



Te Tari Taiwhenua
Internal Affairs

Clutha Rural Water

Summary Report

JANUARY 2023

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MorrisonLow

From the Steering Committee

Rural water supply schemes are critical to the livelihood and wellbeing of Clutha residents. Their future ownership is an important issue for the community. In recognition of this farmers, Clutha District Council and Department of Internal Affairs representatives agreed to work collaboratively to objectively assess the costs, benefits, and risks of user versus Water Services Entity ownership of the schemes.

Independent consultants Morrison Low were commissioned to undertake this assessment. Their work was overseen by a joint farmer, Council and DIA steering committee and their assessment and the following report accepted by this steering committee.

The report's purpose is to provide objective and jointly agreed information on the pros, cons and risks of community versus Water Services Entity ownership of the Clutha District rural schemes. The report does not, and was never intended to, give a recommendation as to the preferred ownership option.

It is expected that farmers and scheme users will use the information in the report together with future information on how water services entities will operate and charge for their services to decide on whether to seek direct ownership of the schemes under a legislative provision provided for by government in the Water Services Legislation Bill. This will occur after the legislation has been enacted and when more information is available on how Entity D will operate and charge for water services. This is expected to be later in 2023. To this end Water Scheme chairs will continue to work together and will liaise with scheme users.

Government will use the information to fine-tune the approach to providing for users of mixed-use rural schemes to seek direct ownership. This mechanism is currently provided for in Part 8 of the Water Services Legislation Bill. Government will also use the information to inform decisions on how Water Services Entities will be expected to involve farmers in decisions on their management and operation of mixed-use rural water supply schemes.

It is also anticipated that the report and the approach to assessing the costs, benefits and risks of community versus Water Services Entity ownership of mixed-use rural schemes will be of interest to farmers and councils in other parts of New Zealand.

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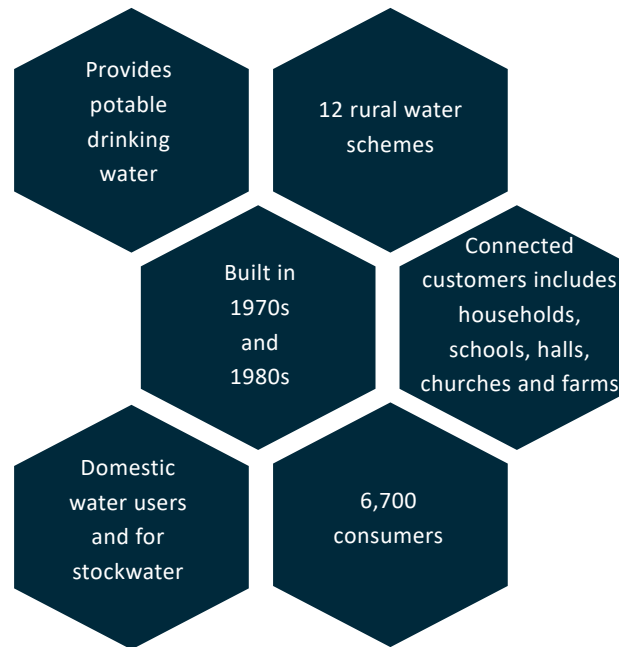
Introduction and strategic context

The three waters reform will see responsibility for council owned drinking water services, including all assets and rural mixed used schemes transferred to one of four newly established Water Services Entities. In Clutha District, this will mean a transfer to “Entity D”. This covers the geographic area of Ngāi Tahu’s takiwā. Clutha has 12 rural water schemes which provide drinking water for domestic consumption and water for stock.

These rural water schemes were mostly established as stock water schemes in the 1970s and 1980s with support from Government funding. Each scheme is represented by a rural water scheme committee that makes recommendations to Council on the operations/ governance and management of their scheme. Over time the schemes have expanded to provide drinking water to households, townships, and community facilities including halls, schools and churches. The rural water schemes provide potable drinking water to approximately 6,700 consumers.

Three waters reform has significantly changed the operating environment for drinking water suppliers. The establishment of Taumata Arowai to administer new water services regulation is resulting in a firmer and more consistent approach to water services regulation with new requirements on providers to demonstrate compliance with standards. The establishment of Water Services Entities will replace the roles of councils in the operation of rural mixed use schemes and economic regulation of water services entities will result in improved protections to consumers. Over time, the effects of climate change and changes to water standards and other environmental regulatory requirements will likely result in further challenges to the operators of rural water schemes.

Figure 1: Key facts on Clutha’s rural water schemes





Rural water schemes will be able transfer to community ownership where more than 85% of the water is for stock water and where 75% of the customers (eligible votes) support that transfer. Otherwise, the rural water schemes will remain with Entity D. There is no other option. The rural water schemes cannot simply stop providing drinking water and become stock water schemes. It is not technically feasible to split the water networks as the systems are integrated.

Initial estimates of water use across the different schemes indicate that most schemes are likely to meet the 85% threshold, however for some schemes this will depend on how water supplies to townships are addressed in the transfer proposals.

The transfer of the rural water schemes to Entity D or to community ownership represents significant change from the current approach.

This summary report provides a snapshot of key issues, risks and benefits of the two options.

Limitations

There were various limitations with undertaking the options assessment. The key limitations are:

- The report is a point-in-time assessment using the information available at the time of writing and assessments are based on currently proposed legislation at the time of writing.
- At the time of writing, specific details regarding the operating practices, funding and pricing approach, and investment plans for Entity D were not known (draft funding and pricing plans are anticipated to be released in June/ July 2023).
- The assessment has been developed to support transparent decision making and does not make recommendations on a preferred ownership model.

Summary of the two ownership options

This section outlines the advantages and disadvantages of the two ownership options:

- Community ownership
- Entity D ownership.

In conclusion, both potential ownership models did not sufficiently address all the assessment criteria without the introduction of specific remedies to address concerns.

Community ownership

Rural water scheme customers know their land, their water networks, and often have local knowledge that can be valuable for decision makers who may be planning investments in their networks. In the past, this local knowledge has been considered essential in ensuring that the right solutions are adopted, particularly where this has related to the scheme performance (such as impacts on pressure and capacity constraints) or where a local understanding of the geography of the area is important (such as finding water leaks in rural areas).

Customers of the schemes have a connection with the schemes that is very different to customers of urban water supplies. The current system provides a high level of influence and control by the rural water customers of the schemes through the scheme committees. We understand that there is support for maintaining a similar level of influence and control of the schemes through community ownership if that is a viable option.



In our view community ownership at an individual scheme level would be challenging for most of the schemes within the Clutha District. In particular, the lack of scale and limited financial resources if considered on a scheme by scheme basis may result in schemes struggling to attract suitably qualified and experienced treatment plant operators, adopting sound asset management approaches and having the systems and processes required to comply and demonstrate compliance to the level required with the new environmental, regulatory and cultural standards. It is a complex operating environment and the requirements are likely to get increasingly complex. These challenges remain if the schemes were combined but while the increase in scale provides some opportunities to better meet the requirements, it will not be to a level that could be expected to provide organisational or operational efficiencies.

The obligations to comply with the environmental and regulatory requirements of providing drinking water and penalties for non-compliance will exist for both staff and the directors of a community owned scheme. The benefits and risks of the community ownership model are as shown:



Benefit

- ✓ Utilises local knowledge
- ✓ Enhanced local control
- ✓ Clear and accountable levels of service for the agricultural water users



Risk

- ✗ Challenges in accessing debt and an increased cost of debt
- ✗ Exposes staff and Directors of Community Owned schemes to legal and personal risks
- ✗ Operational challenges difficult to meet at this scale
- ✗ Exposed to future price risks due to small customer base



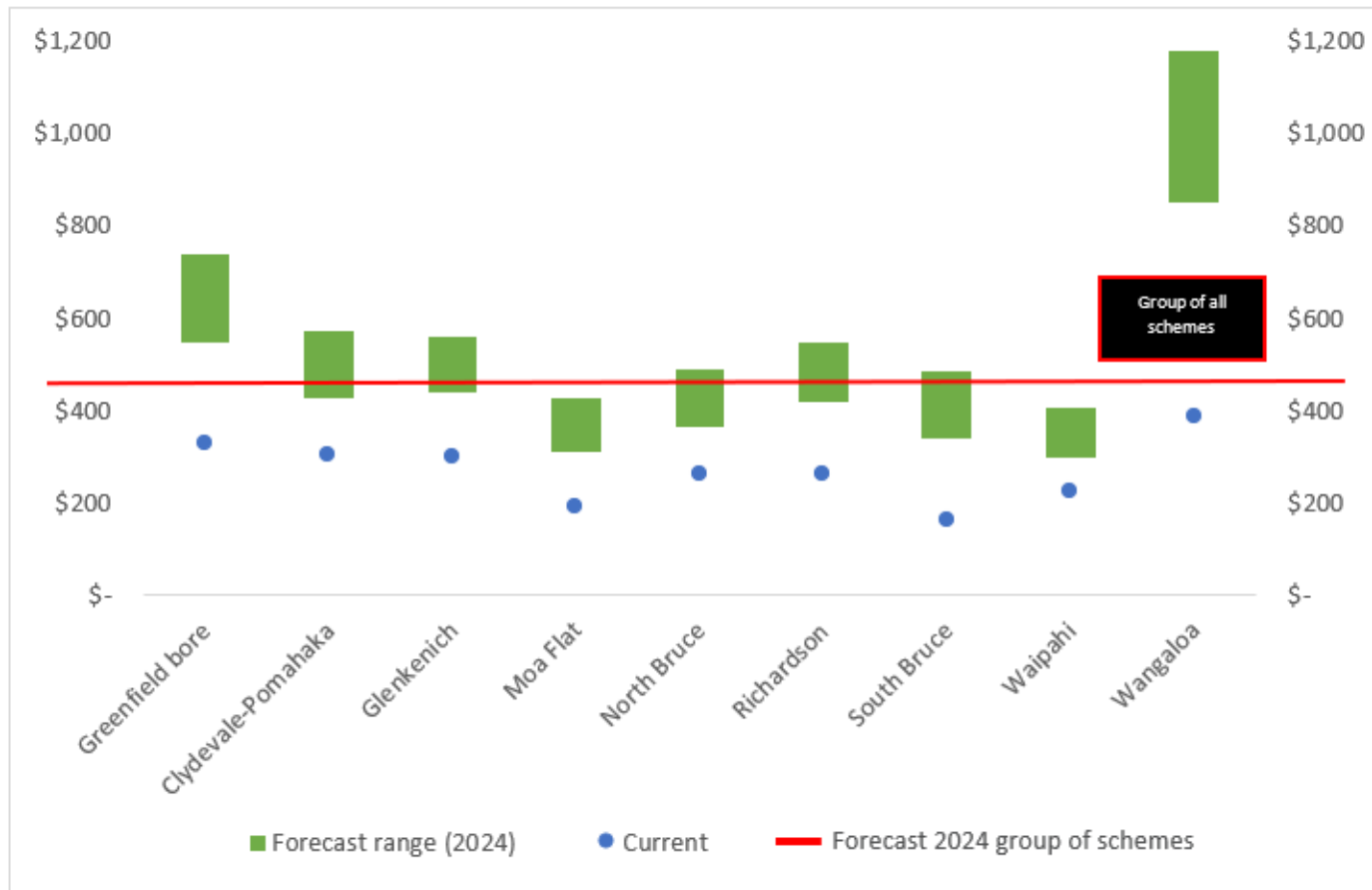
A community owned scheme does not have the same standing as Council or a Water Services Entity. It would not automatically have access to the same legislative powers to operate. For example, a community owned scheme has no power of entry to land and would have to make agreements with every customer and in some case landowners who are not connected water customers. All of the typical types of controls or powers will have to be set out in customer contracts. These challenges are not insurmountable and there are examples in New Zealand, but they add to the challenge of operating at a small scale.

Issues relating to affordability and access to the debt or capital necessary to fund future infrastructure investment are fundamental to the viability of community owned schemes. These are:

- Our analysis shows that under a community ownership, options are largely driven by the cost of debt, depreciation and overheads. In our view these will make the community ownership model more expensive than current charges. For example, Council can access debt at a lower cost (as will Entity D) and both Council and Entity D are able to spread overhead costs over more users. The level of debt that transfers under the community ownership option has a significant impact on the initial unit rates. **The transfer of debt is a major issue with the community ownership model.**
- In some schemes, the level of debt required to transfer would, in our view, be challenging for a community ownership option to obtain. This is due to differences in structure (public water utility versus a private company) as well as the size of its community owned business and its customer base.
- There are currently no exemptions from income tax that are likely to apply to community owned water schemes. Similar schemes in other areas of NZ are subject to income tax. Income tax may be an impediment to the schemes being able to accumulate asset replacement reserves (as a surplus would be taxable), an additional cost that would have to pass onto consumers or both. This would increase the costs beyond what is forecast in this report.

Figure 2 below compares the estimated change in costs if the schemes are transferred to community ownership. While there is no comparator with estimated costs for Entity D at this stage, a transfer to community ownership is **forecast to result in increased costs for all schemes individually or collectively.**

Figure 2: Comparison of current and forecast unit rates (\$ per daily m³ allowance) as at December 2022



Entity D ownership

A transfer of the rural water schemes to Entity D as part of the wider reforms also sees a transfer of responsibility for meeting all regulatory requirements to Entity D. Collectively, they are a significant responsibility. Central to the three waters reform has been the creation of organisations considered large enough to give them the scale required to manage the risks of providing drinking water, wastewater and stormwater services to the new standards that will be required.

The capability and capacity within Entity D to plan, deliver and manage investment in networks as well as financial capacity to invest in the systems, processes and the people required to satisfy operational needs and meet compliance requirements comes from the scale of the organisation and the size of its customer base. The advantages and disadvantages of the Entity D ownership model are as shown:



- ✓ Scale provides capability and capacity through systems, processes and resources and improved access to capital
- ✓ Management of risk transfers to Entity D
- ✓ Ability to better respond to natural hazard risk, including access to Government contributions
- ✓ Subject to full economic regulation and consumer protections to ensure efficient operation



- ✗ Loss of involvement and influence
- ✗ Concern that the economic use is not given appropriate priority during events impacting supply
- ✗ Uncertainty over future price
- ✗ No accountability for providing sound service levels for the agricultural water users



However it is also the scale of Entity D that creates the risk or issues for the rural water scheme customers, in particularly the agricultural water users. The most significant issues for rural scheme customers under the Entity D ownership option arise from the loss of influence and control that currently exists. In particular through:

- Uncertainty over the future role for rural water scheme committees and the voice of the agricultural customers that represents
- Risk that the importance of security of water supply for providing drinking water for stock and other farming purposes (which currently represents 95% of the water) could be overlooked in an organisation that provides three waters services across the Ngāi Tahu takiwā to over 1,000,000 predominantly urban water customers; and
- Concern that the current transparent relationship between costs of particular schemes and the price paid by those users would be lost through a different approach to the tariff structure including pricing.



Conclusion

Ultimately each scheme or the schemes collectively will need to determine whether the potential risks involved in taking on community ownership of the rural water scheme, and the requirement to comply with the requirements of being a drinking water supplier are outweighed by the benefits of influence and control that community ownership brings.

At this stage in the process there is still time for Clutha District Council, Department of Internal Affairs and the rural water schemes to work together to address the challenges with either option that were highlighted in this review. A summary of those steps and an indicative timeline are set out on the next pages¹.

¹ For more information, including the full report visit <https://bit.ly/3XA14vL> or <https://bit.ly/3kgcWod>



Next steps

Joint actions:

- Negotiation and confirmation of key issues and clauses, including:
 - The value of debt to be inherited by community owned schemes
 - The payment terms and transfer arrangements applying to that debt
 - The specific provisions relating to consumer protections that are required to be included in a community ownership model
 - Agreement around any operational arrangements for Water Services Entities to preserve the role of the rural water scheme committees and security of supply for water used for farming purposes.
- Development of an agreed approach to potential referendums, particularly where community ownership is only being pursued where there is a combination of schemes.
- Agreement around the treatment of urban settlements that currently receive bulk drinking water from rural water schemes.

Department of Internal Affairs / National Transition Unit actions:

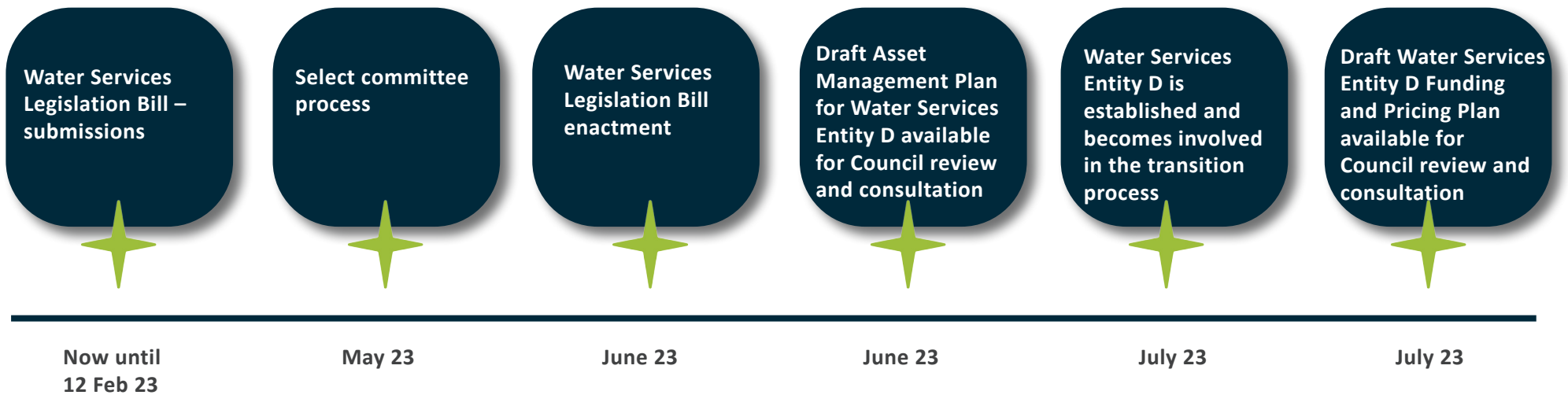
- Determination of potential rural water price paths for the Water Services Entities.
- Collaborating with rural water scheme customers to find and agree on a workable solution.
- Amendment of proposed legislation to provide greater influence from rural water scheme customers on decision making matters.

Rural scheme committee actions:

- The development of a day one operating structure for private community owned water schemes, including the legal form of the entity, shareholding arrangements, and provisions to ensure retention of community ownership.
- The development of key communication points and consultation plans to get community feedback on the ownership options available for each scheme.



Indicative timeline



Notes:

1. Dates from June 2023 onwards are indicative only and subject to change.
2. It is unlikely that the Constitution (and therefore the Boards) will be in place at the time of establishment of WSE D. Such matters will be addressed in due course.



Document status					
Job #	Version	Written	Reviewed	Approved	Report Date
2756	DRAFT SUMMARY	D Bonifant	C. Anich	C. Anich	January 23
2756	SUMMARY FINAL	D Bonifant	C.Anich	C.Anich	January 23

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