



Three Waters Workshop

Part 2 – Financial Analyses

Castalia Evaluation

31 August 2021

Background

The Water Industry Commission of Scotland (WICS) was contracted by the Department of Internal Affairs to evaluate the Request For Information (RFI) data collected from Council in 2020 and 2021.

The data included the completed Annual Report 2019-2020 and Long Term Plan 2021-2031 financial information. It described each District, its ratepayer base and the District's Three Water Services, Operations and Infrastructure. It provided all the financial information needed to evaluate the financial viability of the enterprise. The Long Term Plan infrastructure investment strategy was explained including how it is to be funded.

The data was modelled for each Council as well as for each of the proposed multi-regional Entities by WICS in order to derive a cost per household value for each Council with and without reform.

WICS calculated a 50% decrease in projected costs for Kawerau District Council and up to 80% decrease for other Councils. When the modelling assumptions were eventually released, significant discrepancies were noted.

Kawerau District Council was advised to have the WICS modelling and its impact reviewed by an independent external consultant. Kawerau District Council appointed Castalia Advisors to perform this task.

Castalia Advisors

Castalia is a global strategic advisory firm headquartered in New Zealand with offices in Wellington, Auckland, Sydney, Paris, Bogota and Washington, DC.

Castalia has a global team of specialists skilled in infrastructure, economics, finance and law and environmental studies.

Castalia has a 40-year history as the world's preeminent advisors on reform in the water sector. Castalia is expert in the major institutional structures for water (French, British and US). Castalia has worked on 354 projects in 124 countries helping to raise US\$11 billion of finance.

In New Zealand, Castalia has advised a range of local authorities and Watercare Services Limited on the implications of the government's proposed Three Waters Reforms. Castalia led advice in 2020 to Local Government New Zealand (LGNZ) and the Three Waters Steering Committee on institutional options for reform and the existence of economies of scale in the water sector.

Castalia has previously also advised Department of Internal Affairs on water sector performance.



Evaluation Report

The Castalia Evaluation Report is attached for your information.

The evaluation utilised the submitted Request for Information data submitted to Department of Internal Affairs in February 2021.

This is not the latest data as submitted in the Long Term Plan 2021-2031. However the purpose of this evaluation was to assess the Opt In / Opt Out options and their impact on Kawerau District Council and its ratepayers. Therefore, it was decided to use a consistent set of data to ensure we do not compare apples with oranges.

The differences between original Request For Information (RFI) and Long Term Plan data did not affect the evaluation as it focused on the methodology, underlying assumptions and applicability.

The Evaluation Report focuses on Kawerau District. However, it also discusses the Entity modeling and will therefore be applicable to other Councils in New Zealand.

Senior staff have collaborated closely with neighbouring Councils' staff and this will continue to ensure the best outcome of Reform.

The Evaluation

The evaluation was requested to address two fundamental questions:

1. **Will the Kawerau Council District and Residents be better off under Reform?**
2. Are there significant risks to Council should Council decide to Opt out

In order to answer question 1, the realistic benefits of Reform needed to be assessed and that required a detailed analyses of the Water Industry Commission of Scotland (WICS) modelling assumptions and methods. WICS did not release the actual modelling and calculations and this had to be done from first principles. Castalia was unable to replicate WICS results from available information.

The assumptions made were evaluated and found to be implausible, not applicable to New Zealand or not reasonable. Notable exceptions were applied without sufficient justification.

Furthermore, it was found that the stated assumptions in presentations were not used in the actual modelling (e.g. 45% claimed CAPEX (Capital Expenditure) efficiency vs 50% used). Similarly, different assumptions were used for the Council evaluations than for the Entities (e.g. 2.5 times borrowing limit for Council and 5.8 times borrowing limit for Entities).

These significant issues rendered the WICS evaluation valueless to determine whether Council will be better off under Reform in the view of the report writer.

The Evaluation

The evaluation was requested to address two fundamental questions:

1. Will the Kawerau Council District and Residents be better off under Reform?
- 2. Are there significant risks to Council should Council decide to Opt out**

In order to answer question 2, the realistic risks under both Opt Out and Opt In need to be considered.

The Opt Out risks are the risks Council currently have which may increase when the new Regulator, Taumata Arowai is introduced later this year. The specific issues that Council may face are discussed in the report and are not significant in the view of the report writer.

The evaluation then proceeds to address the new and additional risks that Kawerau District Council and ratepayers (and/or residents?) will face under the currently proposed Reform. Some of these risks are significant in the view of the report writer.

These risks need to be carefully considered when community consultation starts.

Other Evaluations

Castalia was one of the first consultancies requested to peer review the Water Industry Commission of Scotland (WICS) assessment of New Zealand Three Waters in 2019 by both the Department of Internal Affairs and Local Government New Zealand. Similar concerns were raised in those early reviews. However, those reports were not released until July 2020 after mounting pressure from Mayors of several District Councils.

The Department of Internal Affairs ordered several other consultancies to peer review the WICS assessment after the initial Castalia review, however each with a different scope. These reviews have been presented to suggest that the Castalia reports are no longer applicable or have ‘limited use’. Parts of the reports were recognised as ‘useful to assess, test, challenge and strengthen’ the WICS modeling and DIA’s use of it. However, there is no evidence that any changes were made in response to the original Castalia reports.

These core issues have not been addressed and have not been raised by LGNZ or consultants hired to support Councils during the Reform preparation process.

LGNZ maintains that the original Castalia reports are no longer applicable since it was performed on “Stage 1 WICS modeling” and “old 2018 Long Term Plan data”.

It is therefore interesting to note, that a further, more recently completed Castalia evaluation raises the same issues (along with several new ones).

Other Evaluations

In formal responses by the Minister of Local Government and LGNZ, it was implied that the WICS modeling had been reviewed and accepted by other consultants, notably FarrierSwier (to assess if the methodology and assumptions are reasonable) and Beca (the applicability of UK and Scottish experience to NZ). However the reports state the following:

FarrierSwier: “. . . we cannot provide an opinion on whether the forecasts and estimates generated by WICS by applying its methodology and assumptions are reasonable. Given this, we have focused our review on whether the modelling is likely to give estimates that are appropriately either positive or negative (i.e. direction) and are at an appropriate scale (i.e. order of magnitude).”

BECA: “On balance, the predictions from WICS modelling may well underestimate the necessary investment costs and could give overly optimistic timeframes for implementation due to supply chain limitations in New Zealand, and the pressures of managing and delivering improvement and asset renewal backlogs simultaneously.”

Therefore, both evaluations do not approve the WICS modelling to the extent claimed by both Central Government and LGNZ.

Other reviews by Deloitte and Standard & Poor listed by LGNZ does not deal with WICS modeling nor the concerns raised by Castalia but rather the economic impacts after Reform under the assumption that WICS modelling is correct and the Entities will perform as promised.

Other Evaluations

More evaluations and reviews are being performed by other Councils in Entity B.

As these evaluations and reviews become publicly available, they will be considered by Kawerau District Council staff for the purpose of building a complete picture and ensure better outcomes for the reform process.

Discussion

Please read the attached Castalia Report "Advice on Water Reform Opt Out".

The report was presented on Tuesday 31 August after the August monthly Council Meeting when all questions and comments can be shared and discussed.

At this workshop, Council agreed to commence gathering feedback earlier than planned from Kawerau ratepayers and residents. The aim is to gather all questions, concerns and issues raised by the community and submit this feedback into the report Council will submit to Central Government at the end of September 2021.

The principle of the Three Waters Reform information process will ensure that all evaluations about the Kawerau District will be shared first with ratepayers and residents.

This ensures that ratepayers and residents have the opportunity to become fully informed of the evaluations completed by Council which are available on the Council website kawerudc.govt.nz

Further information is available from the Department of Internal Affairs dia.govt.nz and Local Government New Zealand lgnz.co.nz/reforms/three-waters/