

# Local Water Done Well

## Analysis of water services delivery options to demonstrate the financing efficiency of a regional water CCO

17 January 2025

*This document has been prepared to provide information to Horowhenua District Council, Kapiti Coast District Council, Manawatu District Council, and Palmerston North City Council on the financial sustainability requirements of water services provision, and to demonstrate the financing efficiency of a regional water CCO.*

*The Department of Internal Affairs has relied on information provided by councils in the development of the analysis and guidance included in this report, including publicly available information from long-term plans and other council accountability documents.*

*This guidance is not legal advice; and is intended to support council decision-making requirements under Local Water Done Well.*

# Request for analysis from the Department

- Officials from the Department met with officers from Horowhenua District Council, Kapiti Coast District Council, Manawatu District Council, and Palmerston North City Council on 18 December 2024, to discuss reports developed for these councils on Local Water Done Well options, prepared by Morrison Low.
- In this discussion, council officers requested the Department to provide guidance and analysis on how a regional water CCO might provide a more effective financing vehicle for water services delivery – compared to individual council delivery of water services – and how this could consequently result in lower charges to consumers against other financially sustainable delivery models.
- In this report, we provide further guidance on Local Water Done Well to complement councils' current advice and understanding. This report sets out:
  - High level analysis on a hypothetical joint water CCO consisting of the councils' water services.
  - High level analysis on each council's water services, to demonstrate the difference in average projected charges for consumers between:
    - 2024-34 long-term plan projections;
    - 2024-34 long-term plan projections, modified to meet the financial sustainability requirements for Water Services Delivery Plans; and
    - 2024-34 long-term plan projections; modified to demonstrate lower revenue requirements for a regional CCO, whilst meeting the financial sustainability requirements for a Joint Water Services Delivery Plan.
  - Benefits that accrue to owning councils who establish a water CCO, through increased borrowing headroom.
- Annex 1 sets out further guidance on:
  - Financial sustainability requirements under Local Water Done Well;
  - Guidance issued to councils by the New Zealand Local Government Funding Agency on lending requirements for water CCOs;
  - A description of the 'FFO to debt' measure and why it is critical to the financial sustainability of water services provision; and
  - Assumptions and limitations of analysis completed in this guidance.

# Key insights on a potential regional Water CCO

- Each council would benefit from the establishment of regional Water CCO:
  - **Horowhenua District Council (HDC)** - Establishing a regional Water CCO would enable water services charges for consumers to reduce by approximately 16% against LTP projections over ten years. The separation of water services into a Water CCO (whether that be a regional CCO or an HDC owned CCO) would create approximately \$40 million of new borrowing headroom for HDC's non-water services, due to water services being more highly leveraged than non-water services.
  - **Kapiti Coast District Council (KCDC)** - Establishing a regional Water CCO would not materially impact the projected charges and revenues needed to be financially sustainable against in-house delivery. Separating water services into a Water CCO (whether that be a regional CCO or an KCDC owned CCO) would create approximately \$100 million of new borrowing headroom for KCDC's non-water services initially (increasing to \$188m by FY33/34), due to water services being more highly leveraged than non-water services.
  - **Manawatu District Council (MDC)** - Establishing a regional Water CCO would not materially impact the projected charges and revenues needed to be financially sustainable against in-house delivery. Separating water services into a Water CCO (whether that be a regional CCO or an MDC owned CCO) would create approximately \$40 million of new borrowing headroom for MDC's non-water services initially (increasing to \$95m by FY33/34). This would effectively mean MDC has no net debt from FY31/32 at LTP projected revenues.
  - **Palmerston North City Council (PNCC)** - Establishing a regional Water CCO would enable water services charges for PNCC consumers to reduce by approximately 8% against LTP projections over ten years. The separation of water services into a Water CCO (whether that be a regional CCO or an PNCC owned CCO) would create approximately \$40 million of new borrowing headroom for PNCC's non-water services initially (increasing to \$74m by FY33/34).
- Each council has different investment requirements and costs of service. Our analysis retains regional differences as this ensures that prices that different communities pay (as modelled) would reflect the direct costs of service to each community. It is important to note that there is **no requirement to harmonise prices across communities under Local Water Done Well**.
- This analysis demonstrates that **a more affordable price path for water charges could be realised for individual councils**, than equivalent charges for financially sustainable operations delivered by individual councils.
- The additional borrowing headroom that can be accessed by establishing a Water CCO would create additional flexibility to efficiently deliver water services to communities.
- Establishing **a regional Water CCO will deliver significant financial benefits to all owning councils**, through the establishment of new borrowing headroom, due to water services being higher leveraged than other council activities. Significant financial benefits of establishing a Water CCO accrue to owning councils themselves.
- The benefits for each council, when compared to status quo delivery, vary by council based on the initial starting point, projected investment requirements and costs of service. Each council should consider **trade-offs between levels of water services revenues, investment and debt financing to realise the full benefits of Local Water Done Well**.

# Analysis completed on service delivery options

## Scenarios

- For each council we have developed three scenarios:
  - 2024-34 LTP financial information for water services under status quo arrangements;
  - Amending LTP financial information for water services to ensure that revenue and financing requirements are set to the assumed minimum 'FFO to debt' ratio requirement for the individual council; and
  - Amending LTP financial information for water services to represent the council's 'share' of a regional Water CCO, with a lower 'FFO to debt' ratio requirement of 8%.
- Our analysis does not assume any harmonisation of prices across the four councils under a regional Water CCO. Instead, regional differences are retained as this ensures that prices that different communities pay reflect the direct costs of service to each community.

### Horowhenua District Council (HDC)

HDC's 2024-34 LTP shows water charges increasing by approximately 148% per connection over ten years.

Water services net debt peaks in FY24/25 (at a net debt to revenue of 438%), with projected revenue increases used to fund capital investment and pay down debt (with debt to revenue decreasing to 247% in FY33/34).

At an all-council level, HDC's debt to revenue peaks at approximately 254% in FY25/26 (against a limit of 280%), reducing to 200% by FY33/34.

There are no material financial sustainability issues for water services in HDC's LTP; however the projected revenue increases required in LTP require material increases in charges for consumers over ten years.

#### Scenarios run:

- 2024-34 LTP projections;
- 2024-34 LTP projections, modified to reduce projected revenue increases to maintain FFO to debt of 11%;
- 2024-34 LTP projections, modified to maintain FFO to debt of 8% in a regional Water CCO.

#### Benefits of a regional Water CCO

Establishing a regional Water CCO would enable water services charges for HDC consumers to reduce by approximately 16% against LTP projections over ten years.

The separation of water services into a Water CCO (whether that be a regional CCO or an HDC owned CCO) would create approximately \$40 million of new borrowing headroom for HDC's non-water services, due to water services being more highly leveraged than non-water services.

### Manawatu District Council (MDC)

MDC's 2024-34 LTP shows water charges increasing by approximately 56% per connection over ten years.

Water services net debt peaks in FY28/29 (at a net debt to revenue of 487%), with projected revenue increases enabling debt to revenue to reduce to 422% in FY33/34.

At an all-council level, MDC's debt to revenue peaks at approximately 166% in FY25/26 (against a limit of 175%), reducing to 75% by FY33/34.

There are no material financial sustainability issues for water services in MDC's LTP; however MDC would benefit from significant additional borrowing headroom from separating water services into a CCO structure.

#### Scenarios run:

- 2024-34 LTP projections;
- 2024-34 LTP projections, modified to reduce projected revenue increases to maintain FFO to debt of 12%;
- 2024-34 LTP projections, modified to maintain FFO to debt of 8% in a regional Water CCO.

#### Benefits of a regional Water CCO

Establishing a regional Water CCO would not materially impact the projected charges and revenues needed to be financially sustainable against in-house delivery.

Separating water services into a Water CCO (whether that be a regional CCO or an MDC owned CCO) would create approximately \$40 million of new borrowing headroom for MDC's non-water services initially (increasing to \$95m by FY33/34). This would effectively mean MDC has no net debt from FY31/32 at LTP projected revenues.

### Kapiti Coast District Council (KCDC)

KCDC's 2024-34 LTP shows water charges increasing by approximately 116% per connection over ten years.

Water services net debt peaks in FY24/25 (at a net debt to revenue of 581%), with projected revenue increases enabling debt to revenue to reduce to 464% in FY33/34.

At an all-council level, KCDC's debt to revenue peaks at approximately 210% in FY25/26 (against a limit of 280%), reducing to 118% by FY33/34.

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### Palmerston North City Council (PNCC)

PNCC's 2024-34 LTP shows water charges increasing by approximately 146% per connection over ten years. This increase excludes the impact of levies to be charged to households for IFF funded infrastructure.

Water services net debt peaks in FY29/30 (net debt to revenue of 395%), with projected revenue increases enabling debt to revenue to reduce to 270% in FY33/34.

At an all-council level, PNCC's debt to revenue peaks at approximately 230% in FY27/28 (against a limit of 280%), reducing to 178% by FY33/34.

Financial sustainability considerations: IFF funding for the WWTP project is required to be able to deliver the necessary investment set out in the 2024-34 LTP. Projected revenue increases required in LTP lead to material increases in charges for consumers over ten years.

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#### Benefits of a regional Water CCO

Establishing a regional Water CCO would enable water services charges for PNCC consumers to reduce by approximately 8% against LTP projections over ten years.

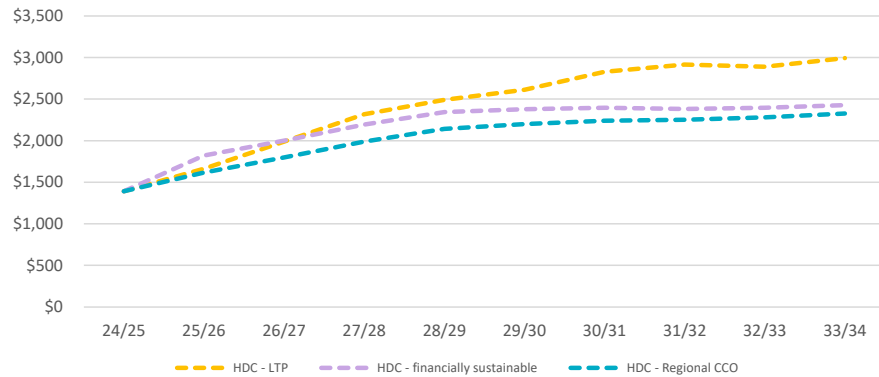
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# A regional Water CCO would deliver lower charges to consumers than financially sustainable water services delivered by councils individually

The following charts set out projected average costs per connection under the three scenarios for each council. Further detail on the impact of each council is set out on the following slides.

## Horowhenua District Council (HDC)

Average water services bill per connection (ex GST)

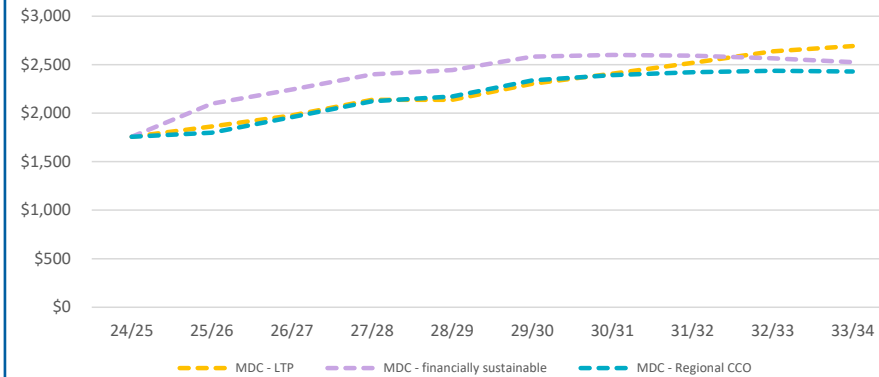


Average charges in the LTP are higher than the minimum requirement for financial sustainability.

Under a regional Water CCO, projected charges to consumers would be significantly lower than LTP.

## Manawatu District Council (MDC)

Average water services bill per connection (ex GST)

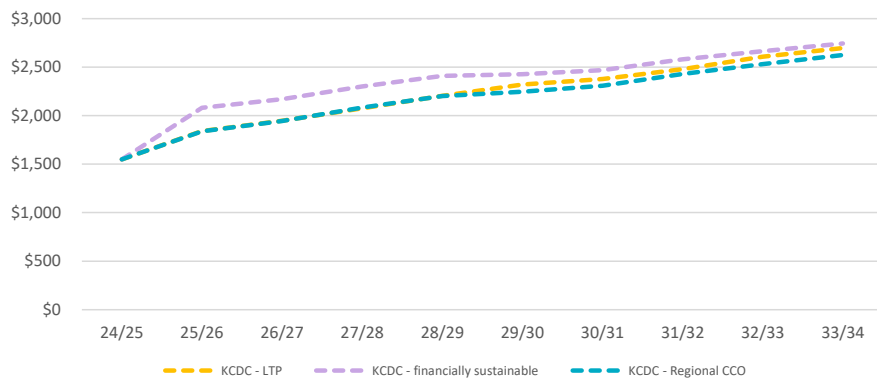


Average charges in the LTP are lower than what is required to meet an assumed minimum FFO of 12% for in-house or a single council owned CCO.

Under a regional Water CCO, projected charges to consumers would be in line with LTP, while being more financially sustainable.

## Kapiti Coast District Council (KCDC)

Average water services bill per connection (ex GST)

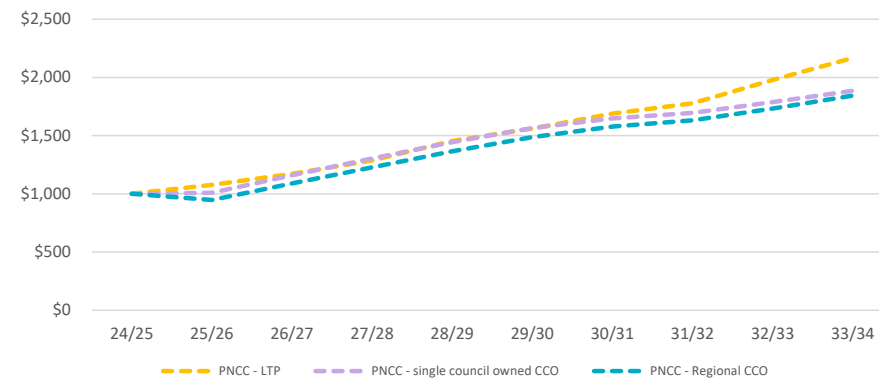


Average charges in the LTP are lower than what is required to meet an assumed minimum FFO of 11% for in-house or a single council owned CCO.

Under a regional Water CCO, projected charges to consumers would be in line with LTP, while being more financially sustainable.

## Palmerston North City Council (PNCC)

Average water services bill per connection (ex GST)



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Under a regional Water CCO, projected charges to consumers would be lower than LTP.

These charges exclude any levies for IFF funded infrastructure.

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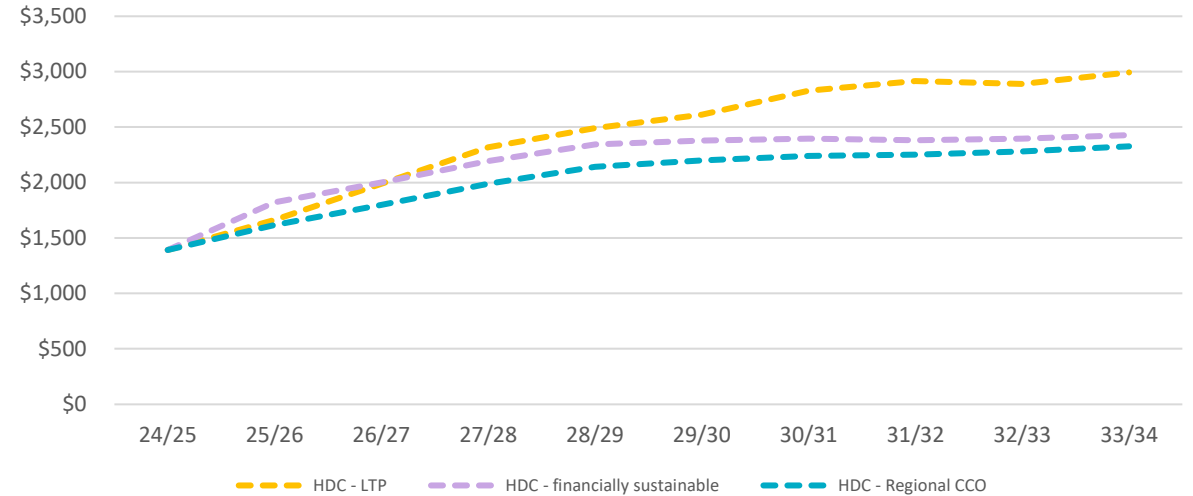
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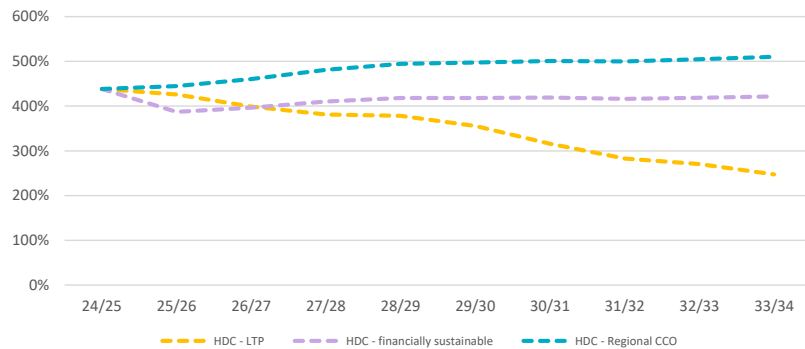
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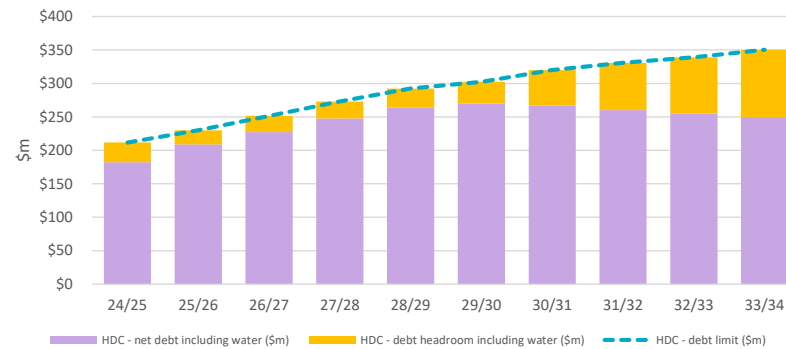
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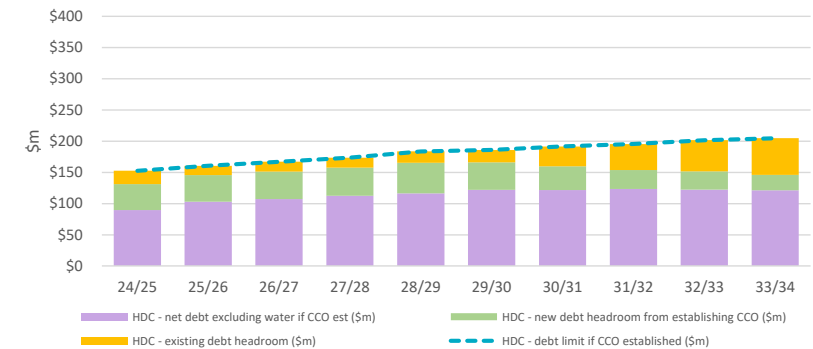
Water net debt to operating revenue



Council net debt including water



Council net debt excluding water if CCO established



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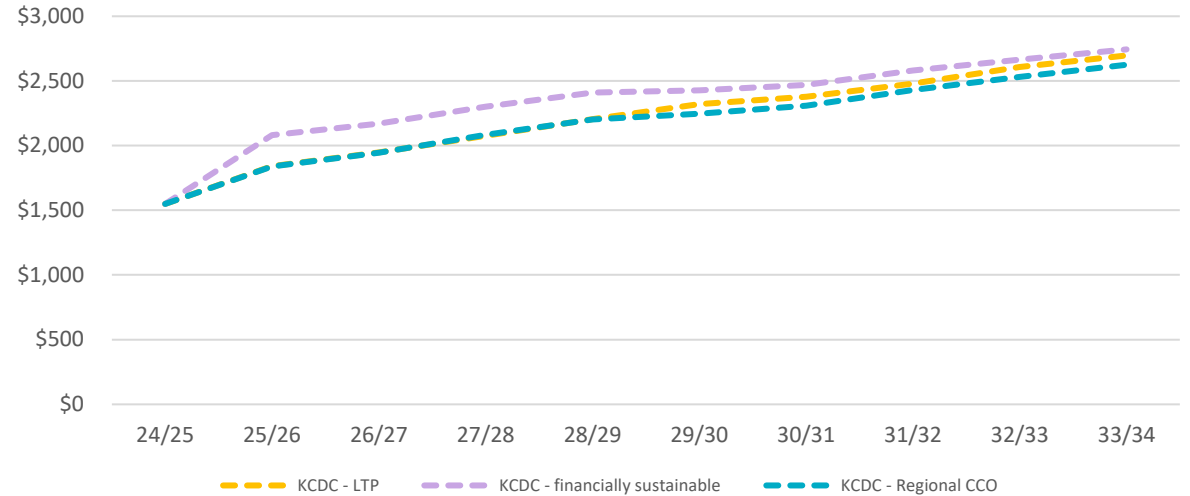
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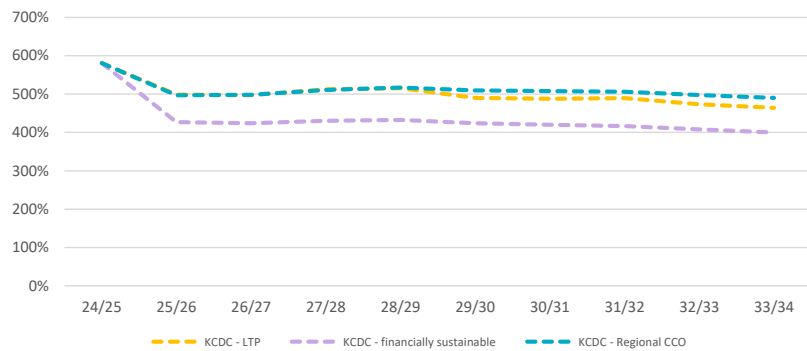
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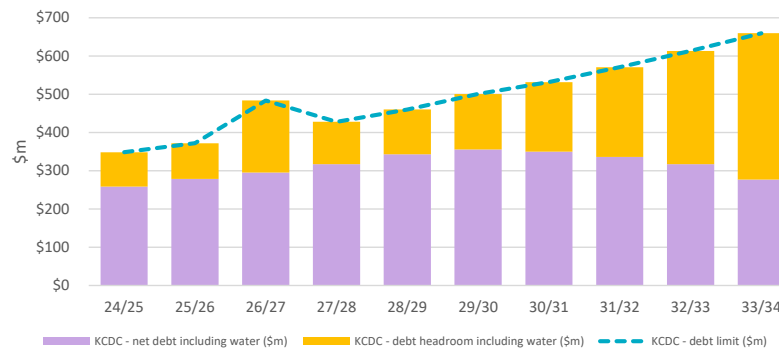
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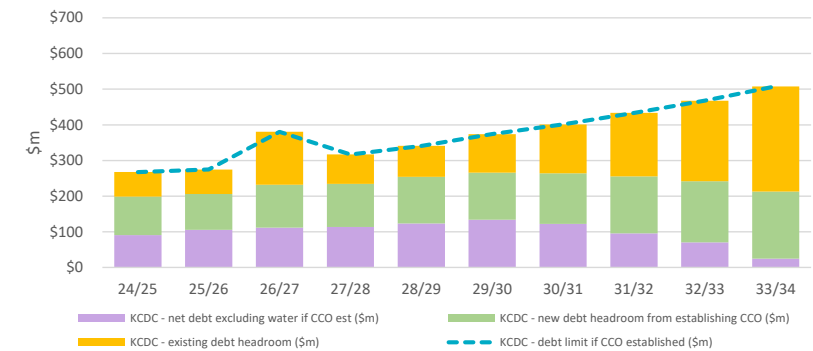
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Council net debt excluding water if CCO established



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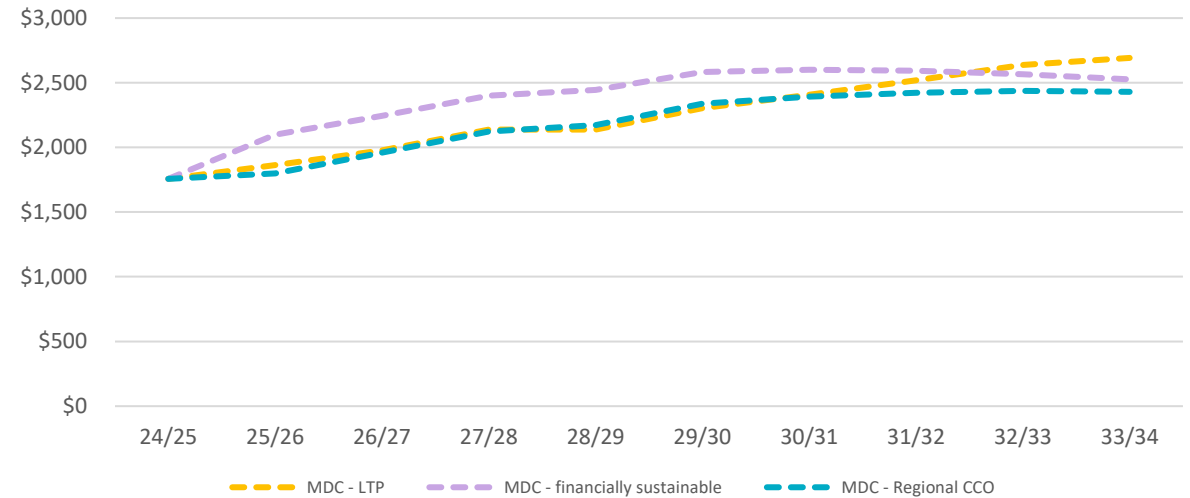
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## Benefits of a regional Water CCO

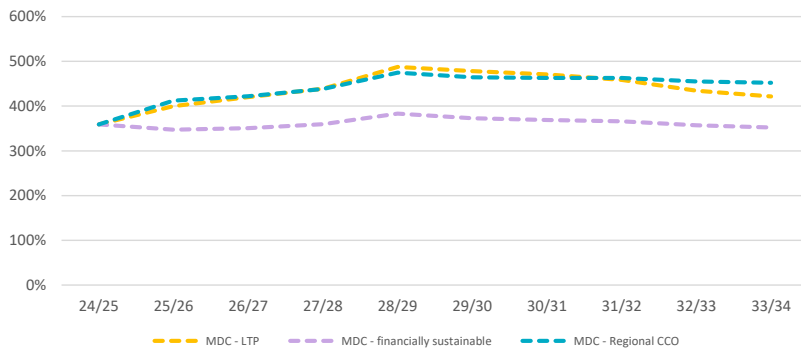
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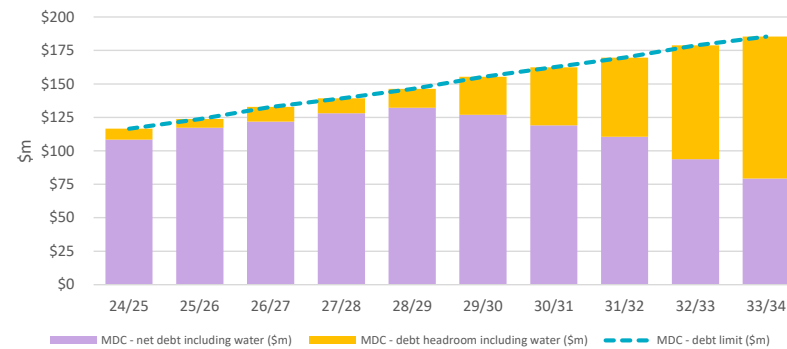
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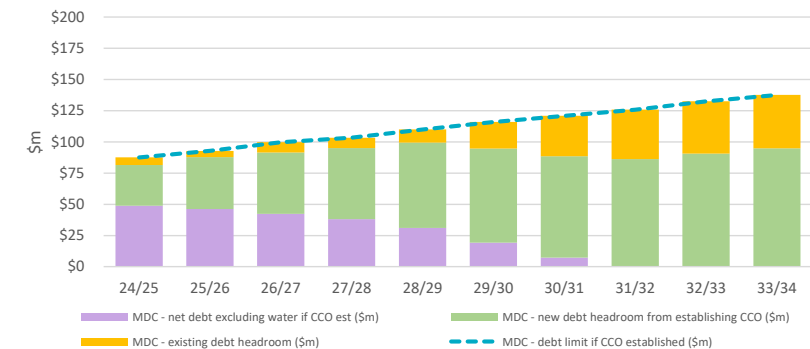
Water net debt to operating revenue



Council net debt including water



Council net debt excluding water if CCO established



# Palmerston North District Council

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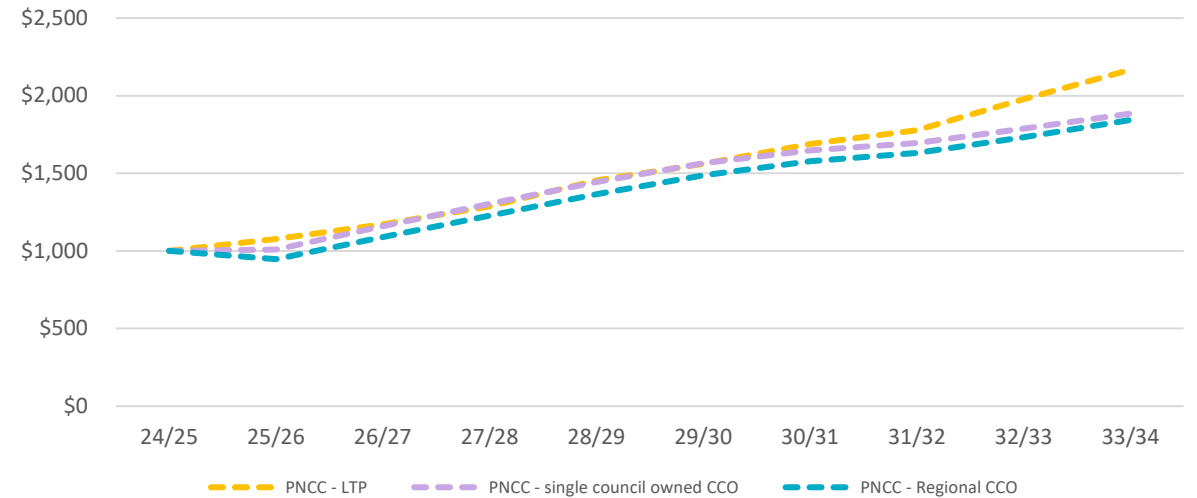
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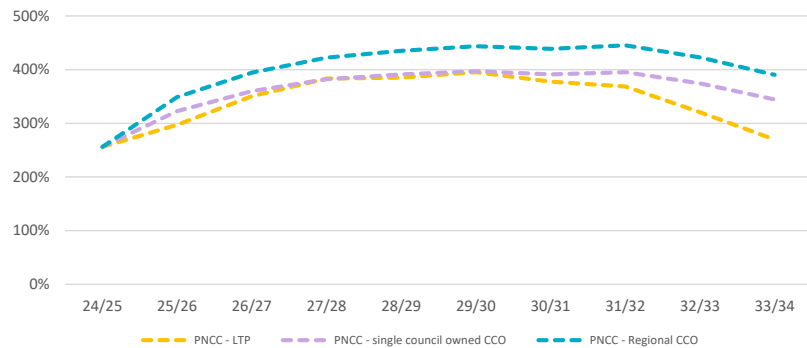
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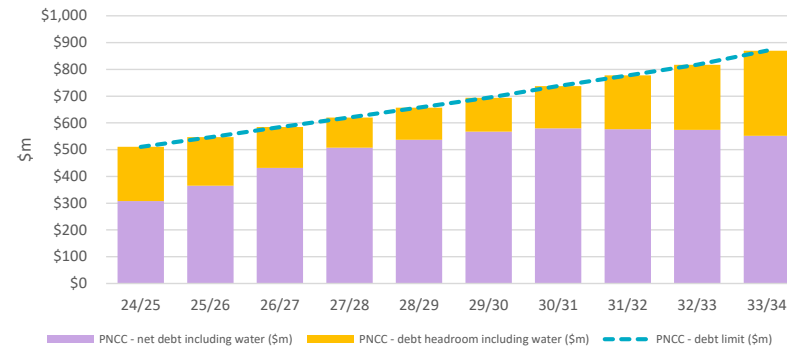
Average water services bill per connection (ex GST)



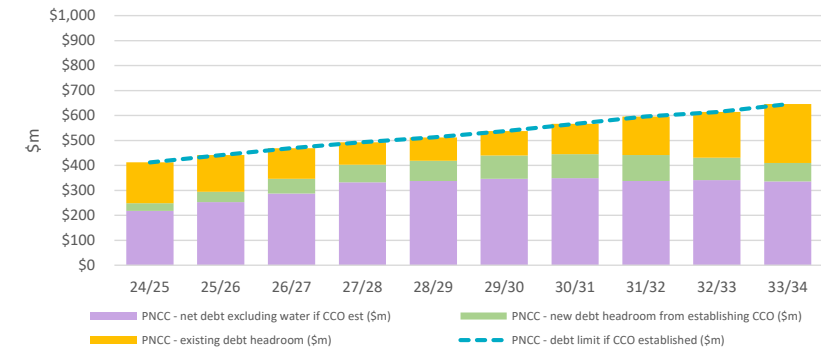
Water net debt to operating revenue



Council net debt including water



Council net debt excluding water if CCO established



# Prices, operating costs and investment for a regional Water CCO

Household water charges are directly determined by proposed levels of investment, operating expenses and the utilisation of debt versus revenue funding of investment. Each council is facing trade-off decisions on these factors.

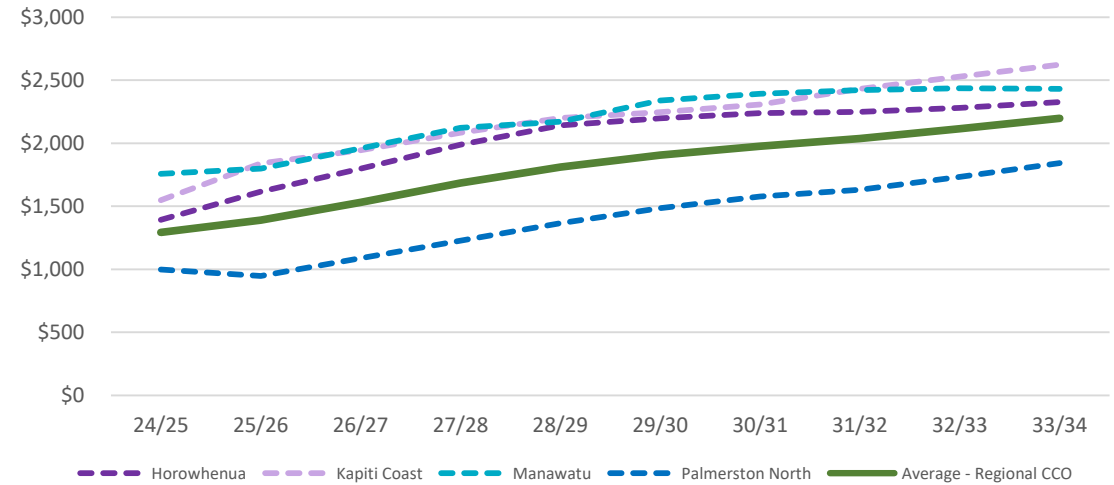
The charts on this slide show projected water services bills, operating costs and investment per connection, for councils under a Regional CCO. Revenues and debt financing have been set to maintain a minimum 8% FFO to debt ratio.

Higher water bills are due to higher operating costs and/or higher borrowings per connection (and vice versa for lower water bills).

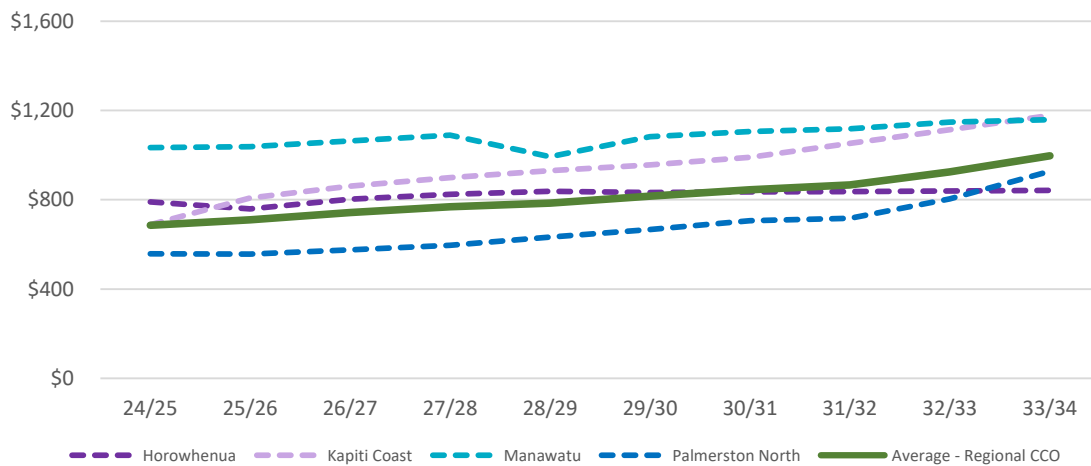
These charges exclude any levies for IFF funded infrastructure.

High level financial viability assessments for a regional Water CCO are included at Annex 3, which **demonstrate that a regional Water CCO would be financially viable.**

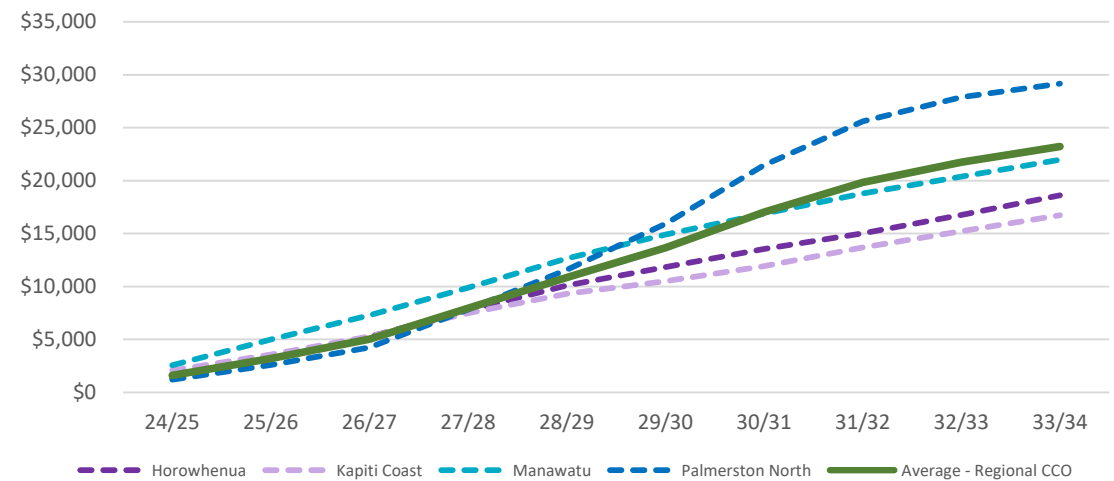
Regional Water CCO average water services bill per connection (ex GST)



Regional Water CCO opex per connection (excl interest, depn)

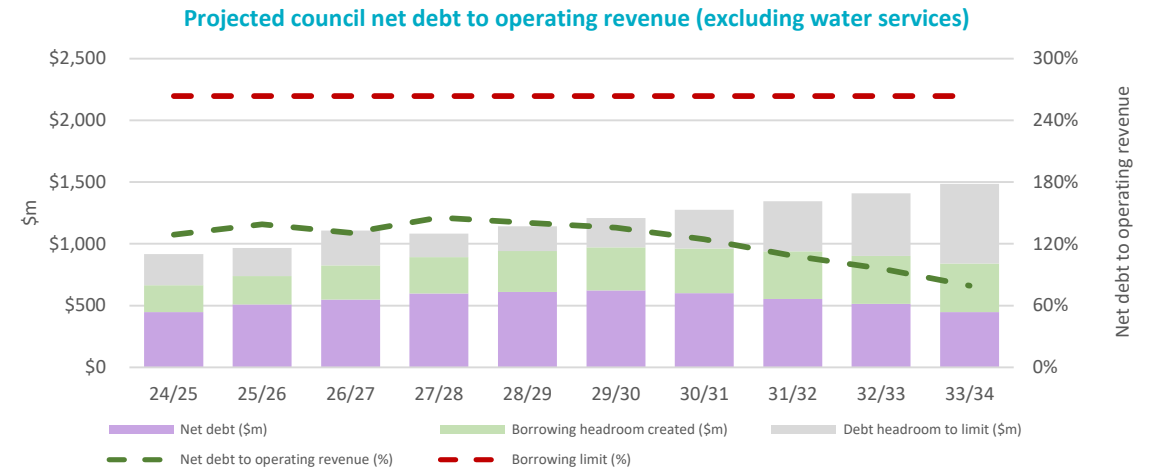
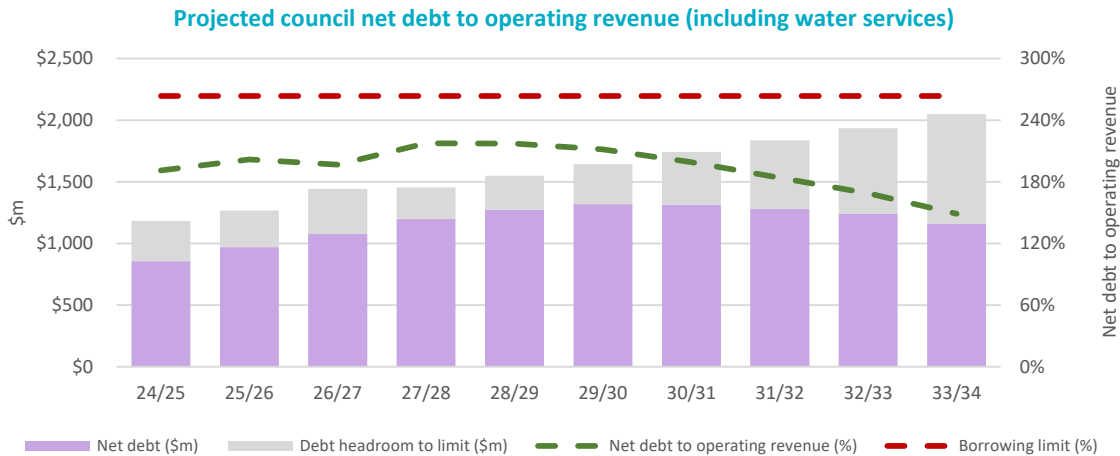


Regional Water CCO capital investment per connection



# Establishing a water CCO will allow water revenues to directly support all water services borrowing requirements and create new borrowing headroom for owning councils

LGFA has committed to lend to water CCOs and treat their debt as separate to owning councils' debt, where there is a guarantee or uncalled capital from owning councils in place, and adherence to prudent credit criteria. This means that LGFA would exclude a water CCO's water services debts from owning council's borrowing covenants (e.g., in debt to revenue calculations). This creates new borrowing headroom for owning councils, as water services are higher leveraged than other council business. This slide shows notional headroom created if water is treated separately.



Note: debt limit is set at approximately 265% which is the weighted average of the councils' credit limits (a mix of 175% and 280%)

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New debt headroom for owning councils (\$000)	FY24/25	FY25/26	FY26/27	FY27/28	FY28/29	FY29/30	FY30/31	FY31/32	FY32/33	FY33/34
Horowhenua District Council	41,686	42,679	43,893	45,107	49,006	43,860	37,851	30,265	29,373	24,741
Kapiti Coast District Council	107,705	100,233	120,701	121,185	130,624	131,583	141,650	159,278	170,956	188,104
Manawatu District Council	32,551	41,511	49,143	56,989	68,310	75,458	81,211	86,209	90,699	94,803
Palmerston North City Council	30,600	41,408	58,979	70,206	80,756	92,947	96,056	104,108	90,077	73,617
<b>Total - Regional CCO</b>	<b>212,542</b>	<b>225,831</b>	<b>272,716</b>	<b>293,487</b>	<b>328,696</b>	<b>343,848</b>	<b>356,768</b>	<b>379,860</b>	<b>381,106</b>	<b>381,265</b>

# **Financial sustainability considerations, assumptions and limitations of analysis**

## **ANNEX 1**

# Financial sustainability requirements for water services provision

- The Local Government (Water Services Preliminary Arrangements) Act 2024 defines 'financially sustainable', in relation to a council's delivery of water services, as:
  - The revenue applied to the council's delivery of those water services is sufficient to ensure the council's long-term investment in delivering water services; and
  - The council is financially able to meet all regulatory standards and requirements for the council's delivery of those water services.
- Each council is required to prepare a Water Services Delivery Plan that demonstrates financially sustainable water services provision.
- Under Local Water Done Well, there are minimum requirements that must be met by all water services providers, irrespective of the delivery model. These relate to financial sustainability, ringfencing, a new economic regulation regime, and new planning and accountability requirements, which require the corporatisation of water services and ensuring of appropriate revenues for water services at a minimum.
- To assist with an assessment of whether a council's water services delivery is financially sustainable, the Department has developed the Water Services Delivery Plan template which asks councils to provide information about three components:
  - Revenue sufficiency – is there sufficient revenue to cover the costs (including servicing debt) of water services delivery?
  - Investment sufficiency – is the projected level of investment sufficient to meet regulatory requirements and provide for growth?
  - Financing sufficiency – are funding and finance arrangements sufficient to meet investment requirements?

# Update on LGFA requirements and 'prudent credit criteria'

- On 20 December 2024, the New Zealand Local Government Funding Agency ('LGFA') updated councils on LGFA requirements for Water CCO lending.
- This update included further information on components for the 'prudent credit criteria' that LGFA proposes to have in place to enable water CCOs to borrow from LGFA.
- A critical component of the 'prudent credit criteria' is that a 'funds from operations' ('FFO') to debt covenant would be required, with an expected minimum 'FFO to debt' ratio of between 8% and 12%, depending on a credit risk assessment to be undertaken by LGFA.
- The Department views the FFO to debt measure as the most critical component of assessing the financial sustainability of water services provision, as it:
  - Provides a benchmark for ensuring that operating revenues are set to an appropriate level to cover the costs of service (i.e., to meet the 'revenue sufficiency test'); and
  - Provides a benchmark for ensuring that financing can be secured to deliver investment requirements, as it is a critical covenant for accessing LGFA financing for a stand-alone water services provider.
- Irrespective of a council's preferred delivery model, the Department's view on financial sustainability will be anchored around ensuring that water services financial projections include sufficient operating revenues to meet a minimum 'FFO to debt' ratio, based on our expectation of what LGFA's covenant requirement would be for direct financing a Water CCO consisting of that council's water services.

# The 'FFO to debt' ratio is key to financial sustainability

## What is the 'FFO to debt' ratio?

- The FFO to debt ratio is a leverage ratio that a credit rating agency, investor or lender can use to evaluate an organisation's financial risk. The ratio compares the cash generated from an organisation's operations to its total borrowings, and represents this as a percentage ratio.
- For example, for an organisation that has an FFO to debt ratio of 10%, this means that operating cash margins generated in one year are equal to 10% of the organisation's borrowings. This also means that ten years of operations would be required to fully pay down existing borrowings (being the inverse of the ratio, 1 / 10%).

## What are funds from operations?

- FFO can also be defined as 'free operating cash flow' and represents the amount of cash that is generated by operating revenues in any year, after cash operating costs have been paid.
- For Water Services Delivery Plans, the Department suggests that FFO is calculated as: *operating revenue minus operating expenses plus depreciation and other non-cash expenses, less interest revenue*. It is important to note that non-cash items such as depreciation are excluded, and that capital revenues such as development contributions are also excluded, from this calculation.

## Why is FFO to debt the key financial sustainability measure?

- This measure provides a clear picture of an organisation's ability to generate cash solely from its core operations, excluding financing and investing activities. FFO is considered a reliable indicator of a company's financial performance because it focuses on the cash flows directly related to the organisation's primary business activities.
- FFO plays a significant role in evaluating an organisation's creditworthiness, and for determining expected returns for lenders (where a more 'risky' lend commands higher premiums to compensate lenders for that risk).
- LGFA (and ultimately credit rating agencies) will assess a Water CCO's FFO to form a view on its ability to generate sufficient cash flow to service its debt obligations.

# Considering the 'FFO to debt' ratio under Local Water Done Well

## How does the setting of minimum FFO to debt requirements impact revenue requirements and prices paid by consumers?

- The minimum FFO to debt ratio requirement directly determines the minimum amount of operating cash margins required to be generated, in order to comply with the covenant. In turn, this impacts the minimum operating revenue and maximum cash operating costs that are tolerable, as they determine the 'funds from operations'.
- A higher minimum FFO to debt ratio requirement (of, say, 12% at the upper limit of LGFA's reported band) would require higher operating revenues (and consumer charges) than a lower minimum FFO to debt ratio requirement (of, say, 8%) for any given level of operating expenses and borrowings.

## What minimum FFO to debt ratio assumption should be used for assessing different delivery models?

- The Department has assumed minimum FFO to debt ratio requirements for this analysis, which councils can rely on for decisions on delivery models and for confirming the financial sustainability of water services delivery in Water Services Delivery Plans. Where a new Water CCO is established and seeks to borrow from LGFA, LGFA would determine in its discretion the minimum requirements.
- The Department's assumptions for minimum FFO requirements are set out on the following slide, and represent an indicative assessment of the creditworthiness of various delivery model options.
- Factors that have been considered in determining these assumed minimum requirements are serviced population (as a measure of scale); geographical diversification of consumers and infrastructure assets; investment and borrowing requirements; and the ability to identify and deliver capital and operating efficiencies to manage costs and/or comply with direction from the Economic Regulator.

# Key assumptions underpinning analysis

- The analysis included in this guidance is primarily based on financial information included in council's 2024-34 long-term plans, specifically the funding impact statements for the water services. The Department has sought further input assumptions from councils where this data is not readily available in LTPs (including opening asset, debt and cash balances).
- The analysis assumed that the level of proposed investment in each council's LTP is adequate to meet the 'investment sufficiency test' for Water Services Delivery Plans. The level of projected investment is kept constant across presented options.
- Operating costs (except for interest costs) are kept in line with LTP information under all scenarios. Similarly, capital revenues and non-rates sources of operating revenues are held constant against LTP.
- Minimum 'FFO to debt' ratio assumptions utilised for this analysis are as follows. The largest driver of determining assumed minimum requirements is serviced population, with a further discount applied for a regional Water CCO to reflect a larger geographical spread of consumers and infrastructure assets:
  - For a regional Water CCO comprising the water services of the four councils – 8% (set to the lower end of LGFA's reported band);
  - For water services provision undertaken by Manawatu District Council – 12% (set to the upper end of LGFA's reported band);
  - For water services provision undertaken by Horowhenua District Council and Kapiti Coast District Council – 11% (assumed 1% discount against the band maximum due to serviced population);
  - For water services provision undertaken by Palmerston North City Council – 10% (assumed 2% discount against the band maximum due to serviced population).
- Under each scenario run, we have calculated the revenue and borrowings required to deliver LTP proposed levels of investment, by determining the appropriate mix of revenues and debt financing needed for the 'FFO to debt' ratio to remain at the assumed minimum requirement above each year.
- For comparison purposes, FY2024/25 financials are not adjusted under scenarios. Financial projections from FY2025/26 are adjusted to demonstrate the different average charges required.

# Limitations and exclusions of analysis

The analysis underpinning this guidance has been completed to demonstrate the revenue and financing sufficiency requirements, and differences in financing 'efficiency', under different delivery models. To enable direct comparison of the impact of financing efficiency and minimum revenue requirements for each council, we have excluded from this analysis:

- Any new establishment or operating costs under any delivery model;
- Any new costs relating to the requirement to comply with new requirements under Local Water Done Well, such as economic regulation and the new Planning & Accountability framework, which would apply under all delivery models.
- Any reduction in operating resources and costs that could be achieved under a consolidated regional Water CCO, where duplicated effort and resourcing could be identified.
- Any operating and capital efficiencies that could be generated from the establishment of new Water CCOs, and/or from compliance with future directives from the Economic Regulator.
- Any reduction to investment requirements that could be achieved due to announced future regulatory changes, including a single wastewater standard and National Engineering Design Standards.

The Department's view is that the above items are immaterial to an assessment of the relative financial sustainability and benefits of various delivery model options, but that they should form a critical part of implementation planning for a council's proposed delivery model.

Levy requirements for IFF delivered infrastructure are excluded from projected household charges (i.e., PNCC's WWTP project that is proposed to be IFF funded). Any levy requirement would need to be added to PNCC charges under all delivery options to show the 'full cost' of water services provision to households.

# Assessing the financial viability of a regional Water CCO

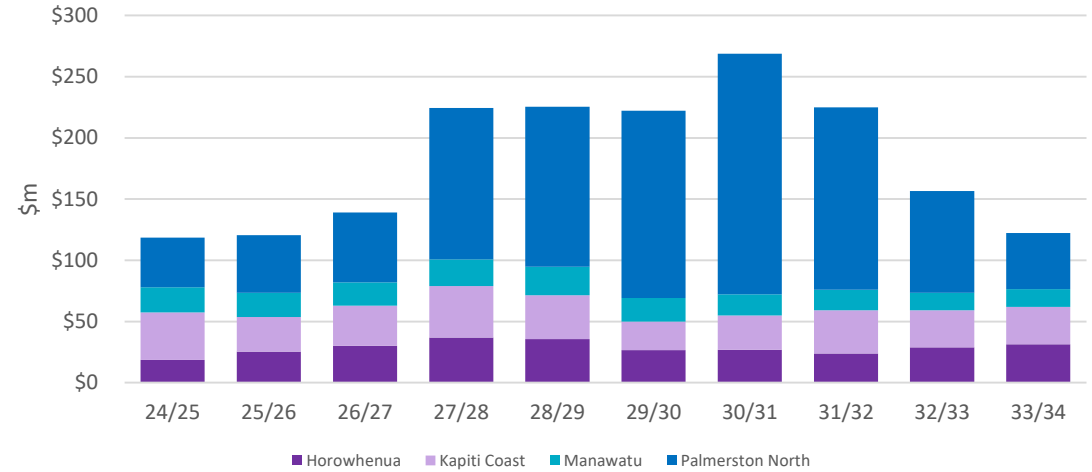
## ANNEX 2

# Regional Water CCO combined water services capital investment

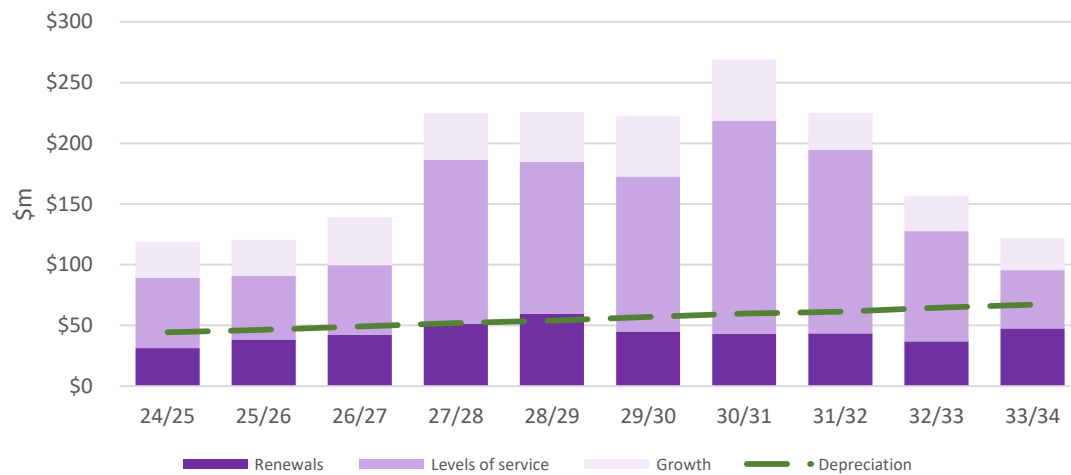
## Overview of regional water services capital investment requirements

The four councils are cumulatively projecting \$1.823 billion of capital investment into water services infrastructure over ten years. This proposed level of investment is substantial –approximately triple projected depreciation charges over ten years. While this capital programme is fundable for a Regional Water CCO, there would be merit in the councils working together on a joint investment programme to determine the most efficient and deliverable phasing of investment, and to identify opportunities to reduce costs. Consideration should also be given to any reduction to investment requirements that could be achieved due to announced future regulatory changes, including a single wastewater standard and National Engineering Design Standards.

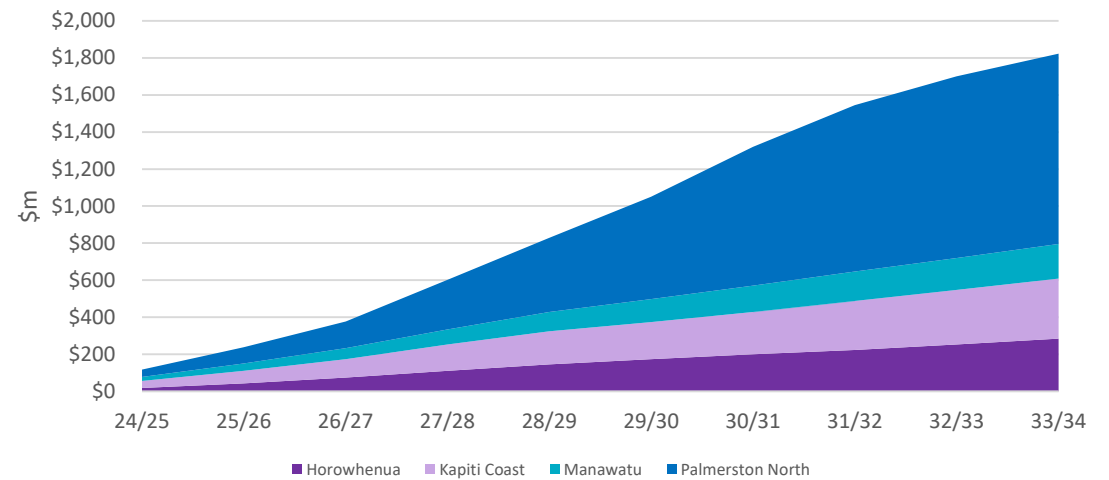
Regional Water CCO capital investment by council



Regional Water CCO capital investment



Cumulative regional Water CCO capital investment



# Regional Water CCO financial viability – LTP projected revenues and debt financing

## Overview of water services revenues and debt financing at LTP projected levels

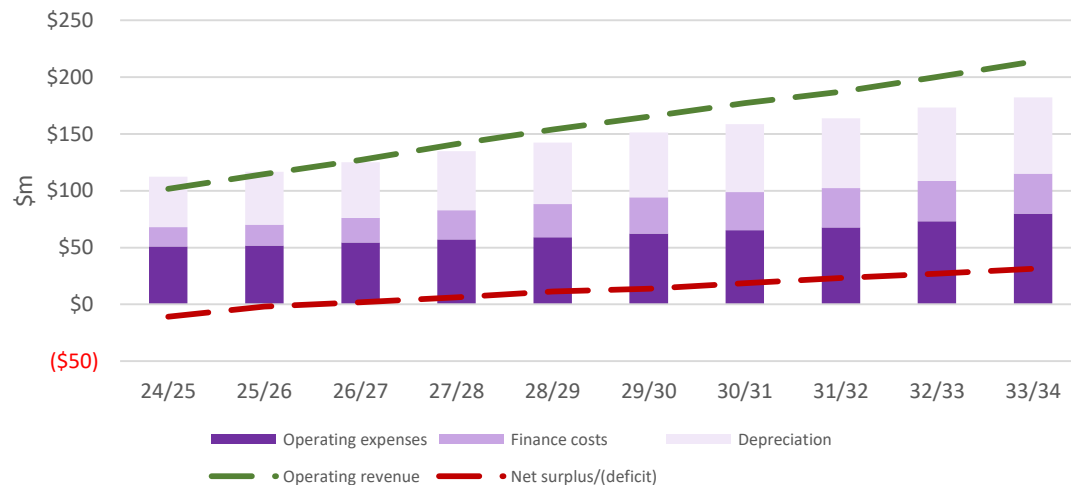
The projected levels of water services revenues are sufficient for the level of investment and expenditure proposed, and fully cover all operating costs including depreciation from FY27/28. At a consolidated level, there is significant borrowing headroom against a 5x operating revenue debt limit. Based on projected levels of investment and revenues, a Regional Water CCO would retain unutilised borrowing capacity across the entire LTP period, with this capacity increasing over the last five years due to projected revenue increases.

Each council has trade-off decisions to make between levels of revenue, investment and debt financing to strike an appropriate balance for consumers, as part of a regional Water CCO.

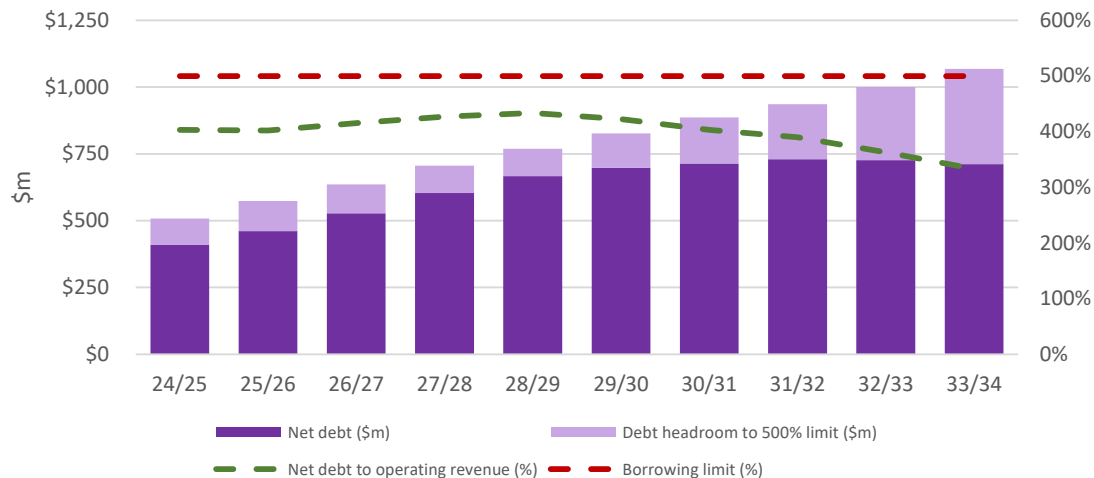
**There is scope for councils to reevaluate the level of water services revenues required, for the level of investment proposed, to potentially pass on savings to consumers. Effectively utilising debt financing is the key to unlocking this.**

On the following slide we have reset the revenue and debt financing, anchored to an FFO to debt ratio of 8% to demonstrate this.

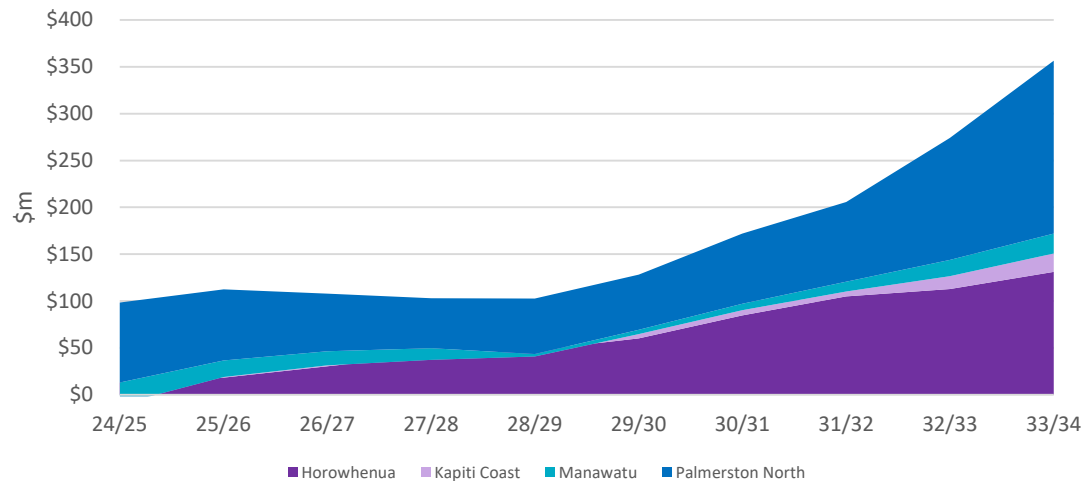
### Regional Water CCO operating revenues and expenses



### Regional Water CCO net debt to operating revenue



### Regional Water CCO borrowing headroom to 500% operating revenues



# Regional Water CCO financial viability – updated revenue and financing to meet minimum FFO requirement

## Overview of water services revenues and debt financing at minimum FFO levels

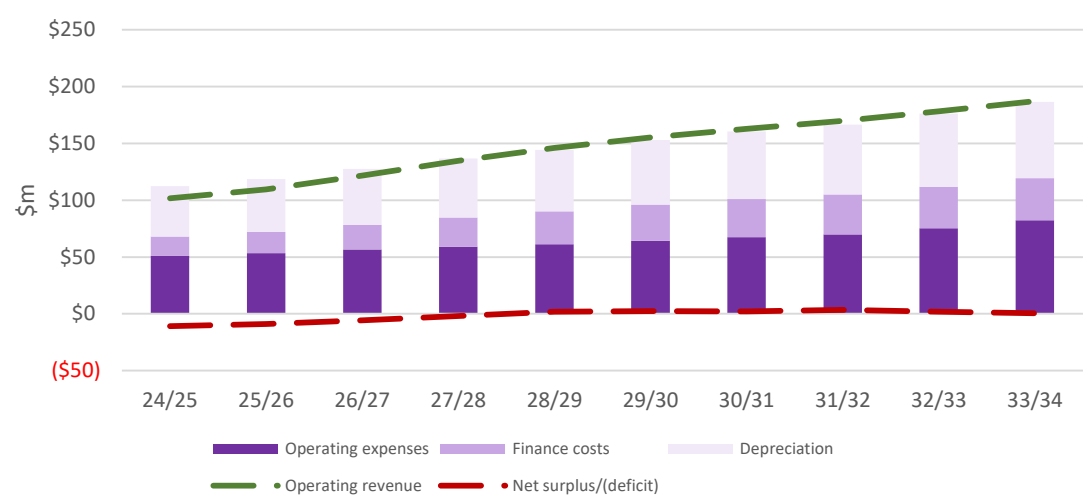
The 2024-34 LTP projected levels of water services revenues are sufficient in aggregate across the Bay of Plenty councils to form a viable Bay of Plenty Water CCO.

The financing efficiency of a regional CCO could be utilised to reset revenues to the minimum requirement to meet borrowing covenants – primarily on an FFO to net debt basis (assumed 8%).

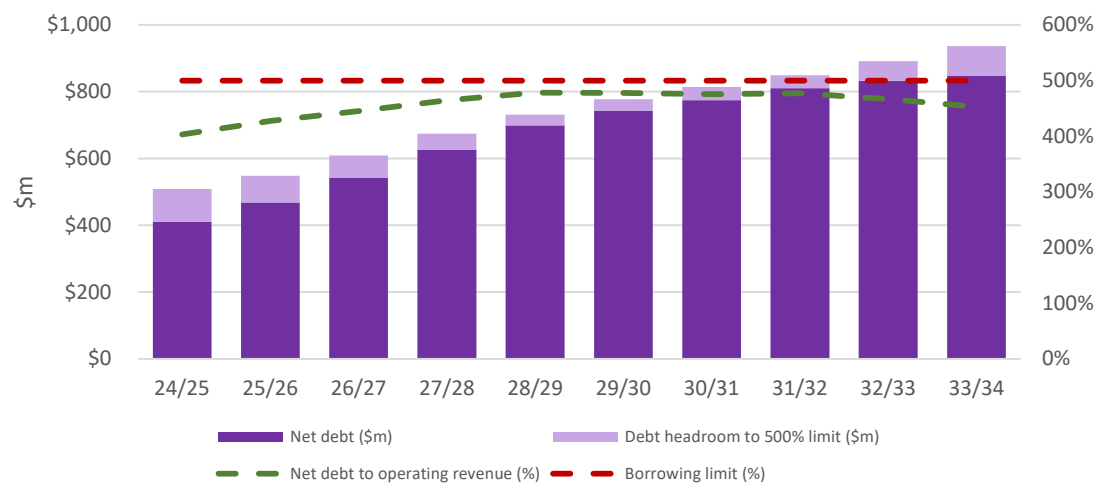
We have modelled a Regional Water CCO, amending the borrowing profile and revenue requirements to prudently utilise borrowing capacity and minimise revenue requirements, against the assumed minimum FFO requirement.

Each council has trade-off decisions to make between levels of revenue, investment and debt financing to strike an appropriate balance for consumers, as part of a regional Water CCO, which could unlock more efficient utilisation of financing and lower charges for consumers.

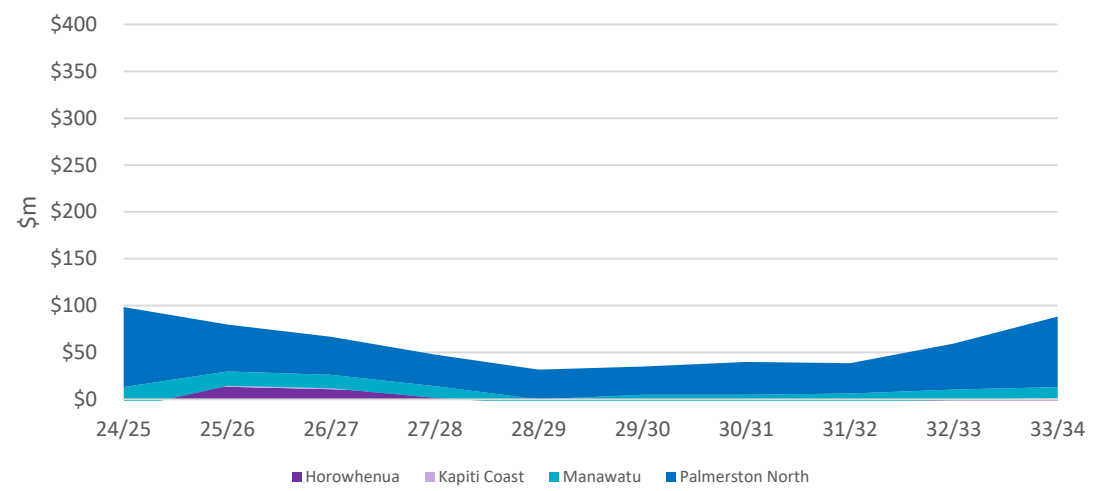
### Regional Water CCO operating revenues and expenses



### Regional Water CCO net debt to operating revenue

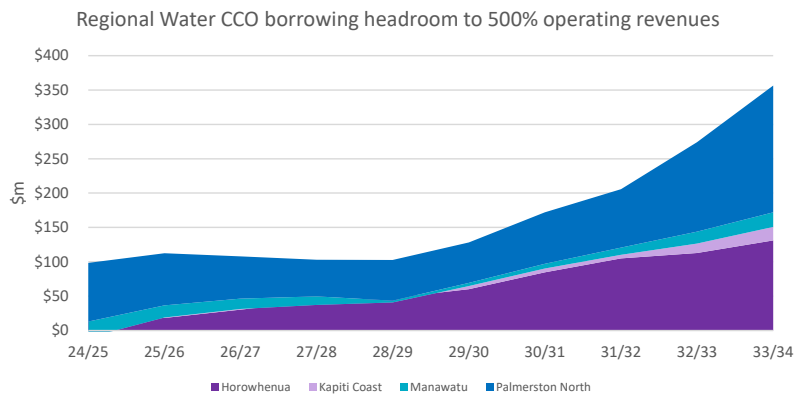
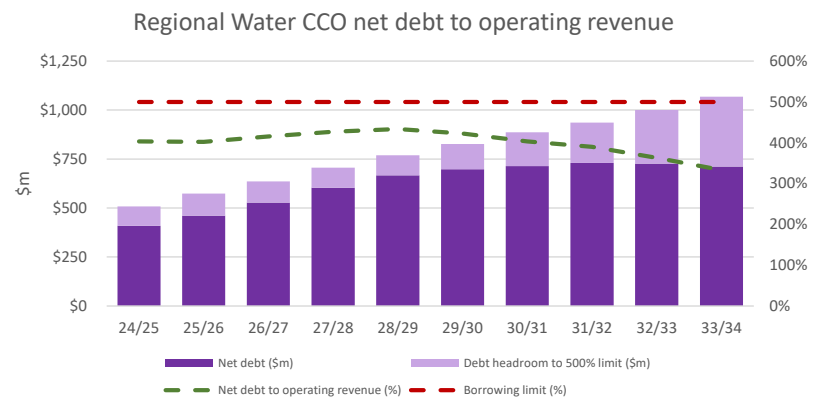
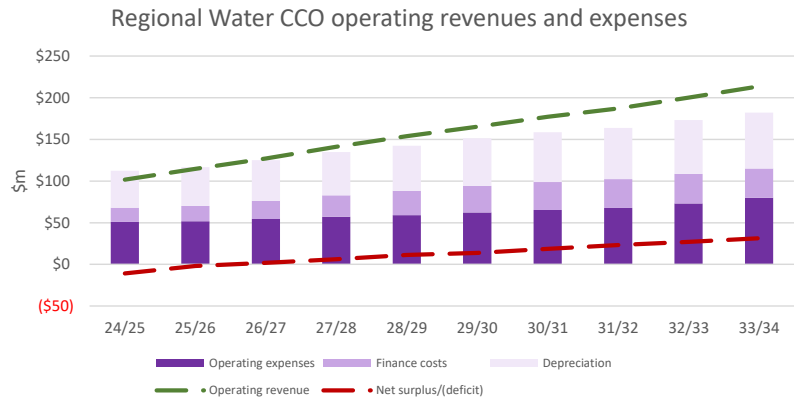


### Regional Water CCO borrowing headroom to 500% operating revenues

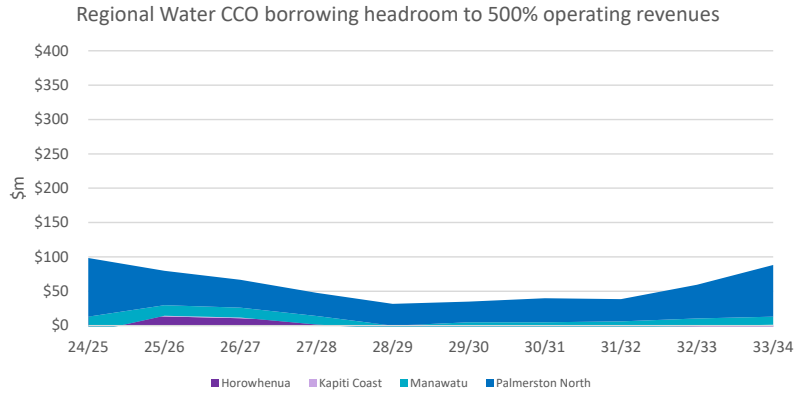
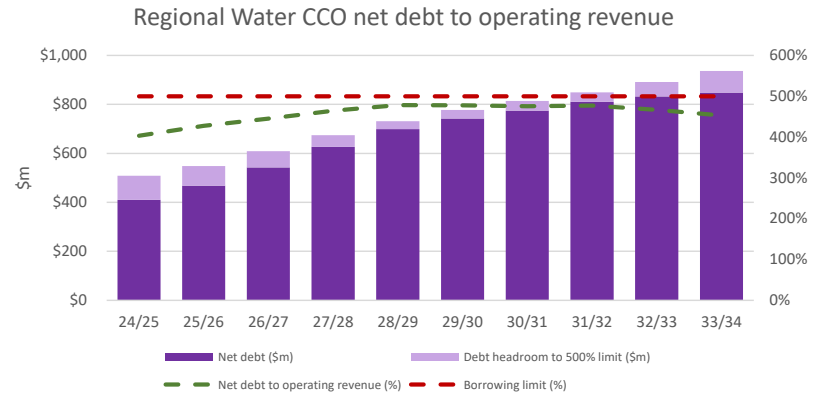
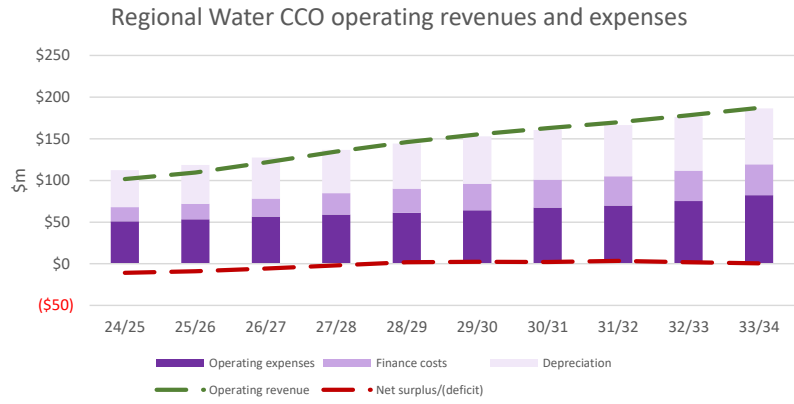


# Comparing LTP projections to regional Water CCO projections that more effectively use debt financing

## LTP projected revenues and debt financing



## Regional Water CCO projections at minimum FFO requirements (assumed FFO to debt of 8%)



**Comment on operating revenues and expenses**

LTP projections show revenues increasing significantly above operating costs (including depreciation) in the last five years of LTP.

These operating revenue increases generate substantial operating cash margins, as depreciation is a non-cash item, which are used to pay down debt.

A regional Water CCO would not need to meet a 'balanced budget' requirement, so depreciation charges would not necessarily need to be covered by operating revenues, if that was inefficient from a financing perspective.

For a regional Water CCO, if target FFO to debt was set to 8% of borrowings, this would mean significantly lower revenues are required, and consequently lower charges to consumers on average against LTP projections.

**Comment on net debt to operating revenue**

LGFA will treat the borrowings of a water CCO as separate to owning councils.

In LTPs water borrowing requirements are substantial and take councils up close to borrowing limits, meaning that revenue increases are required to pay down debt to more manageable levels over the ten-year LTP period.

With a Water CCO, this constraint is removed, replaced by a shareholding council guarantee or uncalled capital.

This means that substantial projected revenue increases could be avoided, if a Water CCO maintained its leverage position towards its borrowing limit, while prudently ensuring that a minimum FFO to debt ratio is maintained.

**IN CONFIDENCE**

**Comment on net debt to operating revenue**

Due to LTP projected revenue increases and debt repayments in the last 5 years of the LTP period, a regional Water CCO that adopted those baseline projections would result in significant underutilisation of borrowing capacity from FY29/30, paid for by increases in revenues and charges to households.

Setting revenues to a target FFO to debt ratio means that debt is prudently managed by generating the amount of operating cashflow that is needed to service and pay down the debt over a reasonable time period.

Utilisation of borrowing capacity, for any given level of capital investment over time, results in lower revenue requirements and lower charges to consumers.

A regional Water CCO would need to determine an appropriate level of borrowing headroom to prudently manage risk and maintain an ability to respond to shocks or urgent investment requirements.