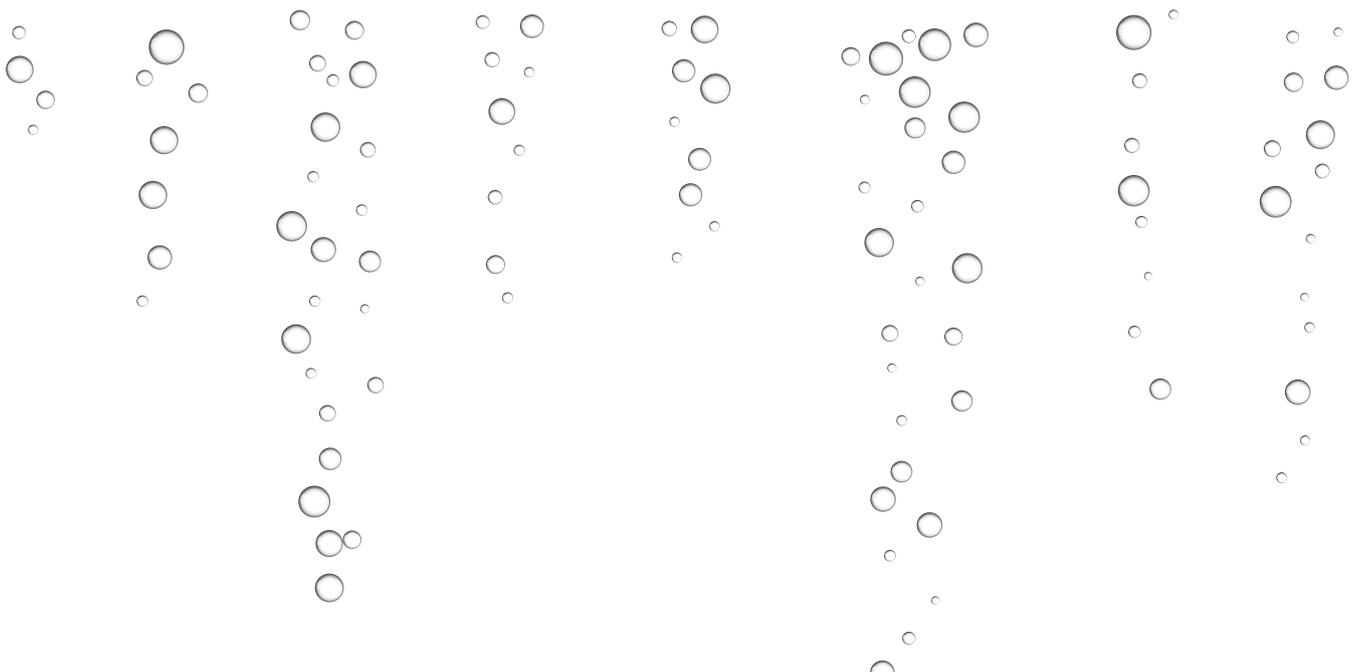


The separation challenge

Three Waters reform





The separation challenge

Government has slowed its Three Waters reform process while it undertakes additional engagement with council and Iwi representatives.

The legislative programme – originally signalled for the end of 2021 has now been pushed into the current year. However, regardless of what modifications are made to reform proposals as a result of further consultation or the legislative process it is highly unlikely that the status quo will endure.

While there is a temptation for councils to “wait and see” what emerges in terms of the final shape of government’s proposals it would be sensible for thought to be given to the implications of shifting water assets and operations to a dedicated, regional entity – whatever the final shape, ownership and governance arrangements might look like.

Such thinking is important for two critical reasons:

No worse off: In order for councils to ensure government’s commitment to its “no worse off” mantra is honoured it is important that councils fully evaluate the implications of the separation out and transfer of their water operations.

Laying a foundation for success: Regardless of the positions that individual councils take with respect to Government’s Three Waters proposals it is in no community’s interests for any structural changes that are ultimately implemented to fail.



A good quality of early thinking about the separation and transition process will serve to protect the interests of councils while also contributing to the smooth transition to any new structural arrangements and positioning new entities for success.

Issues to consider

Preserving/capturing value

Water operations represent a significant part of the operations for many councils. While for larger councils there may be a degree of internal separation of these activities in all instances there will be some form of shared services arrangements and contributions to core infrastructure

and overheads. Any separation process will involve more than simply identifying overlaps and interdependencies. There will be a need to redesign structures and processes aligned with the needs of the go forward activities and responsibilities of the council post separation. Equally, there will be a need to consider the capability that will need to be transferred to any new entity intact to ensure there is no impact on the continuity of service delivery, disruption to critical systems and processes or loss of know-how.

The separation challenge

The separation process will involve considering multiple dimensions associated with current council operations. Those

dimensions will include systems, processes, customers and rate payers, suppliers, employees, and management. Any transition process needs to consider how separation can be effectively implemented without negatively impacting on culture, employees, ratepayers, suppliers, and council financial performance. This significant challenge will need to be met while relying on the same leaders and employees who are attempting to maintain current service levels while managing the divestment of water operations.

Separation readiness - the detail

Ultimately readiness for separation will require a range of activities and considerations.

While there is a temptation for councils to “wait and see” what emerges in terms of the final shape of government’s proposals it would be sensible for thought to be given to the implications of shifting water assets and operations to a dedicated, regional entity



Divestment scenarios

This will involve:

- High-level separation considerations for the current council operating model
- Assessing which assets are transitioning, which people are transitioning, what existing contracts and relationships will transfer and what will be the impact of different scenarios on the current council operating model.
- Identifying what transitional service arrangements will need to be negotiated with any new water services entity to preserve the continuity of service and capacity, capability, and know-how.

Financial modelling

This will involve:

- Development or refinement of the financial models to ensure that these are “fit for purpose” in order to inform the key decisions that will need to be made through the separation process – including ensuring that models are structured so as to enable the stress testing of key assumptions
- Ensuring the robustness of financial information and related assumptions referenced by financial models – including ensuring that there is sufficient detail behind key numbers and support for key assumptions
- Making sure that potential cost savings/ cost rationalisation potentially available post-separation can be modelled accurately and that key assumptions are supported by detailed analysis.

Separation costing

This will involve:

- Stand-alone costing for the water operations of council (including the allocation of all indirect and general management overheads)
- Assessment of one-off and stranded costs by area (the “corporate” centre, shared services, retained activities, divested activities, and potentially discontinued activities)
- Retained cost base pre and post and related restructuring post-separation
- The nature and cost of any new capabilities

Operations

This will involve:

- Determining the future operating model for the council – including how this reflects any changes to the RMA regime or redefinition of the role of local government
- Assessing the practicalities of transferring infrastructure and assets – particularly where these are shared/ difficult to isolate or separate
- Assessing how key supplier contracts and relationships might be carved out and capital works in progress be delivered (including where residual risk would sit)
- Identifying all operational areas that will be impacted by separation and assessing what the impact will be on a standalone basis.

Funding and capital structure

This will involve:

- Forecasting post-separation balance sheet and funding requirements
- Re-setting the rates trajectory in a post-separation environment
- Re-setting capex requirements post the exit of water operations

- Determining the depreciation charges on the retained asset base
- Establishing the debt capacity and headroom post-transfer of water related debt, assets costs and revenues.

Information technology

This will involve:

- Ensuring that any standalone IT systems (i.e. platforms, applications, services) pertaining to the water services to transfer have been identified and the ability to transfer to the new entity has been assessed
- Ensuring that any existing IT hardware, software, and maintenance contracts from third-parties can be transferred or exited
- Identifying any major ongoing or planned IT projects that need to be completed
- Identifying what transitional arrangements will need to be entered into with the new water entity to ensure that the integrity of critical systems is maintained, and data is retained and properly transferred
- Identifying the extent to which the scope of any “in-flight” council IT projects need to be revisited given the change in the nature and scale of the council post separation of water activities.

Human resources

This will involve:

- Ensuring that the management and support staff that are shared have been identified
- Identifying the employees associated with the activities to transfer have been identified – along with their roles, responsibilities, and reporting structures
- Making sure that the council has fulfilled employment law requirements
- Identifying all HR separation issues – e.g. payroll, employee contracts, contractor arrangements, enterprise agreements and other remuneration arrangements.

The endgame

Ultimately councils will be charged with presenting ratepayers with a new value proposition involving adjusted processes, and a streamlined organisation of reduced scale. The above topics represent only a high level view of the activities that will need to be undertaken and performed to a high level to ensure that councils are genuinely “no worse off” as a consequence of the restructuring and that any new water entities are established in such a way so as to maximise their success and ability to deliver an enhanced standard of service over time.

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Our team

The Deloitte team brings extensive experience with the implementation of government reforms across multiple sectors.

We have been involved with all aspects of the establishment process including the design of transitional arrangements, valuation and capital structure advice, organisation design, systems integration, revenue and cost modelling, and debt advisory services.

The Deloitte team assembled to support Councils through the Three Waters reform process hold a combination of the technical skills required to deal with the needs presented by that process combined with the experience learned from earlier processes. They have a deep understanding of the Three Waters Programme including the strengths and challenges of the different delivery models that apply across New Zealand and in overseas jurisdictions.



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