

Commercial Case

The commercial case sets out the transactions that would be required to implement any change and the impact of changes on the commercial arrangements for service delivery.

Summary of the commercial case

Establishing an asset owning CCO for Hawke's Bay requires the creation of a separate organisation that would be collectively owned by the shareholding councils.

The key features of each option are set out in the commercial case which includes:

- Shareholding, if appropriate
- Governance structures
- Mechanisms for holding CCOs to account
- Examples of co-governance
- Draft CCO operating models that respond to investment objectives
- Draft functional structures for CCOs that respond to investment objectives
- Impact on the existing councils
- Draft organisational design principles that respond to investment objectives

An organisational structure would be developed during the transition to a CCO but for the purposes of the review a functional structure was developed based on similar organisations across Australasia and adapted for Hawke's Bay.

All four councils are affected as dedicated three waters staff and in some cases support staff would transfer to the CCO. Importantly, there are additional roles created when the CCO is established so that the overall resourcing of three waters across the region would increase. Wairoa and Central Hawke's Bay would remain as satellite offices with roles in those areas remaining where they are now.

Structures that would need to be established

SSBU

The SSBU would operate as a ring-fenced business unit and would not exist as a separate legal structure. Staff would be seconded into the SSBU but remain employed by their original council on the current terms and conditions.

A CEO would be appointed with all staff from across the region reporting through to them. This may create some issues with reporting lines, formal delegations and having staff on different terms and conditions.

The SSBU would, like the CCOs, report formally through to the Councils via a joint committee. There is opportunity for Māori to be part of the Joint Committee and exercise some aspects of co-governance.

In the financial modelling we have allowed for some costs for an advisory board with external independent advisors. The advisory board could provide support and advice to the CEO but would not have any formal delegations or standing.

Service level agreements would need to be developed for the provision of all the support services e.g. Legal, IT, Finance, HR, Planning etc.

Regional three waters CCO

Governance and accountability

The same basic legal structure would apply to a management CCO and an asset owning CCO, albeit with differences depending on the option. Both are assumed to be companies owned collectively by the Councils and would need to be set up under the Local Government Act. They, and the relationship between the Councils, Māori and the CCO, would be governed by the core foundation documents including:

- Statement of intent
- Constitution
- Shareholders agreement
- Statement of expectations.

Co-governance

The principles developed through discussions with the Māori Committees and confirmed by the Māori Chairs clearly identified co-governance as a key component of any future three waters service delivery model. The review therefore recommends that approach be adopted.

Some examples of co-governance set out below are discussed to highlight the range of scenarios and the different approaches where co-governance is used. Alongside this, in Hawke's Bay the Regional Planning Committee is an example of a co-governance model and more recently the Government has accepted the findings of a review of the health system in which a new entity, Health NZ will be established. That is intended to include a co-governance model where membership of the Health NZ board will be 50:50 between the crown and Māori.

Tūpuna Maunga/Ancestral mountains

In December 2012, a Redress Deed was signed by the Crown and the Tāmaki Makaurau Collective. In August 2014, the Act setting up Tūpuna Maunga o Tāmaki Makaurau Authority (Tūpuna Maunga Authority) came into effect. In September 2014, the authority had its first hui.

The gap between signing the deed of settlement and the first hui gave the Tāmaki Makaurau Collective and Auckland Council time to discuss how they were going to work together. This included determining the financial reporting format, frequency of reporting and the programme of meetings. Participants advise that this time invested at the outset saved time in the long run as the authority was able to "hit the ground running".

The authority has six representatives from Ngā Mana Whenua o Tāmaki Makaurau, six from Auckland Council and one non-voting Crown representative appointed by the Minister for Arts, Culture and Heritage.

It has prepared an integrated management plan for the Tūpuna Maunga and, with Auckland Council, an annual operational plan, a summary of which is included in Auckland Council's annual operational plan.

The objectives of the authority include giving visibility to the mana whenua world view, and their associations and connections with the maunga, through shared decision-making. The role and visibility of mana whenua is central to the discussions and outcomes the authority is trying to achieve.

The legislation provides for funding and staff resourcing through Auckland Council. The Authority is currently supported by a core team of eight council staff. Auckland Council is responsible for managing the maunga under the direction of the authority.

The scale of this arrangement is unparalleled in Auckland and has resulted in a unified and cohesive approach to caring for the maunga.

Healthy rivers/Wai Ora plan for Waikato and Waipā rivers

Waikato Māori and the Waikato Regional Council (council) have established an effective co-management regime for the Waikato River and its catchments to achieve the restoration and protection of the health and wellbeing of the river for future generations.

A key feature of the co-management arrangement is the establishment in December 2010 of the Waikato River Authority (authority). The authority was established as a statutory body by the Waikato-Tainui Raupatu Claims (Waikato River) Settlement Act 2010, the Ngāti Tūwharetoa, Raukawa the Te Arawa River iwi Waikato River Act 2010 and the Ngā Wai O Maniapoto (Waipā River) Act 2012.

The authority has 50/50 Crown and Māori appointees, five of each.

A partnership agreement between the authority and council was signed on 24 November 2011 and sets out the intended relationships and approach to working together. The authority sets the direction for managing the Waikato River in its Vision and Strategy document and, unusually, holds financial decision-making power (this usually sits with council). It is the body responsible for administering a \$210 million clean-up fund for the river.

Following its inception, the authority took a year to set up its processes, such as financial and risk management, and to develop its funding strategy. This was done before any funding allocations were made. The authority used expert advice to help ensure it had good policies and processes in place. During this year, the authority ensured that other parties, especially potential applicants, understood the approach the authority was taking.

Council may apply to the authority for clean-up funds, has a role in reporting to the authority, and provides technical support to the council appointee on the authority. Māori are continuing to develop joint management agreements with council, which include agreed processes for input into resource consents, monitoring, enforcement, and policy and planning matters to do with the river. Four agreements have already been signed.

Externally, the Waikato River Authority is viewed as having helped in bringing industry partnerships and interests together in a constructive way.

Kawa o Te Urewera

The Te Urewera Act 2014 vested the Te Urewera as its own legal entity and established a Board to be the voice for Te Urewera and provide governance and management in accordance with the principles of the Act. The composition of the board was originally four crown and four Tūhoe representatives, which changed after three years (2017) to three Crown and six Tūhoe members. The chair of the board is a Tūhoe representative in perpetuity.

The Act and the co-governance board seeks to strengthen and maintain the connection between Tūhoe and Te Urewera, alongside other environmental and recreation priorities.

The Te Urewera Board is required to produce a management plan and a statement of priorities. The management plan, Te Kawa o Te Urewera 2017 (Te Kawa), acknowledges that time is needed for Tūhoe to “replace low capability with vigour, expertise and confidence”. It also acknowledges the important ongoing investment and contribution of the Department of Conservation, and that together creative models and methods of working can be developed.

Ideal attributes for co-governance success

A 2018 SOLGM wānanga on co-governance identified the critical importance of:

- Enabling and recognising uniqueness in co-governance arrangements. This uniqueness ensures the arrangements reflect the values and aspirations of different iwi, the whakapapa of the partnership, and the values and needs of the place.

Tāmaki Makaurau/Auckland Council, which has several well-advanced co-governance and co-management arrangements in place, has identified the importance of:

- equal representation of mana whenua and council members
- reasonable breath of decision-making powers (mana)
- the support of a dedicated co-management team, ideally including or working towards being 100% mana whenua

In a February 2016 report titled *Principles for effectively co-governing natural resources*, the Auditor-General identified elements that help to achieve successful co-governance which are shown in the figure below. Investing in building quality relationships from the outset was identified as pivotal for productive co-governance arrangements.

Figure 30 Factors that contribute to successful co-governance arrangements

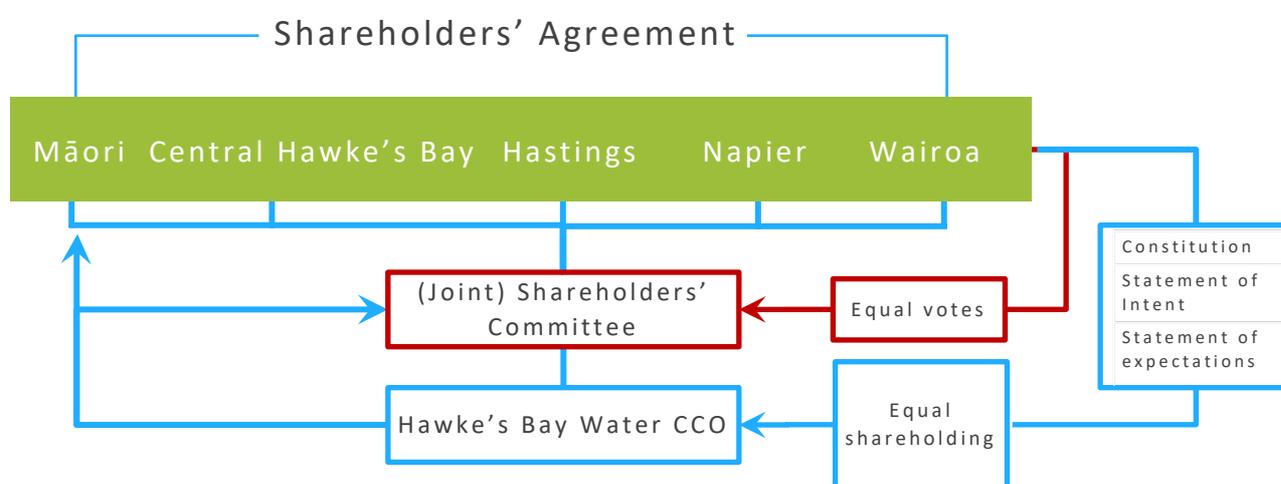


It is clear from the examples above, the findings of the Auditor General and the principles developed in this project that for co-governance to be effective, Māori will need to be part of the process to design and establish any regional water CCO in Hawke’s Bay. Co-design is therefore included as a key part of the next steps should the Councils decide to consult with their communities, and then subsequently to establish a regional water CCO.

However, for the purposes of the review, a draft governance structure is set out for both the management and asset owning CCOs. This explains the relationships between the councils, Māori and the CCO, the councils and Māori and the councils themselves.

Management CCO governance

Figure 31 Management CCO governance structure

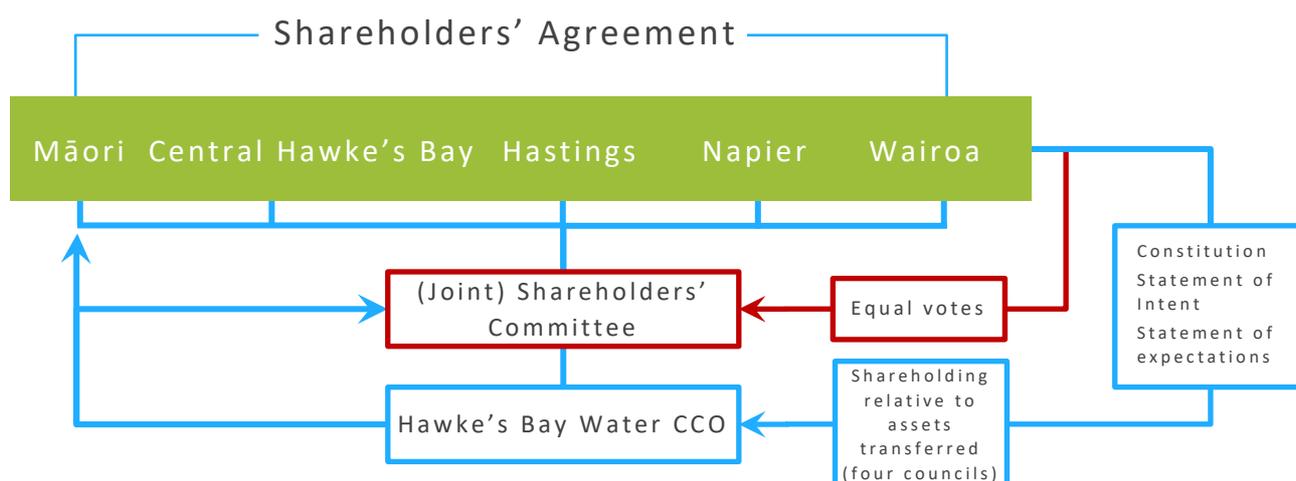


- The CCO will initially have four shares, with each council subscribing for one share. Each council need only be compensated for the operational plant purchased by the CCO. There is no advantage in holding more or less shares, as the CCO is not structured to make profits and requires local council funding and approval to deliver local projects.
- As the CCO is providing similar services to all shareholders any voting is carried out on a one vote per organisation basis, requiring a simple majority to pass, except in specific situations where the councils agree that voting ought to be unanimous.
- A Joint Shareholders Committee would be appointed to be the main liaison between the CCO and each council. Māori representation should be part of the committee in co-governance capacity. Authority would be delegated to the shareholders' committee as agreed by all councils. All have equal 'votes' and decisions reached unanimously with an independent member appointed to Chair the committee. Joint committee would be responsible for proposing by-laws, appointing enforcement officers and enforcement action as required.
- Joint shareholders committee responsible for holding the CCO to account.
- The CCO would be run by an independent board consisting of at three to four members. All board members must be approved by all shareholders with Māori as part of the joint committee having a vote on the appointment and removal of directors.

- Board members would be appointed impartially based on their experience and expertise, not to represent a specific Council. The Auditor General has said that appointing elected members to Boards of CCOs should be the exception³⁵. We endorse that opinion and would recommend that the Board of the CCO be a skills and merit based board made up of independent, appropriately skilled and remunerated directors as is the case for Watercare and Wellington Water.
- The Chair should be appointed separately by the shareholders' committee.
- Initial capital will be provided by the Councils equally and will be based on the assets required and sufficient operational funding to allow the CCO to pay its costs and remain solvent. Ongoing support payments will not be necessary as the CCO will be able to generate a secure source of funds through its activities which are charged through to the Councils.
- The board will determine the scope of any external funding requirements but as it will not own the assets it is unlikely that the CCO would need to incur, or be capable of incurring, debt of any note.

Asset owning CCO governance

Figure 32 Asset owning CCO governance structure



- The CCO will initially have shareholding based on the value of assets at the time of transfer / establishment (or as agreed through an alternative valuation approach).
- Each council will need to be compensated for the operational plant purchased by the CCO, the assets transferred to the CCO and liabilities.
- The CCO would be run by an independent board consisting of three to four members. All board members must be approved by all shareholders with Māori as part of the joint committee (co-governance) having a vote on the appointment and removal of directors.
- A joint shareholders committee would be appointed to be the main liaison between the CCO and each council. Māori representation should be part of the committee. Authority would be delegated to the shareholders committee as agreed by all councils. All have equal 'votes' and decisions reached unanimously with an independent member appointed to chair the committee. The joint committee would be responsible for proposing bylaws, appointing enforcement officers and enforcement action as required.
- Joint shareholders committee responsible for holding the CCO to account.

³⁵ *Governance and Accountability of council-controlled organisations*, Office of the Audit General, September 2015

- Board members would be appointed impartially based on their experience and expertise, not to represent a specific council. The Auditor General has said that appointing elected members to boards of CCOs should be the exception³⁶. We endorse that opinion and would recommend that the board of the CCO be a skills and merit based board made up of independent, appropriately skilled and remunerated directors.
- The Chair should be appointed separately by the shareholders’ committee.
- Initial capital will be provided by the Councils equally and will be based on the assets required and sufficient operational funding to allow the CCO to pay its costs and remain solvent. Ongoing support payments will not be necessary as the CCO will be able to generate a secure source of funds through its activities which will be charged to its customers.
- It is common to expect the CCO to raise some of its required funding through third party financiers using its revenue base as the prime security offering. The board will determine the scope of external funding requirements.

Not for Profit

Neither of the CCOs are intended to be profit making and would not return dividends to the Councils. Their focus would be on delivering the lowest possible price while ensuring the quality of service is maintained. For example, the following legislative provision guides Watercare (and is similar in objective to other international examples such as Scottish Water. Note that this does not mean they cannot make a surplus and indeed a surplus may be part of building financial capacity for future investment.

Part 5, section 57(1), of the Local Government (Auckland Council) Act 2009 stipulates that an Auckland water organisation (Watercare) “*must manage its operations efficiently with a view to keeping the overall costs of water supply and wastewater services to its customers (collectively) at the minimum levels consistent with the effective conduct of its undertakings and the maintenance of the long-term integrity of its assets*”.

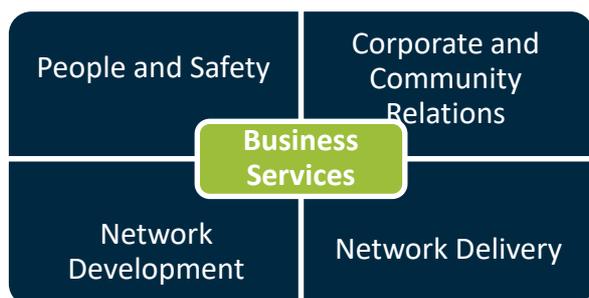
We envisage that the Councils would create a similar obligation on a Hawke’s Bay regional water CCO through the statement of intent.

Developing the structure of the CCO options

In this section we set out the key considerations for the design and development of a CCO. Given there are two CCO options shortlisted, a management CCO and an asset owning CCO, we discuss the structural elements common to both and identify where there are differences.

Having reviewed various water utilities in NZ and Australia, we observed that a typical operating model design would look like the figure below

Figure 33 Typical CCO operating model design



³⁶ Governance and Accountability of Council-controlled Organisations, Office of the Audit General, September 2015

However, considering the findings of the cultural case and the need to support the proposed co-governance role with Māori we adapted the typical model to incorporate a **Māori responsiveness framework**. The proposed Māori responsiveness framework responds to the cultural demands of co-governance and is intended to enable Māori water values to be operationalised

Figure 34 Māori responsiveness framework



Co-Governance professional directors, council leaders, and Māori leaders as co-governors under a Treaty of Waitangi partnership model.

Cultural Performance Indicators (CPIs) set by co-governors to drive the operational embedding of Māori values. The CPIs set the cultural direction, measurements and expectation of the operational three waters service delivery. The CPIs should have oversight by an internal Māori function e.g. Māori partnerships team.

Key Performance Indicators (KPIs) set by management for teams and individuals to meet the CPI outcomes. Cultural KPIs should be normalised throughout the business as standard practice to meet the CPIs set by co-governance. The CPIs should drive internal cultural capability building programmes that enable CCO teams to meet their individual cultural KPIs, and to collectively meet the organisational CPIs.

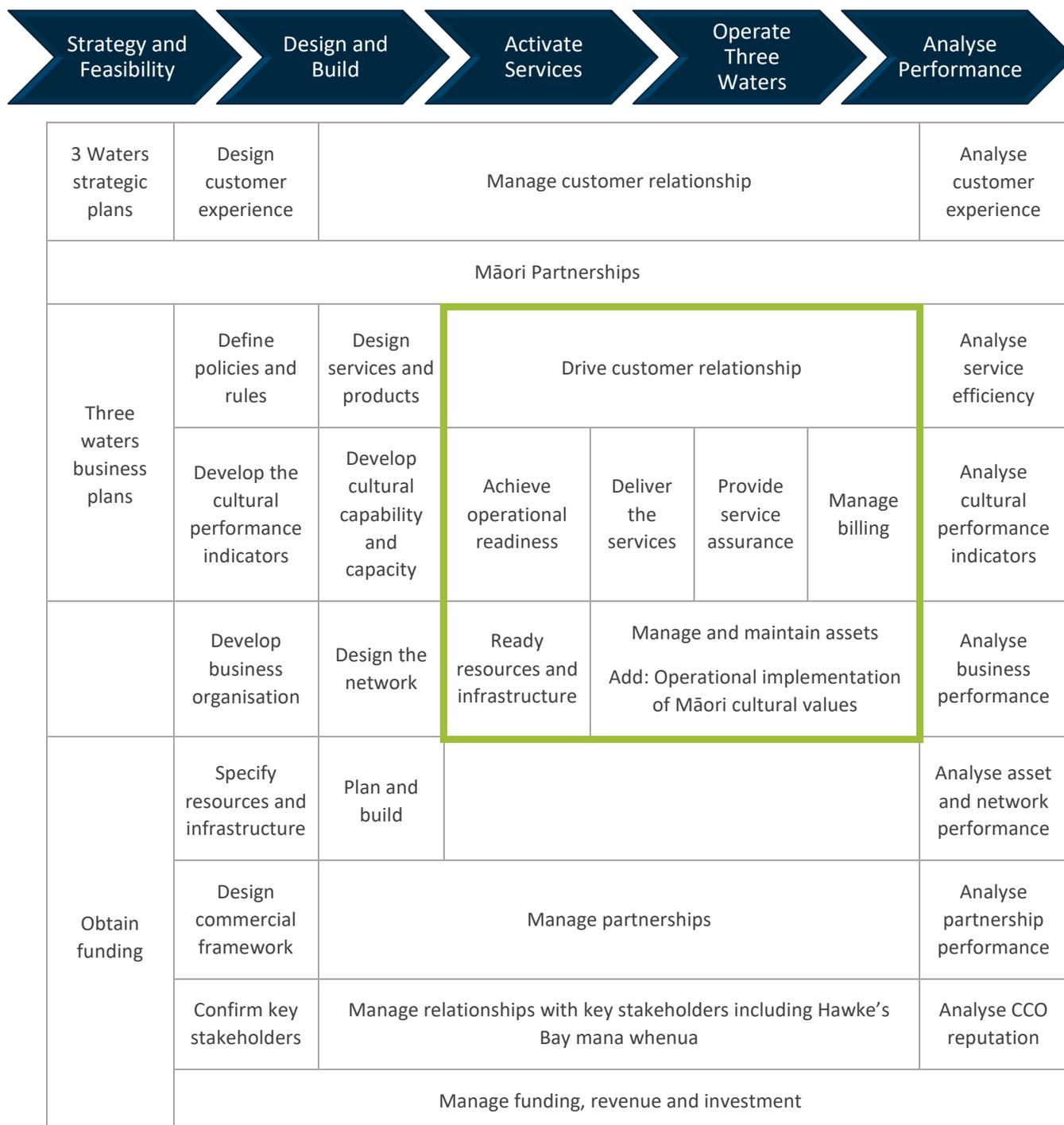
Māori engagement. Through being equipped to meet their CPIs and KPIs, CCO teams are fully equipped to successfully engage with Māori whānau, marae, hapū, hapori with cultural competence. Māori engagement should occur through both regulatory and non-regulatory needs.

Cultural excellence is a reporting mechanism to provide updates to co-governance on the tracking of CPIs. Reporting is to demonstrate that embedding of Māori values across the business is driving a culture of excellence and active kaitiakitanga.

Draft operating model

The following draft operating model helps to inform the development of a functional structure for the management and asset owning CCOs. It sets out the key functions that in our view a Hawke’s bay water CCO needs to operate effectively.

Figure 35 Proposed three waters CCO operating model showing key business functions



A functional structure was then developed to implement the operational model. This is shown in **Figure 36** below. The detailed description of each of these functional groups is found in **Appendix B**.

The functional structure was used as the basis for assessing the overall resourcing required and comparison to the resourcing which is assumed to transfer to the CCO from the four Councils and the additional resources required to support the operation of the asset owning. This in turn informed the analysis in the financial case. There are some differences between the management CCO and the asset owning CCO. For example, some functions do not transfer to the management CCO e.g. billing and some functions would occur in both e.g. finance

Figure 36 Functional structure of CCO

Business Services	People and Safety	Corporate and Community Relations	Network Development	Network Delivery	Māori Partnerships
<ul style="list-style-type: none"> • Finance • ICT • Strategy and corporate planning • Regulation • Audit • Legal • Governance • Risk and business process 	<ul style="list-style-type: none"> • Capability • Learning and development • Employee relations • Payroll • Health, safety and wellbeing 	<ul style="list-style-type: none"> • Government and council relations (public affairs) • Community engagement and communications • Education and strategic relationships • Internal Communications and marketing and design • Sustainability 	<ul style="list-style-type: none"> • Integrated planning • Network strategy • Investments • Integrated water and land management • Water quality • Resilience 	<ul style="list-style-type: none"> • Assets and infrastructure • Operations including Customer Service • Commercial delivery 	<ul style="list-style-type: none"> • Mātauranga Māori (<i>Māori knowledge</i>) • Māori partnerships • Cultural performance • Māori capability and cultural safety

Moving into designing a CCO organisational structure

If there is a decision to create an asset owning CCO then there will need to be a process to design and establish the operating model, functional structure and then the organisational structure. This is identified as part of the next steps in the management case. However, in order to assist that process of we have set out a series of organisational design principles starting on the next page. The organisational design principles can be used to guide the consideration of various alternatives and the basis for the choice of a proposed structure that is fit for purpose.

Organisational design principles

Description	Implication for structure	Application to structure
Affordable		
The structure is affordable now, and into the future.	The structure sets the CCO on the right track for the future in line with the current budget.	Working within the constraints of the current three waters budget, the structure allows an increase in leadership and technical capability and capacity. Grouping functions in line with the operating model gives the ability to further grow and modify the structure in the future, as budget allows.
Efficient and effective service delivery		
This is a key principle so needs to be consistently achieved.	Ensure the critical service delivery functions are well resourced with depth in capability that also incorporates service principles and delivery that are meaningful for Māori.	Account management roles manage and lead relationships at a senior level. This capability ensures contract adherence to allow delivery teams to focus on day-to-day operations. Working with service providers to deliver the network and meet (and surpass) community expectations.
Fiscal responsibility		
The business must be well run so it is financially sustainable and affordable, with no surprises.	Strong partnership links to central government agencies and councils. Capability and capacity for business cases, funding and process management.	Commercial capability added.
Clear responsibilities		
Accountabilities, authorities and duties are clear including those defined in the cultural case and measured through cultural and key performance indicators.	Accountabilities, authorities and duties are clear and include responsibilities for decision points within business processes.	Proposed new roles have clear accountabilities described.
Information driven		
Ensure decisions are informed by good information and insight - relates to all parts of the operating model.	Structure allows the use of data analytics and insight to drive operational performance improvements across all parts of the business.	Capability for this is combined with Strategy to highlight the importance of information requirements and data accuracy for CCO strategy and decisions. Cultural and Key Performance indicators are defined and within CCO strategy and business planning.

Description	Implication for structure	Application to structure
Partners with Māori		
<p>The business is committed to working in partnership with mana whenua.</p> <p>The business is responsive to Māori values, and is equipped and capable to embed Te Ao Māori The Māori Worldview across the business.</p> <p>The business is culturally accountable to Māori directors represented through co-governance.</p>	<p>The structure enables the meaningful role of co-governance to be extended across the organisational delivery of the business with internal Māori capacity and organisational cultural capability to successfully work in partnership with ongoing contributions from mana whenua to the future of land and water management across all parts of the operating model.</p> <p>The structure recognises and incorporates Māori cultural, spiritual and economic connections to land, water and resources and aims to be kaitiaki alongside mana whenua.</p>	<p>CCO leaders and managers are culturally empowered to involve mana whenua in decision making to realise the mutual benefit of working collaboratively.</p> <p>CCO is equipped with internal Māori capacity to guide the business through Te Ao Māori <i>The Māori Worldview</i> and to ensure that Māori values are interpreted and applied to mana whenua expectations.</p> <p>CCO teams are culturally capable to build strong, respectful partnerships with mana whenua. Integrating Māori centred initiatives and projects across the operating model will allow all stakeholders to maintain a balanced view of how kaitiakitanga <i>stewardship</i> can coexist with commercial and operational requirements.</p>
Strategy led		
<p>Taking account of the proposed three waters operating model, business decisions should be aligned with short and long-term strategic outcomes.</p>	<p>The structure should allow for delivery now and planning for the future. Structure is agile enough to respond to new opportunities and changing demands (e.g. price regulation).</p>	<p>Strategy and decisions are data driven and well informed. Strategy and business plans are developed with the business to ensure they are relevant and to guide operational work. Plans give clear direction on how to work, react and link what is delivered now and in the future. Creates a foundation for future transformation.</p>
Integrated product offering		
<p>Three waters is a set of three integrated products providing a unifying experience under the CCO brand.</p>	<p>Business is organised to maximise the value of each product within the overall network and brand. Integrated view of three water services and how they are connected.</p>	<p>Each water service is kept separate at operational level but brought together at leadership level. This allows specialisation of product at the detailed level but supports holistic and integrated view of three water services and how services are connected.</p>

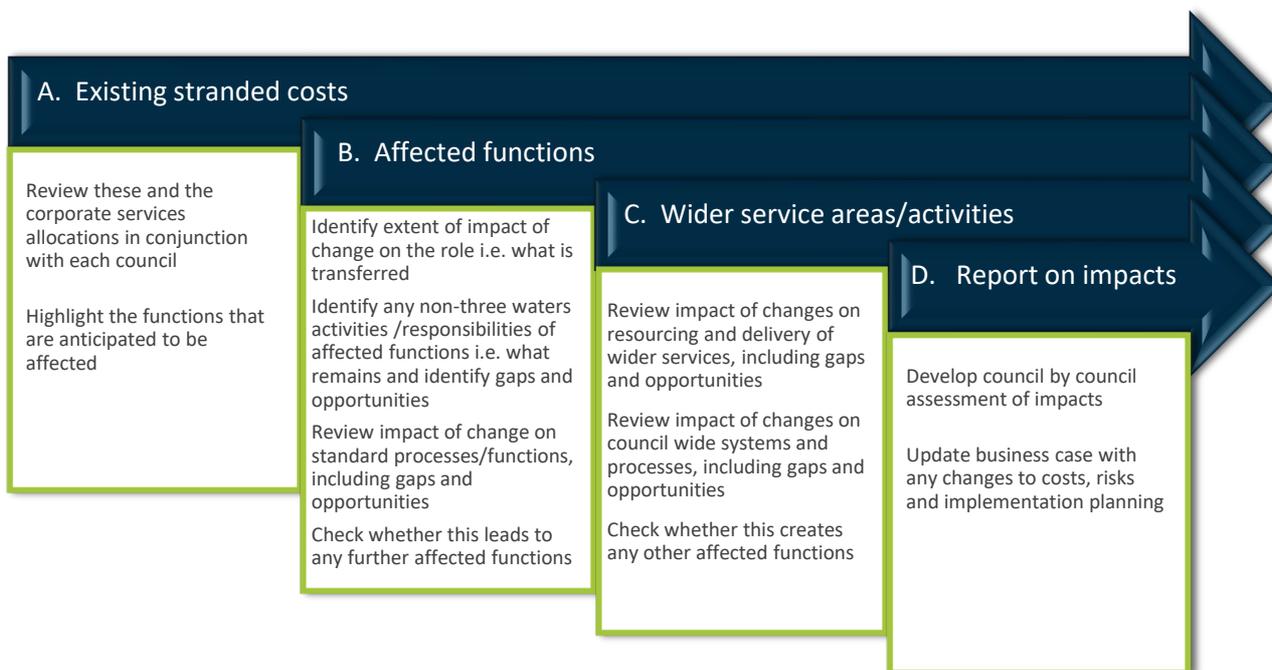
Description	Implication for structure	Application to structure
Community centric		
<p>Business has a strong community focus with mandate to influence, lead and engage in co-design. Importantly the relationship with mana whenua is special and not to be subsumed within a community centric focus</p>	<p>Community input and perspective is enabled through the structure across all parts of the operating model – from strategy to analysing performance.</p>	<p>All teams are empowered to consider the Community’s perspective, as well as design and deliver for customers. The structure encourages the embedding of community-centric principles to feed into business and operational planning. Educating and empowering CCO teams to own the customer experience for their areas, and to work directly with communities to represent their voice. Develop community-centred initiatives and projects. A balanced view between community centricity, commercial feasibility and operational requirements.</p>
Business acumen		
<p>Commercial thinking is ingrained in key aspects of CCO business, including contract management.</p>	<p>Structure needs to enable strong commercial leadership in a partnership model with service providers and vendors. Structure (and processes) need to recognise key dependencies (e.g. finance, pricing, projects, operational performance). This is where post-settlement governance entities (PSGEs) and/or mandated iwi authorities may choose to participate, contribute or joint venture on the basis of shared strategic outcomes.</p>	<p>Business rules ensure commercial and financial health of the organisation and commercial implications are understood. Additional roles enable strong business leadership required in the partnership model with service providers and vendors for commercial performance. A strong focus on financial sustainability through revenue protection and by developing pricing for revenue generation. Contract management allow contract support and implementation at both a senior and operational level. Account management roles provide senior level relationship accountability, support the partnership approach and contractual obligations and allow internal escalation. Procurement outcome opportunities through Matariki Hawkes Bay Regional Economic Development strategy (HBREDS) exist for economic, inclusive and sustainable growth.</p>
Functional alignment		
<p>Like functions are grouped together where logical and practical to minimise hand-offs within business processes. Māori responsiveness has a unique cross-cutting and enabling role across all functions.</p>	<p>Structure has good alignment with proposed operating model. Individuals and teams know where they fit.</p>	<p>Viewing the operating model as a circular function (end-to-end) and aligning the structure, accordingly, will allow smooth handling of business processes and articulate clear accountabilities.</p>

Description	Implication for structure	Application to structure
Strong and motivated workforce		
<p>Enables and enhances talent retention and development of existing workforce and attraction of new people.</p> <p>Māori responsiveness and cultural capability development and its definition within key performance indicators across the entire business will be value-add toward strategic outcomes and professional/personal development</p>	<p>Structure provides opportunities for staff to be involved in wider projects. Structure provides opportunities for professional advancement.</p> <p>Māori responsiveness as a central point of excellence in the business structure and operation is essential. The recruitment pool to attract credible and competent talent is small and competitive.</p>	<p>Separating leadership and technical skill for different career pathways where appropriate. Introducing roles to allow differentiation between technical leadership and people leadership. This presents additional career development opportunities. Both managerial and technical leadership increases on- the- job development through coaching and mentoring for staff. Structure fosters collaboration between teams and support staff so they can be involved in wider projects. A project management framework will allow resources to be pulled across the group for cross functional and agile teams.</p>
Span of control		
<p>Team size, number of direct reports and responsibilities are manageable, enabling a ‘coaching’ approach to management which empowers staff.</p>	<p>Team size, number of direct reports and responsibilities can empower staff, create a coaching environment, and ensures the effective decision-making frameworks are possible.</p>	<p>Maximum number of direct reports is ten to ensure capacity in management roles for leadership, staff development and a coaching approach. Larger teams and those requiring specialist expertise have additional technical senior support provided.</p>

Impact on Councils of change

Our approach

In order to understand the actual impact on each Council of a proposed change to a regional water CCO we used a four-step approach, as shown in the following figure.



Onsite discussions were held with the chief executives, directors/group managers and relevant senior managers that were either directly providing three waters services or involved in supporting the delivery of three waters services.

This section discusses the impacts with the functional charts set after the discussion of each council identifying the affected functions. It is important to note that the discussions have focussed on functions rather than individual roles as at this stage no decision has been made to form a CCO.

All financial implications are included within the business case and to provide context a total FTE for each Council pre and post creation of a CCO has been provided.

It also recommends some approaches that the Hawkes Bay councils could take related to the changing role of local government in New Zealand.

Quantifying the change

An estimate of the quantity of water related work that teams and individuals within each council are currently undertaking was made. This informed modelling of the overall potential costs of establishing the water CCO as well as the assessment of the likely change to council workforces.

The estimate was used as a guide only in determining the level of resource available from each council to be transferred to the newly formed CCO. In practice, reallocation of workload between the staff resource remaining in the councils, and the transfer of staff to the Water CCO will be a complex exercise. Viability of the delivery of the non-water related core council functions and services with the remaining staff will need careful consideration as will matching individual skill and capability with tasks. Support of water service activities is integrated into many roles throughout the council organisations, particularly in Central Hawkes Bay and Wairoa.

- Firstly, an assessment was made to identify and quantify the functions that are directly related to and/or funded by three waters services. These were assumed to transfer into the regional water CCO.
- Secondly, the proportion of resource that supports three waters from across the entire council workforce was identified as well as roles that were not affected.

Impacts on resourcing, structure and functions

Creation of a Hawkes Bay regional water CCO will impact the resourcing, organisational structures and functions of each council. Water activity is a significant proportion of each council's budget, so the transfer of the activity to a CCO will impact the way each council operates in the future.

In the larger councils, Napier City Council and Hastings District Council, specialist functions directly related to the delivery of water services were more easily identified. In the two smaller councils, Central Hawke's Bay District Council and Wairoa District Council, the roles tend to be more generalist. Separating out water related resources from other infrastructure functions is likely to be more disruptive and may undermine the ability of the reconfigured councils to deliver the remaining functions effectively to their communities.

Should the recommended approach (asset owning CCO) progress to be the one with which the Councils proceed to consult with the community on, staff communication will occur in parallel. Consultation with staff and unions will occur after the outcome of the community consultation is known.

The impact of the proposed creation of a regional CCO on council structures extends further than just those staff whose roles are directly related to water. Many functions within council spend a proportion of time on three water-related matters, for example, finance, HR and communications.

If the move to an asset owning CCO proceeds, we envisage that the vast majority of three waters staff would transfer to the new CCO on conditions of employment that are no less favourable than they are currently employed on, and in accordance with the employees existing employment agreement. For ease, this has been referred to as staff being 'transferred' to the new entity. Existing three waters staff (and other staff) from all four councils may apply for additional roles created in the CCO.

There is a balance to be struck between ensuring a water CCO is formed that has the capacity and capability to improve services in an affordable way and maintaining efficient and effective ongoing delivery of the remaining council functions with reduced resources.

Wairoa and Central Hawke's Bay are already facing resourcing challenges in delivering core local government functions and, at times, struggle to attract and retain employees for key roles. Reducing their resource further will mean they will have to consider how they can continue to provide effective services and retain and attract suitably qualified and capable employees in a way that protects the wellbeing of their communities.

Central Hawkes Bay District Council

Before and after functional structure charts of Central Hawkes Bay are set out on the following pages. In all cases vacancies have been included.

What does the change mean for CHBDC?

In our view, the transfer of resource to the proposed water CCO will have a significant impact on the ability of Central Hawke’s Bay District Council to maintain the current level of service across the remaining council functions.

Resources are already at capacity within council. Roles within council tend to be generalist, so the capacity and capability that existing three waters employees provide across non water related functions will be lost to council with the transfer of three waters to a CCO. For example, council has existing challenges in delivering best practice asset management and infrastructure planning. This situation is likely to be exacerbated with any further loss of resource despite the actual transfer of resources from Council to the CCO being small. Our analysis shows only 9% of the council’s FTEs are solely or significantly focussed on water related activities as most roles are already outsourced.

In recent years, Water has been the most significant issue for the predominantly rural Central Hawke’s Bay community. It has become a cornerstone around which the Council has connected with its community and brought change through the organisation. Transfer of responsibility for delivering water to a CCO will mean the Council (from the Councillors, through its leadership and operational staff.) will need to reassess the opportunity it has to effectively deliver on other issues for its community with its remaining resource.

The actual transfer of resources from Council to the CCO would be small. Many roles are already outsourced within the three waters function as well as in other areas, so the impact is different. The number of staff directly involved in three waters is also small and there is insufficient resourcing in the support functions for any other staff to realistically transfer. Some capacity will be created in many key areas of the organisation such as corporate services, finance and HR with the organisation benefiting from this increased capacity. However, this additional capacity will not be funded by water revenue so in effect becomes a stranded cost. The organisation will need to manage this cost as well as the funding of senior positions within the Council whose roles would have in part been based on a span of responsibility that included water. Attracting and retaining high quality staff to the reduced roles in future may also be a challenge.

Overall, the loss of the revenue, the cost of supporting stranded costs and the diminished scope of responsibility may place an unsustainable strain on the remaining council organisation unless further changes are made and/or additional responsibilities or requirements for Councils eventuate. The remaining organisation structure is likely to have to evolve to remain a high performing Council. There may need to be future reorganisation of resources allocated to the various functional areas and most importantly finding a new focus for the council.

Pre CCO FTE	Post CCO FTE
69.6 ³⁷	63.6

³⁷ As at 26 June 2020

Figure 37 Current Central Hawke’s Bay District Council functional chart showing functions impacted by water CCO

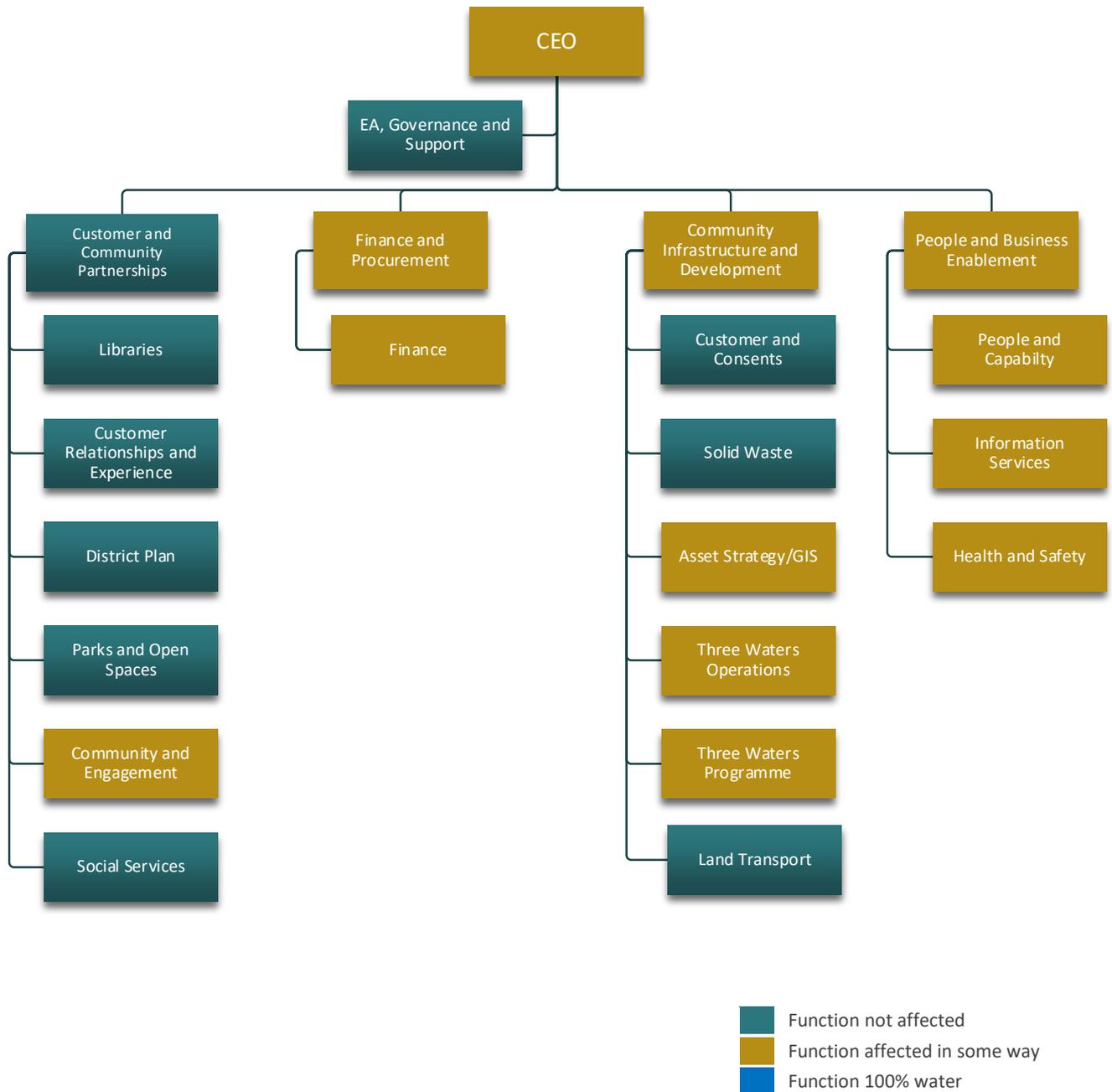
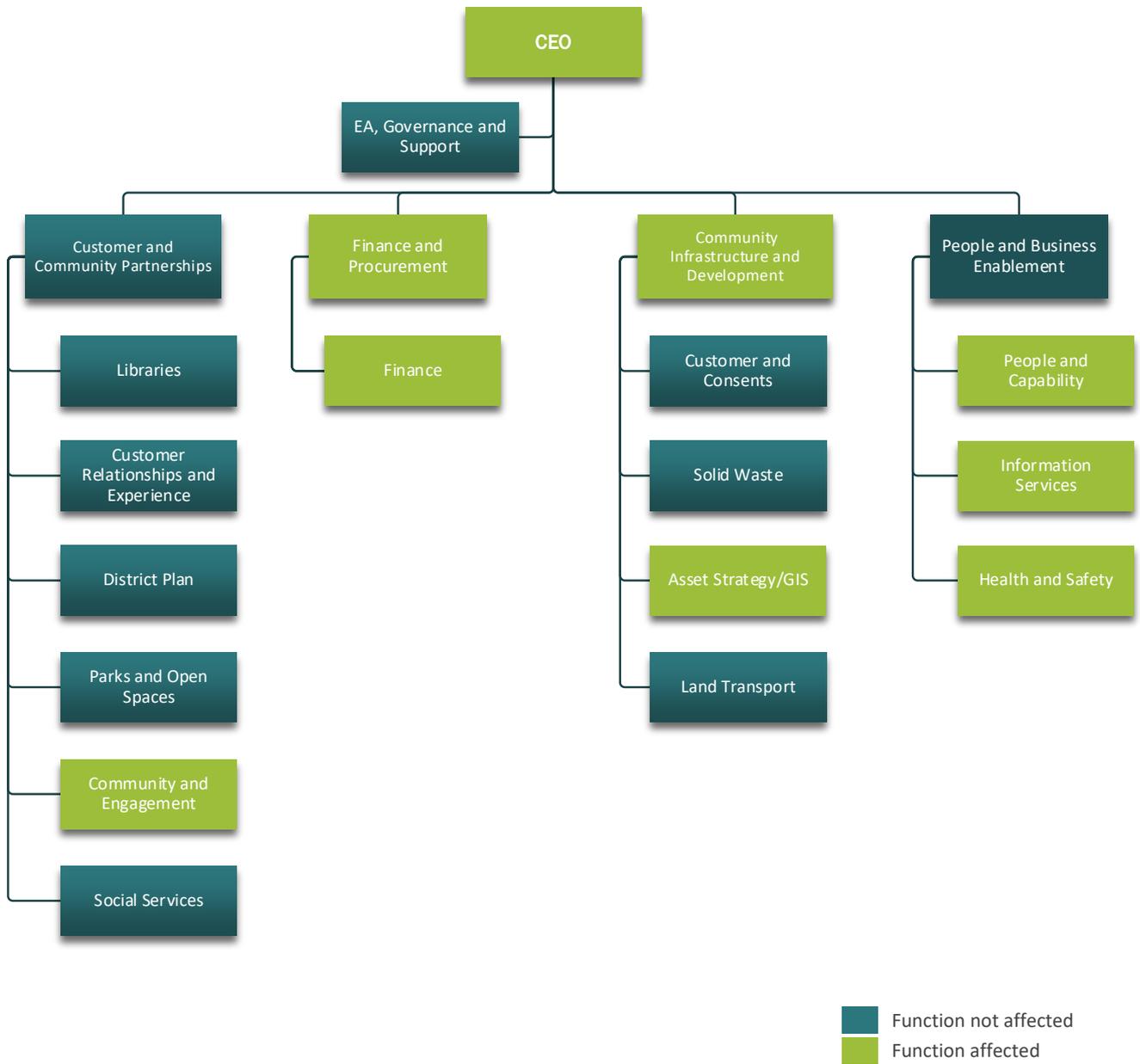


Figure 38 Indicative functional chart for Central Hawke’s Bay District Council post creation of water CCO



Hasting District Council

Before and after functional structure charts of Hastings are set out on the following page. In all cases vacancies have been included.

What does the change mean for Hastings District Council?

The formation of a water CCO appears to have the least direct impact on Hastings District Council. Project delivery, planning for and oversight of the three waters functions are all delivered within one unit and the delivery of three waters operations is already outsourced. It is anticipated that transferring these functions to the water CCO will have minimal disruption on the balance of the organisation and the delivery of business as usual.

Our analysis shows only 8% of the council's FTEs are solely or significantly focussed on water related activities as remaining work is already outsourced.

The existing three waters team is supported by a range of Council corporate services functions including IT, HR, WHS and finance who also have well-resourced teams. Some resource from within those functions would likely transfer to the CCO to continue their support roles. We estimate that 2.4% of the total FTE would transfer resulting in the remaining teams needing to reallocate tasks or complete some reorganisation of resources. There are other support areas where capacity would be created with the organisation benefiting from this increased capacity. However, this additional capacity will not be funded by water revenue so in effect becomes a stranded cost. The organisation will need to manage this cost as well as the funding of senior positions within the Council whose roles would have in part been based on a span of responsibility that included water.

Council officers consider the move to a water CCO is unlikely to materially impact their ability to attract and retain good applicants to roles within the council that would remain. Other factors, such as location and the breadth of responsibilities, are seen to be key influencers.

A loss of integrated infrastructure planning is, however, considered to be the greatest risk to the ongoing delivery of services by Hastings District Council. It is critical that a framework and protocols are put in place as part of establishing the water CCO to ensure effective district and regional planning and policy making. This must be underpinned by regular, timely meetings and communication to ensure council can continue to provide an integrated response to infrastructure issues and development. For example, stormwater is an integral part of the design and decision making for roading design and upgrades and three waters supports housing growth as well as planning for commercial and industrial developments.

Pre CCO FTE	Post CCO FTE
411 ³⁸	368

³⁸ As at 26 June 2020

Figure 39 Hastings District Council functional chart showing functions impacted by water CCO

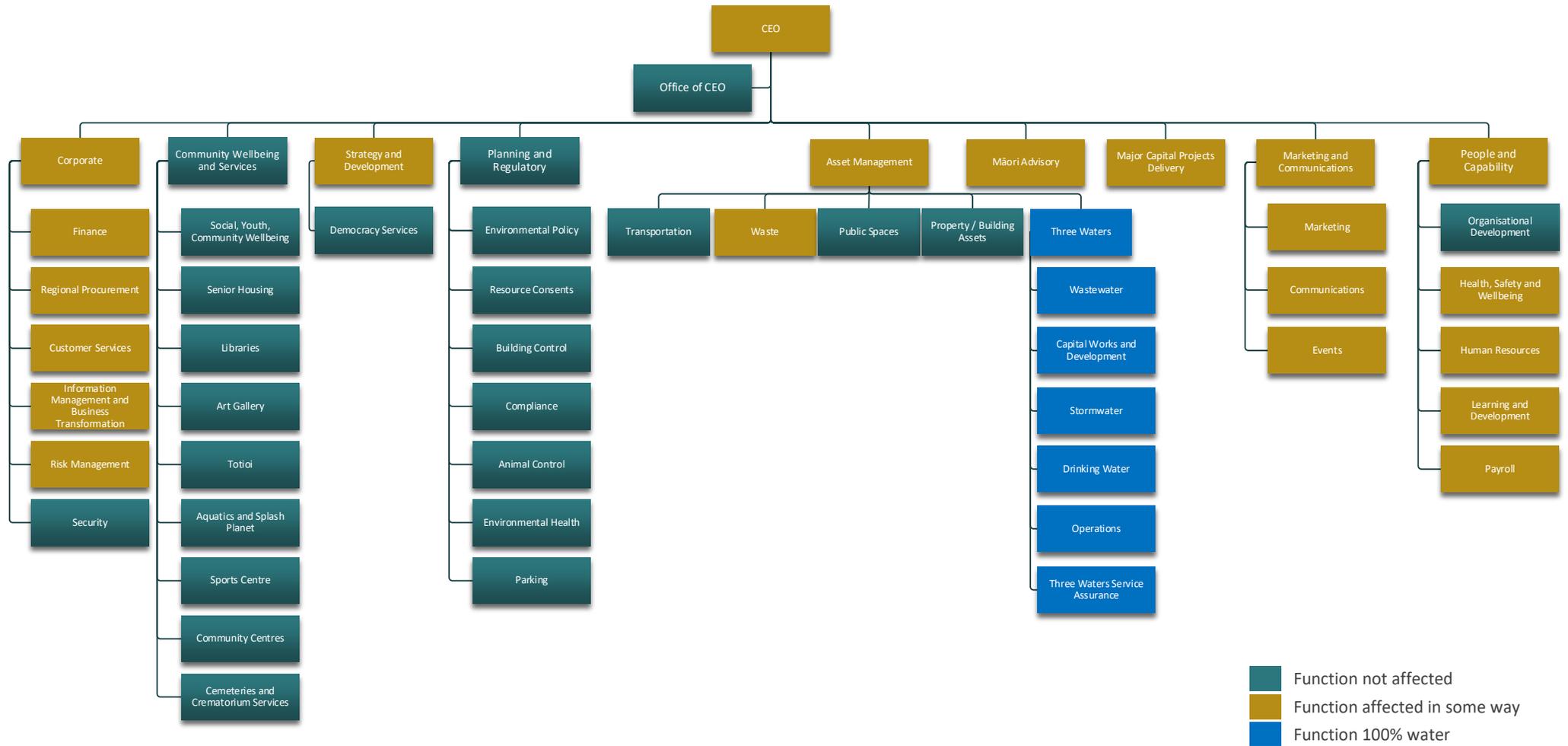
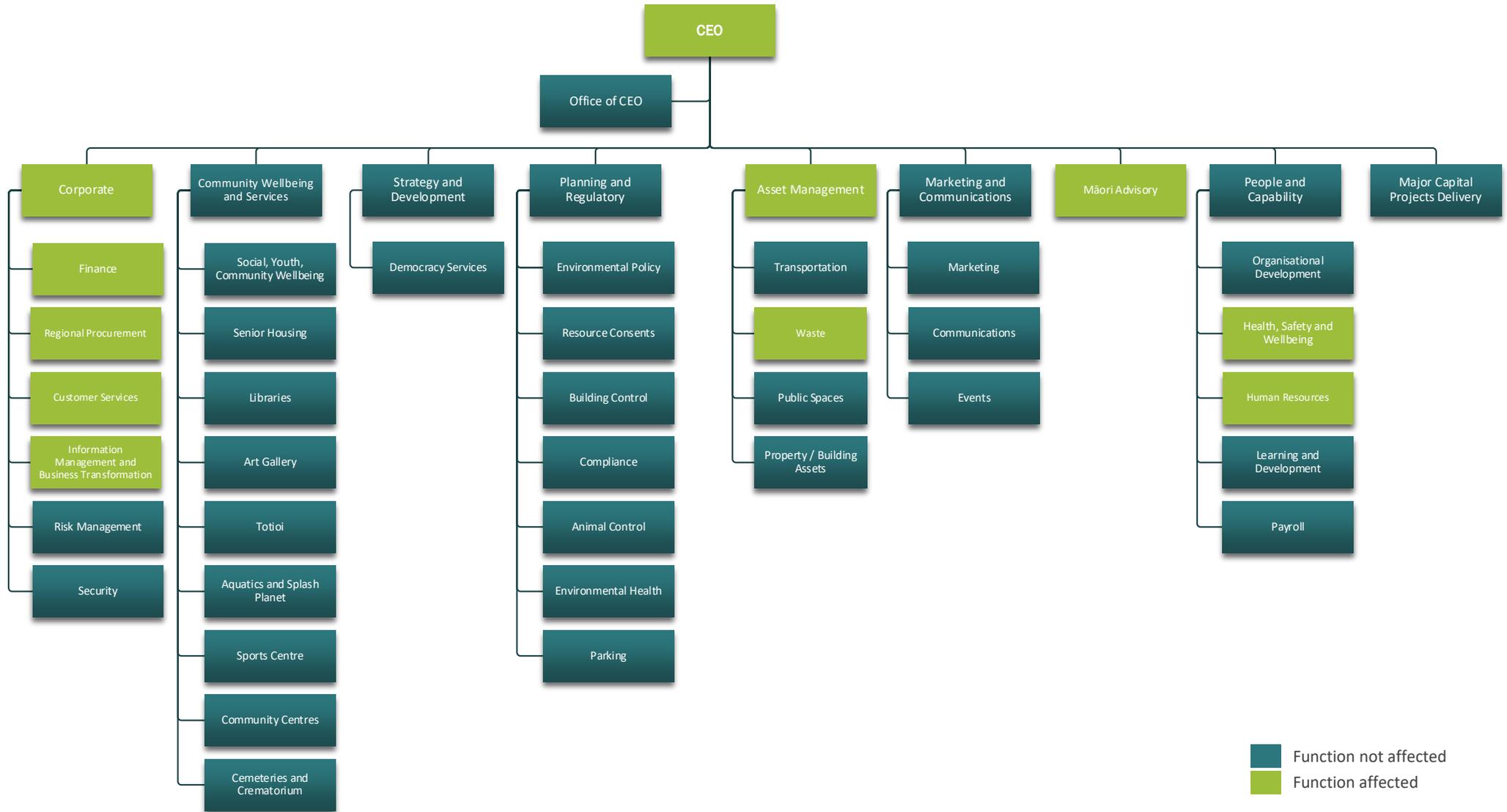


Figure 40 Indicative functional chart for Hastings District Council post creation of water CCO



Napier City Council

Before and after functional structure charts of Napier are set out on the following pages. In all cases vacancies have been included.

What does the change mean for Napier City Council?

Unlike other councils in the region, Napier City Council has predominately retained provision of services in house, rather than outsourcing. The creation of the proposed water CCO will therefore have a greater impact on the organisational structure of Napier City Council as it would affect proportionally more roles when compared to Hastings District Council.

Two functional areas have a significant proportion of specialist staff directly involved in the provision of water services. Approximately 40% of the FTEs reporting through to the Director of Infrastructure would transfer to the water CCO as their role is directly related to three waters, and approximately 26% of the FTEs reporting through to the Director of City Services would likely move to the water CCO should the City Services staff transfer.

While many functions across council provide varying degrees of support for water services and an estimated 5 FTE from across corporate services would transfer to the CCO, generally the organisation would be largely unaffected due to its size and range of activities it undertakes. There are other support areas where capacity would be created with the organisation benefiting from this increased capacity. However, this additional capacity will not be funded by water revenue so in effect becomes a stranded cost. The organisation will need to manage this cost as well as the funding of senior positions within the Council whose roles would have in part been based on a span of responsibility that included water.

Council officers consider the move to a water CCO is unlikely to materially impact its ability to attract and retain good applicants to roles within council. Other factors, such as location and the breadth of responsibilities, are seen to be key influencers.

Council officers also consider the loss of intellectual property and expertise that would occur through transferring all water specialist roles to the CCO increases organisational risk. This may be partially, but not completely offset by the creation of a good service level agreement with the water CCO and regular, structured communication and information sharing.

The ability to continue integrated decision making for infrastructure is essential to the success of the proposed water CCO. Given these concerns, it is considered likely council would prioritise retaining strategic engineering expertise at the executive level to somewhat mitigate the risk.

Pre CCO FTE	Post CCO FTE
529 ³⁹	456

³⁹ As at 19 June 2020

Figure 41 Current Napier City Council functional chart showing functions impacted by water CCO

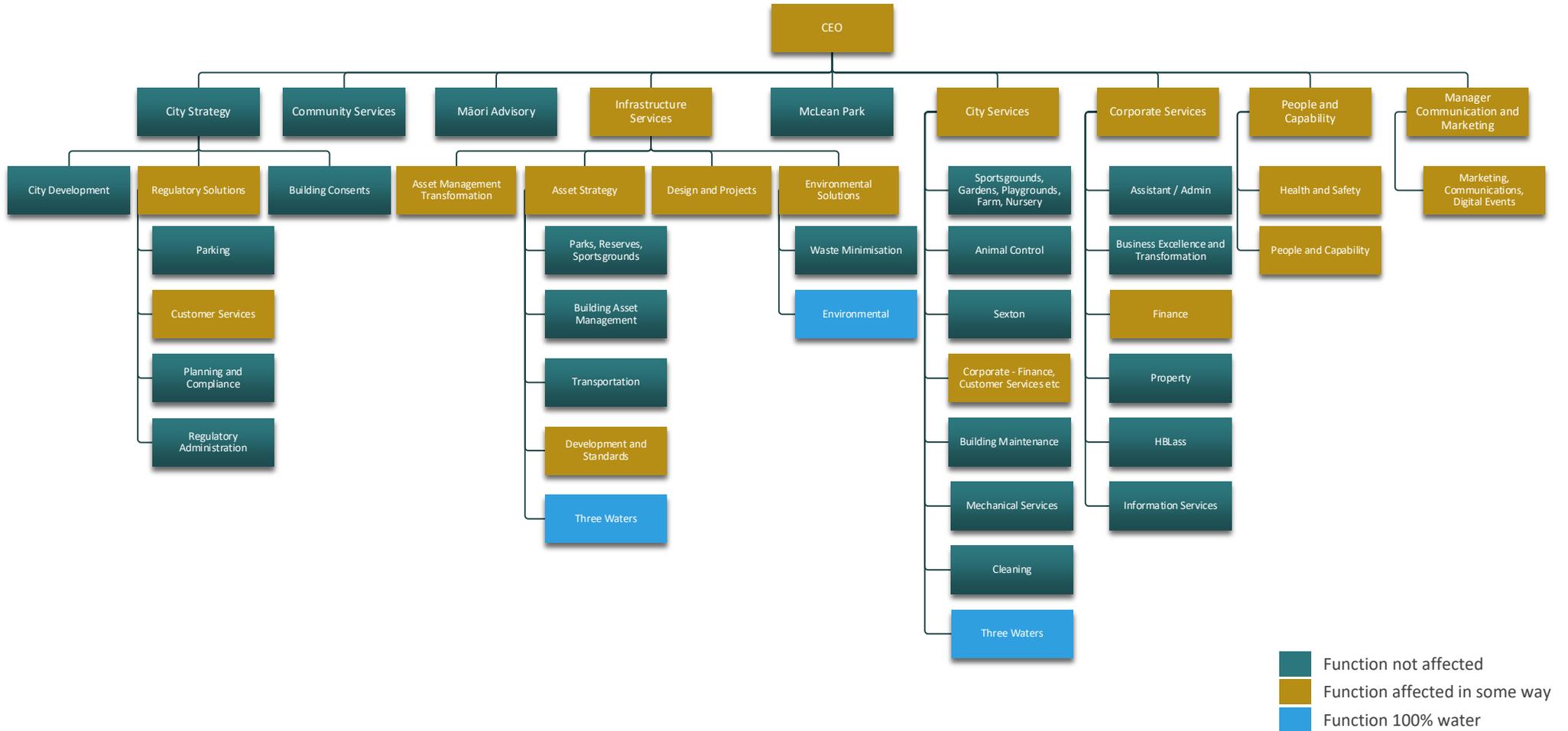


Figure 42 Indicative functional chart for Napier City Council post creation of water CCO – scenario one (City Services staff transfer)

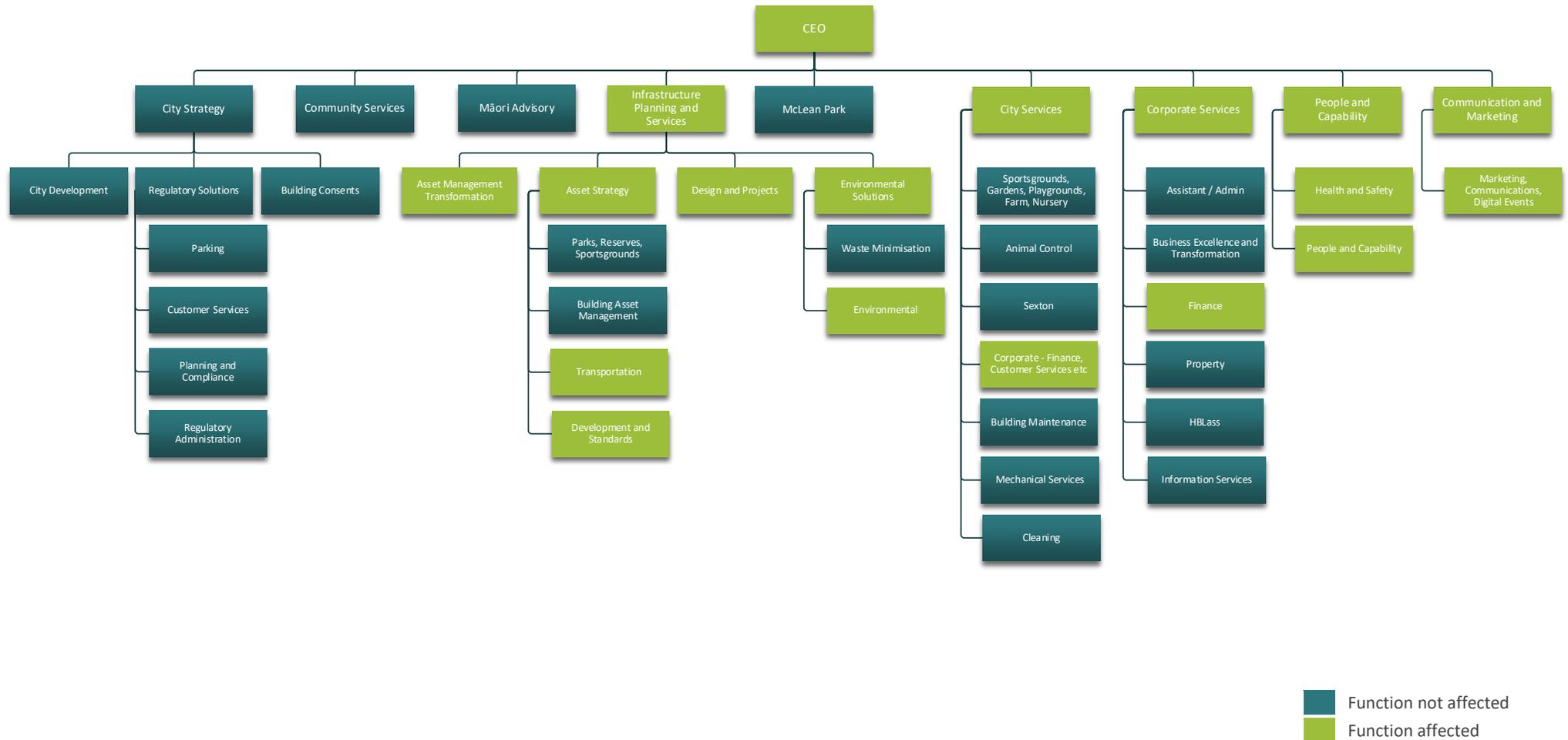
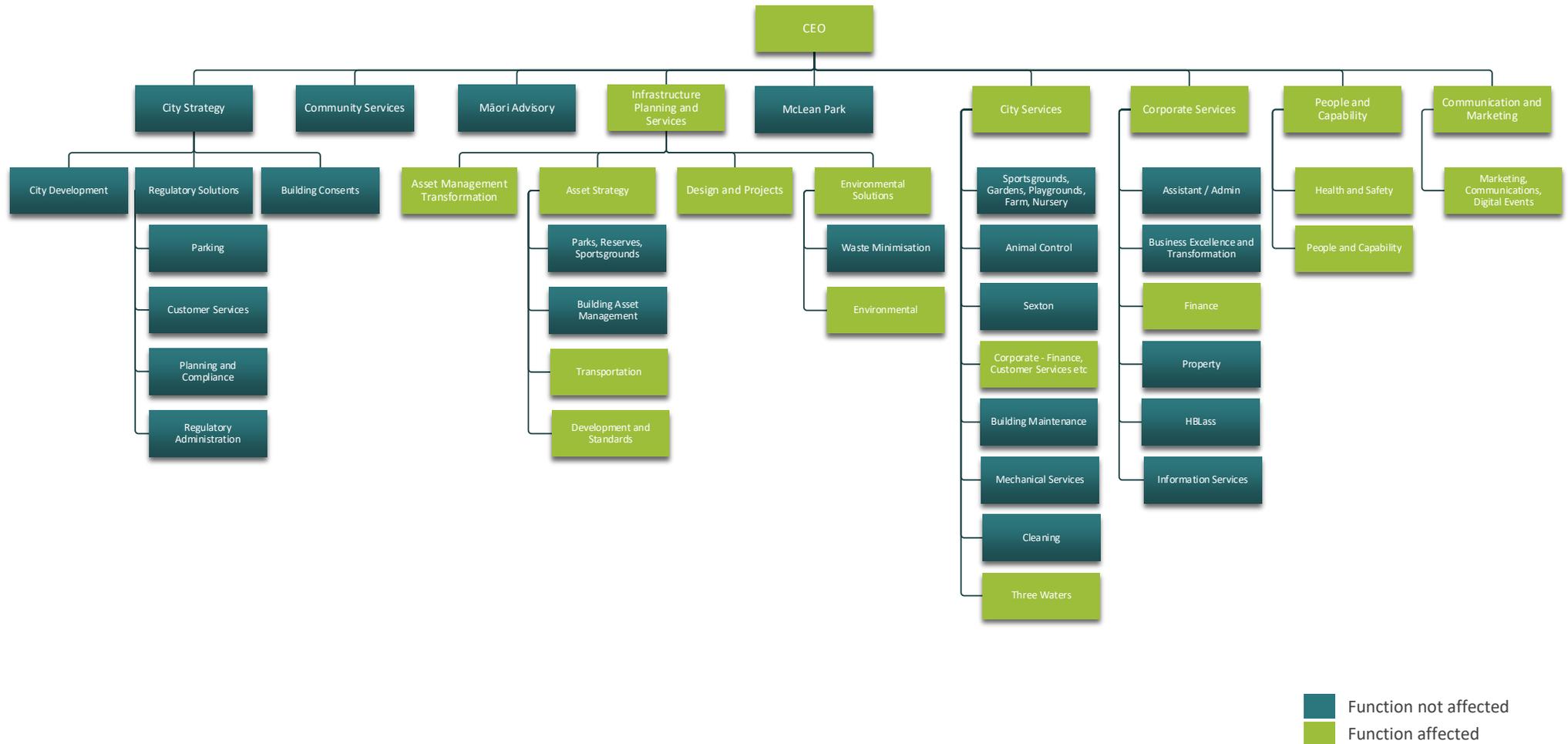


Figure 43 Indicative functional chart for Napier City Council post creation of water CCO – scenario two (City Services staff transfer)



Function not affected
 Function affected

Wairoa District Council

Before and after functional structure charts of Wairoa are set out on the following pages. In all cases vacancies have been included.

What does the change mean for Wairoa District Council?

In our view the creation of a regional three waters CCO will have a significant impact on the ability of Wairoa District Council to maintain the current level of service across the remaining council functions.

Given the relatively small size of Wairoa District Council, roles within the organisation tend to be generalist with a wide range of responsibilities delivered across a relatively small asset base when compared with other councils in the region. The actual transfer of resources from Council to the CCO would be small, only 8% of the council's FTEs can be demonstrated to be solely or significantly focussed on water related activities as most roles are already outsourced.

While many roles within council provide some degree of support for three water activities, as a proportion of the total resource for any given function it is frequently less than 20% due in part to the activity being largely outsourced or varies on an issue by issue basis (for example, communications). Overall, it was difficult to identify resources applied to waters and given the limited capacity within council there is insufficient resourcing in the support functions for any other staff to realistically transfer to a CCO.

Some capacity will be created in many key areas of the organisation such as corporate services, finance and HR with the organisation benefiting from this increased capacity. However, this additional capacity will not be funded by water revenue so in effect becomes a stranded cost. The organisation will need to manage this cost as well as the funding of senior positions within the Council whose roles would have in part been based on a span of responsibility that included water. Attracting and retaining high quality staff to the reduced roles in future may also be a challenge.

Wairoa is already resource constrained when delivering some core services to its community. For example, it has been late in producing its LTP and annual report. Any further reduction in FTEs may significantly impact council's ability to deliver its remaining services and may impact its ability to recruit to vacancies. This situation is likely to be exacerbated by the demands placed on council to engage in governance and relationship development activities arising from the creation of a water CCO.

Overall, the loss of the revenue, the cost of supporting stranded costs and the diminished scope of responsibility may place an unsustainable strain on the remaining council organisation unless further changes are made and/or additional responsibilities or requirements for Councils eventuate. The remaining organisation structure is likely to have to evolve. There will need to be future reorganisation to reprioritise the resources allocated to the various functional areas.

Pre CCO FTE	Post CCO FTE
66.7 ⁴⁰	61.7 ⁴¹

⁴⁰ As at 15 June 2020

⁴¹ Ibid

Figure 44 Current Wairoa District Council Current Wairoa District Council functional chart showing functions impacted by water CCO

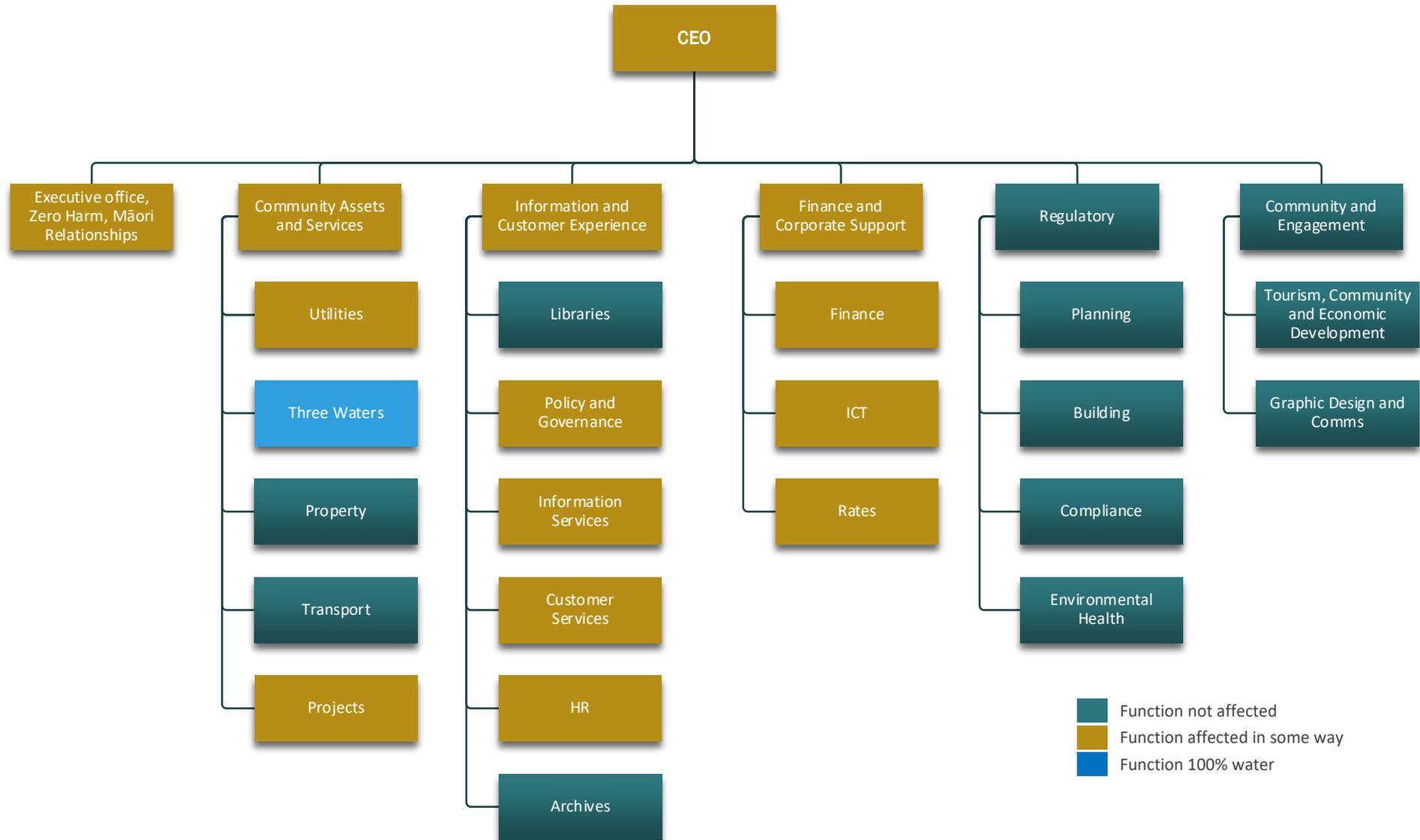
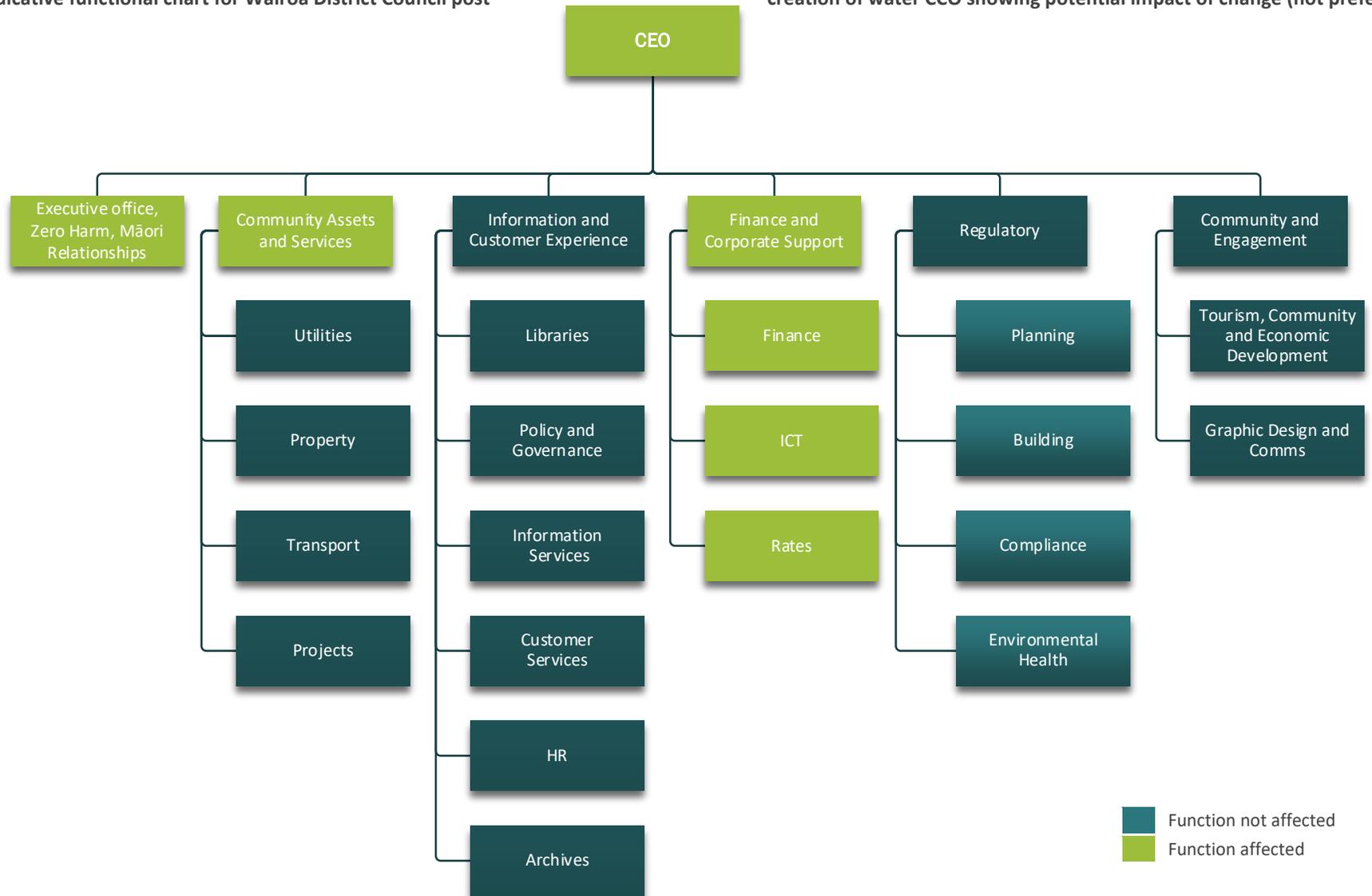


Figure 45 Indicative functional chart for Wairoa District Council post

creation of water CCO showing potential impact of change (not preferred option)



Opportunity for a different future

If a regional water CCO is formed, then all councils need to consider how they will function after such a significant change. This can be viewed as an opportunity to return to first principles to find ways to deliver important council services in a new way to ensure that Central Hawke’s Bay and Wairoa have a viable future.

Supporting a regional water CCO

In addition to the immediate change in functions related to water activity transferring, some new functions are likely to arise for councils in guiding and supporting the regional water CCO (see **Table 18** below). There may be merit in regionalising these costs to the CCO, which in practice would result in a small financial contribution being returned from the CCO to councils to offset these cost increases.

For example, the New Zealand Government in its 7 August 2019 Cabinet Paper: *working with local government on community wellbeing* signalled its intention that local authorities would put greater focus and, presumably, resource into more inclusive community participation and partnerships, particularly with Māori. Local government would be expected to

- build capacity and capability of parties to engage
- use innovative engagement methods and communication tools
- demonstrate a greater flexibility and range of consultation methods
- increase the uptake of effective Māori participation mechanisms.

In terms of the NZ Government’s wellbeing priorities (social, cultural, economic and environmental), a regional water CCO would be considered a priority for increased engagement. Some of these potential new functions for Hawke’s Bay councils arising out of the creation of a water CCO are detailed in **Table 18** below. In some councils, aspects of these functions may already exist. They will need to become more formal if a CCO was created.

Table 18 New functions for councils with water CCO

New council functions to support CCO
Oversight and governance of three waters.
Set key outcomes and performance measures for CCO.
Monitor and audit CCO performance against these measures.
Develop strategic relationship with Māori. Ongoing Māori liaison, consultation and engagement on the strategic, sustainable management of water regionally.
Regional strategy development for three waters.

We note that South Wairarapa (the 14th smallest Council in NZ by population), reported very positively on the change associated with becoming part of Wellington Water. The depth of expertise and resources that could be brought to bear was a significant help when Martinborough faced water contamination issues. The organisation now, quite deliberately, has a second-tier role of Group Manager Partnerships and Operations as it responds to the changes that flow from joining Wellington Water.

The evolving role of local government

The NZ Government is considering the role of local government in strengthening the delivery of intergenerational wellbeing for all New Zealanders, and in better supporting regional growth. Government has signalled its intention to evolve the role of local government. This is in part due to the increasingly unsustainable financial position of many councils, with growing financing and debt constraints, and the need for more localised responses to effectively address societal and economic challenges. The economic shock from the COVID-19 pandemic has further demonstrated the need to promote wellbeing in regions that are heavily reliant on tourism and exports.

The Local Government (Community Well-being) Amendment Act 2019 restored the four aspects of community wellbeing. The amendment broadened the purpose of local government to include promoting the social, economic, environmental and cultural well-being of their communities, while taking a sustainable development approach.

While assessing the proposed structural reform of Hawke's Bay water provision, Hawke's Bay councils have the timely opportunity to review their ongoing structures and roles and consider how to:

- organise council's functions and activities to best deliver the wellbeing needs of their communities in a measurable way
- best bring together and deliver on the intergenerational aspirations of central government, their local communities and Māori
- in a financially sustainable way, achieve good outcomes to pressing social issues, build community resilience and drive local economic growth

In the Cabinet paper released in August 2019 the government also indicated its intention to explore a more meaningful and efficient role for local government in the design, targeting and (where appropriate) commissioning of traditionally central services.

Role of local government internationally

Local government in New Zealand is responsible for a comparatively low proportion of total government expenditure. In New Zealand central government controls 89% of government expenditure, whereas the OECD average is 44%. In other countries local government often plays a greater role in economic development, health, education and social welfare. It also plays a far lesser role in infrastructure provision.

Refocus activities

Hawke's Bay councils could also consider what else they can offer to their communities. For example, they could become a centre of excellence for a particular aspect of council services that they can trade with other councils. A smaller size will allow them to become more nimble and responsive in a changed economic climate as new technology emerges and their ratepayer demographic changes. An example of a council that has pursued a new focus is Hamilton city. Hamilton has a younger population and has developed a focus on being a smart city by using new technology to automate, become more efficient and partner with the local university and industry.

Napier City Council – options for City Services staff

Napier City Council resources the delivery of three waters services differently to the other councils as it relies on internal resources to a far greater extent. This includes operational staff who undertake operations and maintenance of the treatment plants and the reticulation networks. There are more than 40 staff within the Napier City Services who work directly on three waters services as well as those support services and management within City Services.

The presumption in this report is that if the future model is a regional water CCO then all staff directly associated with delivering three waters services as well as some additional staff who support service delivery would transfer to the regional water CCO.

Given the unique nature of City Services there are options that have been considered in this report as to who employs the Napier City Services staff who deliver three waters services.

- Option A – City Services staff transfer to the regional water CCO in the same way other staff do from across the region and City Services staff continue to deliver the same activities and services they currently do.
- Option B – City Services staff remain employed by Napier City Council and a contract is developed between Napier City Council and the regional water CCO such that City Services staff continue to deliver the same activities and services they currently do.

Under all options the same people would effectively remain doing the same roles, the question is about which structure they operate within.

Understanding the different options

The transfer of operational staff from Napier to the regional three waters CCO makes the transition more complicated. The large number of City Services staff, their location and the differences between their duties and activities when compared to the remainder of the regional water CCO staff mean that including them in the organisation would make creating it more complicated. Additionally, as the staff are currently located in the Napier City depot, then either those staff would need to continue working out of the existing depot despite being employed by a separate organisation or move to another location.

- A regional water CCO would need to create a new culture – focussing on the regional and local priorities that they determine. Having a large group of staff co-located within the Depot of their former employer is likely to make it difficult to implement that change.
- If the City Services people, plant and equipment that service three waters were moved to another location then that would leave Napier City Council with responsibility for the entire depot. That would create a significant stranded cost over and above those considered in the review.

We also understand that Napier City Council places a high value on having City Services and the loss of that capacity or perceived capacity of City Services may not be desirable.

The alternative approach, where Napier City Council becomes a contractor to the CCO, does create some risks for Napier. Napier City Council would become a commercial contractor and take on all the associated risks and issues. However, this would be limited to the contract with the regional water CCO, that is a separate entity, with separate management and ownership. A regional water CCO would rightly expect Napier City Council to develop the sort of systems and processes that a comparable contractor would have and take similar responsibility for delivering work on time, budget and to the standard required.

While the transition process would allow time for a contract to be developed, the nature of any contractual relationship between distinct organisations with different objectives, responsibilities and 'owners' may lead to tensions. There are also risks and opportunities for Napier if changes were made in the future by the regional water CCO. In our view, there are mechanisms that can be used to ensure the future employment of City Services staff would be as protected under either option should the regional water CCO decide to review its model of service delivery and, for example, chose to have a regionally consistent approach. Having the staff within Napier means that those risks fall onto Napier rather than the regional water CCO. There is also a risk that any stranded costs or flow on impacts from such a change would be seen as falling on Napier City, rather than being seen as part of considering the regional impacts as has been done through this business case.

Operationally, a regional water CCO may prefer to have a greater level of control over practices, processes and systems, and ability to create change through having the City Services staff as employees from the start rather than contractors. By having its own operational staff it would have also have the ability to directly compare the performance of its operational staff and those of its contractors. This was the approach in Wellington Water where it inherited operational staff as well as contractors. Over time that information was used to evaluate what was the best model before establishing it regionally.

Impacts on the review

When considered from a regional perspective there is little difference between the two options, and the net impact of the difference for the purposes of the financial modelling used throughout this report is negligible for both a regional water CCO and for Council. Regardless of how City Services delivers its services (as a contractor to a three waters CCO or as staff working within a three waters CCO) the full cost of the City Services staff associated with three waters, plant, equipment, and overheads (including the depot) site are accounted for and charged through as a three waters cost and levied on the appropriate group of ratepayers. The only difference would be if Napier determined that as a commercial contractor to the CCO they would need to add a margin to their current costs. If that were the case, then there would be financial impacts for both the CCO and for Napier.

There are some minor additional costs with the more complicated transition but those are not significant. The differences between the options really lies in the complication of giving effect to a larger transition with a distinct group of staff. This is not an insurmountable issue and City Services staff have indicated that either option is, in their view, manageable. Ultimately, we believe the decision needs to lie with Napier City Council, not just because it is their staff but the impact of the decision falls on them to a much larger extent than the other councils.

Valuation and shareholding

Management CCO

Equal shares, one per council.

Under this option the CCO does not own any of the three water assets. What assets it does own will be related to operational delivery. There is no expectation by the owners of a profit being made and returned as a dividend to shareholders. The purpose of the CCO is to deliver the lowest cost service while meeting all other obligations.

The shareholders agreement will contain clauses preventing privatisation (as does the Local Government Act) and sale of the shares but not the winding up.

Asset owning CCO

There are a number of different valuation methods which could be used to establish relative shareholdings. These include those based on future cashflows (Net Present Value) and different models of determining asset value (Optimised Depreciated Replacement Cost, Discounted Future Cashflows, Condition Based Value). A brief summary of each is included in the table below.

Table 19 Valuation approaches

Approach	Basis of valuation	Characteristic of system rewarded
Optimised Depreciated Replacement Cost	Theoretical remaining life and replacement cost	Younger assets, longer asset lives
Discounted Future Cashflows	Sustainable cashflows	Revenue generation
Condition Based Value	Actual remaining life	Well maintained assets

The typical approach for previous regional water CCOs (e.g. Waikato Water) has been to use the optimised depreciated cost and that is shown in the table below. The debt of each council is taken off the assets transferred to equate to the equity being transferred and therefore the relative shareholding. The asset values used to determine the shareholding percentages below represent the current value of assets in each of the councils.

Table 20 Shareholding based on asset value

	Book value of assets	Debt	Net assets	% shareholding
Central Hawke's Bay	\$100,526,039	\$19,827,906	\$80,698,133	8.2%
Hastings	\$617,395,765	\$109,579,830	\$507,815,934	51.4%
Napier	\$376,929,221	\$10,949,751	\$365,979,471	37.0%
Wairoa	\$40,923,976	\$6,746,112	\$34,177,864	3.5%
Combined	\$1,135,775,002	\$147,103,600	\$988,671,402	100%

WSP was commissioned in May 2020 (**Appendix D**) to undertake a review of asset values and unit rates for each of councils. That review found most differences in unit rates were explainable, however it also made adjustments to 'standardise' some component of the unit rates including Preliminary and General cost allowances, and indexation to current values. In **Table 21**, we outline the impact of those adjustments on the relative shareholding of each council. Note that these adjustments to asset value also have flow on impacts to the total cost of service and debt profile for all of the options modelled in this report.

We have also set out an alternative approach below for comparative purposes. We note that under the model used in this business case where there is equitable regionalisation applied during the first ten years that the discounted cashflow approach doesn't match the relative population, which is what you would expect it to do.

Effectively this highlights that, under this approach, Central Hawke’s Bay and Wairoa are, relative to population, bearing a higher proportion of the costs of the regional water CCO in the initial years due to the significant investment occurring within their area.

Table 21 Alternative approaches to valuation and shareholding

	Asset Value (Depreciated cost)	Asset value (WSP update)	Discounted cashflow
Central Hawke’s Bay	8.2%	9.2%	8.4%
Hastings	51.4%	45.9%	45%
Napier	37%	41.1%	40.6%
Wairoa	3.5%	3.9%	6.1%

The shareholders agreement will contain clauses preventing privatisation (as does the Local Government Act) and sale of the shares but not the winding up.

A key part of the next steps will be a common valuation and condition assessment across the region. This, amongst other changes, may lead to adjustments in the relative shareholding.