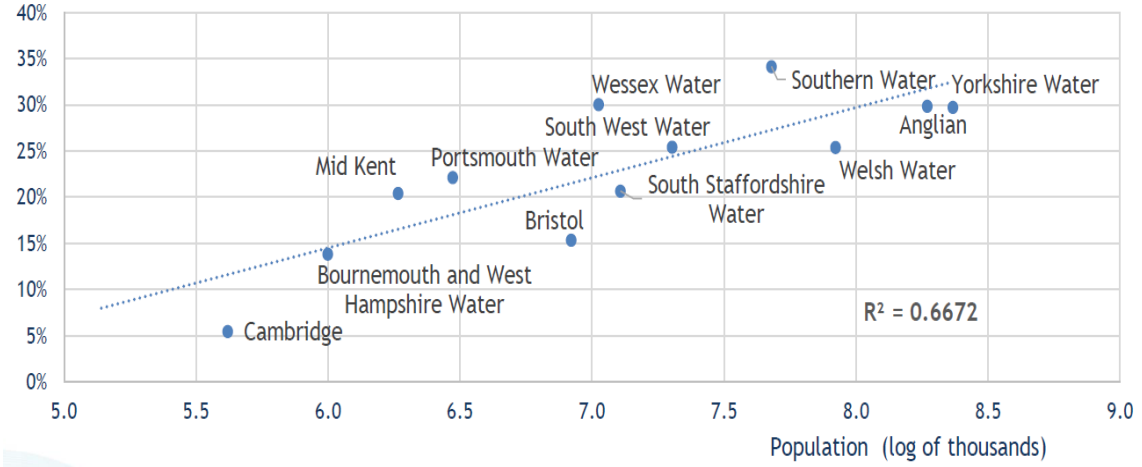
# WICS compared efficiency for different scale UK water utilities following corporatisation, and used this to inform estimates for NZ councils

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

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

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

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




| Council Area | LGNZ classification | Population served (thous) | Log of population | Assessed catch-up based on observed experience |
|---|---|---|---|---|
| Auckland | Metro | 1,758 | 7.47 | 100% |
| Christchurch | Metro | 385 | 5.95 | 55.1% |
| Wellington City | Metro | 223 | 5.41 | 38.9% |
| Hamilton | Metro | 162 | 5.09 | 29.6% |
| Tauranga | Metro | 143 | 4.97 | 25.9% |
| Dunedin | Metro | 121 | 4.80 | 21.0% |
| Palmerston North | Metro | 89 | 4.49 | 11.8% |
| New Plymouth | Provincial | 64 | 4.16 | 2.0% |
| Hastings | Provincial | 64 | 4.15 | 1.9% |
| Upper Hutt | Metro | 63 | 4.14 | 1.6% |
| Rotorua Lakes | Provincial | 62 | 4.13 | 1.3% |
| All other Councils | | <60 | 4.1 | 0% |

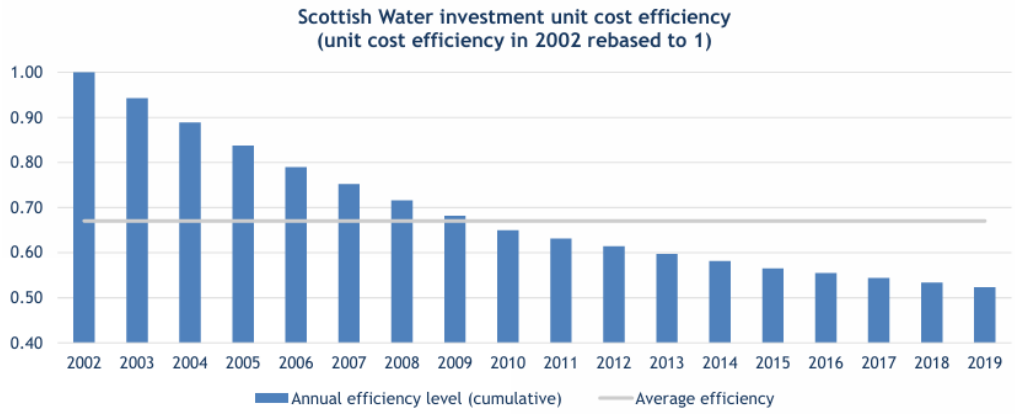
*Source: Water Industry Commission for Scotland*

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

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

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

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




*Source: Water Industry Commission for Scotland*

***FarrierSwier in reviewing the WICS approach noted that:***

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

***As such we believe it is prudent to use a significantly more conservative capital efficiency assumption (relative to WICS) and vary this less with increasing scale.***

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