

# Waimea Community Dam Joint Funding and Governance Proposal

7 September 2017

## 1 Executive Summary

- 1.1 The purpose of this document is to make public the parts of an 'In-Committee' report Council considered on 7 September 2017 that are not subject to confidentiality agreements.
- 1.2 That report set out how Council, in conjunction with Waimea Irrigators Limited (WIL) and Crown Irrigation Investments Limited (CIIL), can fund the proposed investment in the Waimea Community Dam (Dam) in the most cost effective way for the whole community including urban water users, irrigators and recreational users. It also covered the proposal to establish a company for the joint venture that will be a Council Controlled Organisation (CCO) to own and operate the Dam. For the time being the company is being referred to as DamCo.
- 1.3 The proposal discussed in the report is the best that we believe can be achieved. This will form the basis for public consultation on the funding and governance of the Joint Venture Company (DamCo). The final investment proposal is still subject to approval by Council (following public consultation), irrigators (WIL) and CIIL.
- 1.4 Under the proposal:
  - a) DamCo would be formed as a Council Control Organisation and owned by WIL and Council(s). Council will appoint the majority of the directors on the Board and will hold at least 51% of the shares at all times.
  - b) The total estimated cost of the Dam (excluding sunk costs) is \$75.9 million (m). This would be funded on the following basis:
    - The environment/community benefit portion has been estimated as \$22.7m. This would be funded via a grant of \$7.0m from the Government's Freshwater Improvement Fund (FIF Grant), a \$10m zero interest CIIL loan (that Council would need to repay) and the remainder by Council.
    - The portion that provides a secure water supply would be funded by water users. Council would fund \$9.6m for urban water extraction, and WIL would be responsible for \$37m. This in turn would be funded from \$15m of irrigator equity, and \$25m from a low interest loan from CIIL, to be made directly to DamCo.
    - The report has been prepared on the basis of a \$5m contribution from Nelson City Council (NCC). However, this contribution is still subject to public consultation and confirmation by NCC.
- 1.5 This means Council would be responsible for funding \$26.8m in total.
- 1.6 Council would provide credit support to DamCo, and in turn, irrigators. This is necessary as Council is the only party that has the necessary financial strength, and because it would, in any event, step in to protect its investment, the wider community benefits, and financial responsibility obligations under the Public Works Act. It also means that funding comes at a lower interest cost to the project.

- 1.7 The alternative to this proposal is for Council to go it alone with a fully rate funded option. Taking that approach would mean losing the FIF Grant, the low interest rate loans from CIIL (\$10m plus \$25m), and equity investment from WIL (\$15m).
- 1.8 The allocation of Council's investment costs of \$26.8m is proposed to be \$9.6m to the urban water account and \$17.2m to environmental/community benefit. These costs will be met from fees and charges, development contributions (DCs), and targeted rates.
- 1.9 While the language in the report is often affirmative, it contains proposals that are subject to the Council, NCC, WIL and CIIL completing their various processes including statutory obligations – in Council's case this includes public consultation on the proposal, feedback and a final decision on whether to proceed. A commitment to build the dam only occurs once the funding arrangements have been agreed by all parties, all approvals have been obtained, the construction price is known and the necessary funds have been raised.

## **2 Background and Discussion**

- 2.1 Council and irrigators have been investigating augmenting the flow in the Waimea River in dry summer months as there is currently insufficient water to provide a secure urban water supply for the Richmond, Mapua, and Brightwater areas. There is also not enough water for irrigators on the Waimea Plains. If we are to ensure a continued water supply and meet the minimum river flow requirements in dry summer months, doing nothing is not an option.
- 2.2 As reported to the 27 July 2017 Council meeting, the review of alternative schemes for augmenting the urban water supply has now been completed. The review confirms that the Waimea Community Dam (WCD) delivers water at a substantially lower cost than any alternative. The alternatives do not offer environmental and broader community and economic benefits, or attract Central Government and private sector funding to lower the cost to urban water users and district ratepayers.
- 2.3 Under the Local Government Act 2002 (LGA), Council is obliged to meet the current and future needs of communities for good quality local infrastructure in a way that is most cost effective. Good quality means infrastructure (water infrastructure in this case) that is efficient and effective, and appropriate for present as well as anticipated future needs.
- 2.4 The paper discusses how Council, in conjunction with WIL and CIIL, can fund the proposed investment in the WCD in the most cost effective way for the whole community including urban water users, irrigators and recreational users.
- 2.5 It is proposed that the Joint Venture will be a Council Controlled Organisation (CCO). That is an organisation where Council has control at the governance level (the board) and/or owns the majority of shares. CCO's are subject to mandatory reporting, audit, and other controls under the LGA.
- 2.6 The immediate next step is to finalise the agreement of the key commercial terms amongst Council, WIL, and CIIL, and agree the forward process. These key commercial terms provide the platform for the next phase of the project. This will include Council public consultation, WIL raising irrigator equity, and the project selecting a construction contractor.
- 2.7 A public consultation document, known as a Statement of Proposal (SOP), on the funding investment proposal and allocation of costs across the District, together with the ownership details of the Dam, will be prepared by staff. The SOP is the basis for Council's formal community consultation. The SOP will be ready for consideration by Full Council at its 19 October 2017

meeting. The SOP will deal with the sequencing of decisions through to the final decision by Council in early 2018 to proceed or not with the project under the proposed Joint Venture approach.

## **Funding**

- 2.8 The figures that follow set out the overall investment and funding flows along with the capital cost allocations for the Dam. Figure 1 sets out the capital investment flows and proposed funding sources. Overall, Council is contributing \$26.78m (with \$10m of this funded by an interest free loan from CIIL), irrigators \$37.12m (including an up to \$25m low interest CIIL loan), Nelson City \$5m (to be confirmed), with the balance of \$7m funded from the FIF Grant. The project is more affordable due to the low interest lending to Council and irrigators by CIIL.
- 2.9 The capital costs of the overall Waimea Community Dam project have been estimated at \$82.5m with construction costs set at the P<sub>95</sub> confidence level. The budget for the actual construction of the Dam is around \$50m. At a P<sub>95</sub> level there is only a 5% probability that the Dam construction will exceed estimated construction costs and a 95% probability that the Dam construction costs will be at or less than estimated. After deducting sunk costs to 2014/15, the funds that need to be raised to complete the project are estimated at \$75.9m. This \$75.9m in capital costs is being spread across the JV partners.
- 2.10 Figure 2 sets out the cost allocations based on hectare equivalents (hae). This ensures that the required urban capacity can be compared on the same basis as irrigation, which is set on a per hectare basis. Thirty percent of the dam costs has been estimated as relating to meeting the environmental (community) benefit. This has a capital cost of \$22.7m, to be partly funded by the FIF Grant and the \$10m CIIL interest free loan.

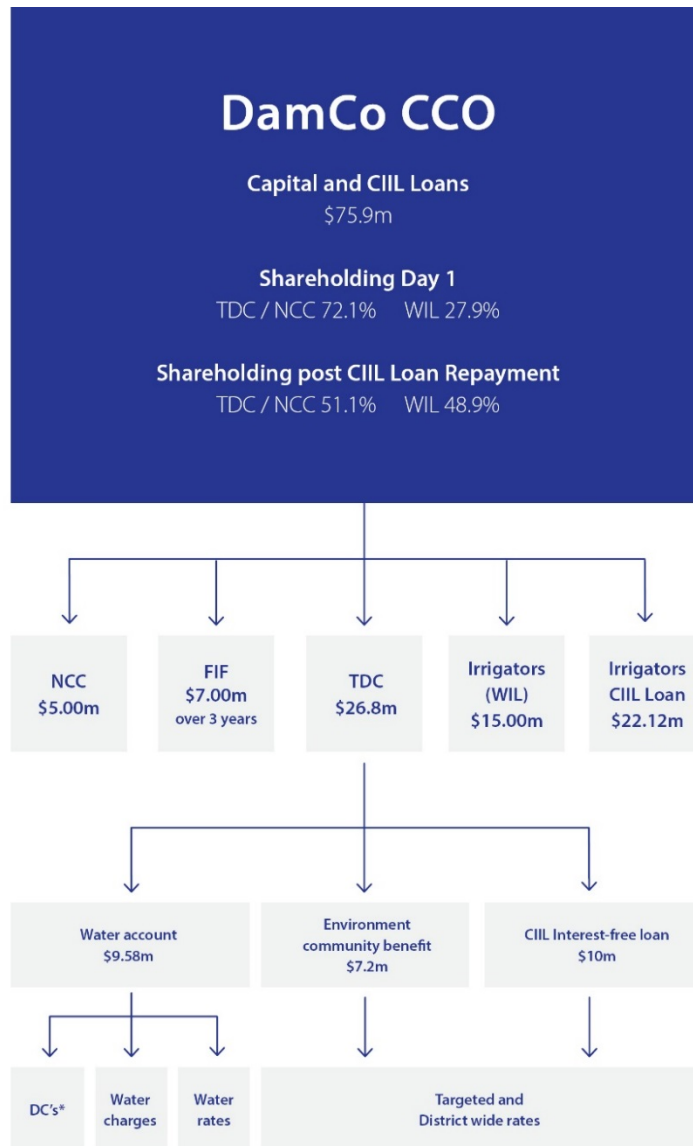
## **CIIL Zero Interest Rate Environmental Loan to Council**

- 2.11 As part of the overall project financing, and linked to both the credit support and WIL/DamCo borrowing, CIIL is making an interest free loan of \$10m available to Council. This loan is to support the capital costs in relation to the environmental/community benefits of the Dam. The report recommends Council repays the loan in two lump sum repayments of \$5m each, one at year six and the other at year 11. Staff recommend that funding for this should come from Council's commercial investment income, which would have no direct impact on rates. This decision is however yet to be made.

## **Council Credit Support**

- 2.12 Council credit support is critical to the overall project and is a condition of the \$10m environmental/community benefit loan from CIIL. Credit support reduces the overall cost of servicing the CIIL loans, which in turn makes the project more affordable and allows Council to leverage the \$37m private sector investment. If this was not to be provided then Council would need to finance the whole project on its own if it was to proceed.
- 2.13 Even without the credit support, Council would step in to protect both its investment and the community's investment in the Dam. Council also has financial responsibility obligations for the Dam as a public work under the Public Works Act. Under the finance arrangements, Council will have recourse to WIL if there is a default.
- 2.14 The proposed credit support covers the CIIL lending to DamCo for the benefit of WIL. The lending CIIL limit is set at \$25m. The credit support is set at \$29m to cover the capitalised interest and contribution for construction cost overruns. In addition, DamCo will be required to maintain a (WIL

funded) debt service reserve account (DSRA), which will allow DamCo to meet a full quarter's payment to CIIL, should WIL not meet its payment obligations.



The capital costs of the Waimea Community Dam have been estimated at \$82.5m. After deducting sunk costs to 2014/15, the funds that need to be raised to complete the project are estimated at \$75.9m. This \$75.9m in capital costs is being spread across the joint venture partners.

**The CCO advantages**

- Public interest is secure – the council has a controlling shareholding and majority on the Board
- Ability to clarify funding streams
- Access to more favourable credit and funding as well as ability to use Public Works Act

\*Development contributions

Figure 1 Investment Flows

			<b>Total Capital Cost</b>	
			<b>%</b>	<b>\$/m</b>
Dam Project Costs				\$82.50
Less funded sunk costs				\$ 6.60
<b><u>Balance to be funded</u></b>				<b>\$75.90</b>
Less Environmental Flow			30.0%	\$22.77
				<b>\$53.13</b>
<b><u>Balance to be funded by extractive users</u></b>				
Irrigators	5,425 ha		48.9%	\$37.12
Councils (TDC & NCC)	2,340 hae		21.1%	\$16.01
<b>Total</b>	<b>7,765 hae</b>		<b>70.0%</b>	<b>\$53.13</b>
<b>Grand Total</b>				<b>\$75.90</b>

Figure 2 - Capital Cost Allocation

### Project Cost Under and Over-runs

- 2.15 Council and WIL will have an indicative tender price by the end of November 2017. This will allow both parties to assess the risk of cost over-runs or scope changes in light of an updated overall project budget. The investment proposal currently provides a mechanism to manage cost over or under-runs with a contribution from WIL and Council for the first \$3m.
- 2.16 Council, as the JV party with the stronger balance sheet would step in to support the project if it got into financial difficulty, for example significant cost over-runs over \$3m. This is notwithstanding the proposed credit support, as we need to protect our investment and the wider community. Under the Public Works Act (PWA) provisions, Council must have overall financial responsibility for this to be a Public Work.
- 2.17 The dam costing is based on a P<sub>95</sub> confidence level which means Council can have a 95% confidence that the dam will be constructed at or below the proposed cost. Within this budget there is \$13.5m included for changes in scope and unexpected costs. Within the financial modelling we have been able to agree that there will be a 50/50 sharing between WIL and Council of the first \$3m of both project cost savings and over-runs. In the unlikely event of cost over-runs above \$3m, Council would need to meet these. For any cost saving over \$3m this will shared be on a 50/50 basis between Council and WIL.

## **Governance**

2.18 With the CIIL loan to support irrigation going into the CCO, the JV is a simplified structure. DamCo will be a normal company incorporated under the Companies Act. This reduces costs and complexity. The company will not be able to trade for a profit, i.e. it will never be a Council Controlled Trading Organisation (CCTO). CCTO's are set up on a commercial basis to trade with the intention of making a profit. DamCo will be operated to recover its costs only. The same restriction is being placed on WIL. In order to meet Council and CCO requirements, Council will appoint the majority of the company board. The Board will be comprised of seven members and proposed as follows:

- 1 x Iwi representative
- 2 x WIL appointed directors
- 4 x Council appointed directors (one of whom may be jointly appointed by TDC/NCC)

2.19 The Board will appoint its own Chair and the Chair will not have a casting vote. Elected members will not be eligible to sit on the Board.

## **Operating Costs**

2.20 With a 51% majority shareholding, the current proposal is for Council to pick up 51% of the operating costs and WIL 49%. Operating costs are estimated at \$1.3m to \$1.4m per year. Council's allocation would be approximately \$714,000 split \$420,000 against environmental/community benefit funding and \$294,000 allocated to the urban water account.

2.21 As Council is to make a larger contribution to operating costs than WIL, this will require a review of our current policy position on only extractive users funding operating costs. In order to address affordability issues and make the project financially viable, Council will need to cover an additional 30% (\$420,000) of operating costs now re-assigned to environmental/community benefit. We are proposing these costs will need to be funded across the District. However, this increase is mostly offset by the savings in interest costs from the \$10m interest free CIIL environmental/community benefit loan.

## **Rating and Funding Impacts**

2.22 Council is yet to make a decision on how the costs will be apportioned across the District. That decision will be subject to public consultation. Under the LGA, Council is required to consider allocation of costs and their impact.

2.23 One approach being considered would be a layered approach as illustrated in Figure 3 below. For example:

- a. no cost to the urban water users through their service charges (see 2.23.b.) for the environmental /community benefit
- b. cost recovery for Council's urban water users will be dealt with through the current urban water cost recovery regime (fixed annual service charge and a volumetric charge)
- c. environmental/community benefit costs could be met by a potential combination of District wide fixed charges per property, and a targeted rate based on capital value for all properties in, near, or serviced from the Waimea Basin (Zone of Benefit).
  - If Council were to recover the environmental/community benefit cost solely by a District wide fixed charge, this would be approximately \$45 per property per year.



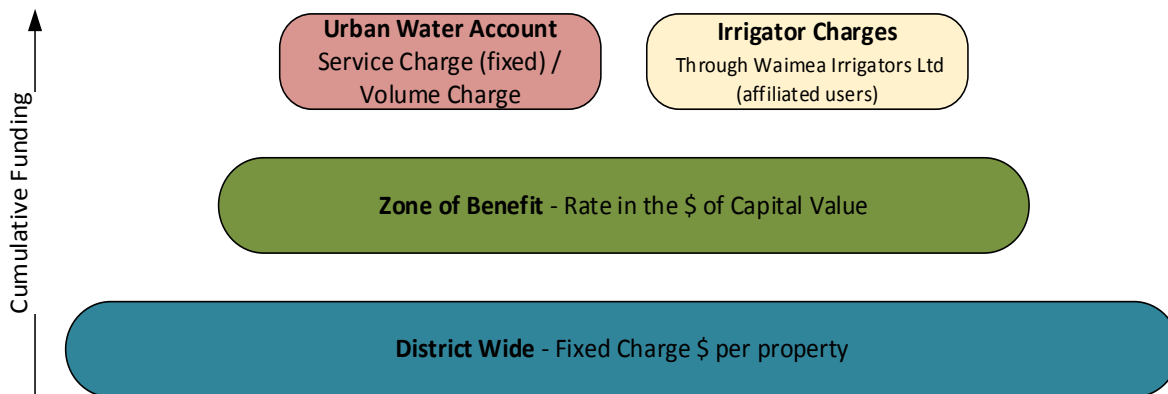


Figure 3 – Proposed Rating and Charging Layers

2.24 Based on the investment proposal, the split of costs between the urban water account and other rates funding is: \$9.58m to the water account and other rates \$17.2m. Some of the water account funding related to growth could be met by development contributions and this is being investigated.

2.25 Examples of how this approach could operate are:

- a. a Richmond urban rate payer could be charged the District wide rate, the zone of benefit rate and pay an increase in water charges.
- b. an unaffiliated Waimea irrigator could pay the District wide rate and the zone of benefit rate.
- c. an affiliated Waimea irrigator could pay the WIL irrigator charges, the district wide rate and the zone of benefit rate.
- d. ratepayers in the District, (approx. 23,000 rateable units), could pay a District wide fixed charge per property.

2.26 The physical boundaries for the “zone of benefit” are yet to be fully determined. It is envisaged that they would include those properties on the Waimea Plains within the 2014 designated zone of effect, as well as properties supplied from the zone of effect and urban areas including Richmond, Brightwater, and Mapua.

2.27 Staff are working through options and will report back to Councillors in due course. The preferred option and alternatives will be included in the SOP.

### Hydro Power Generation

2.28 Engineering Services is currently updating the costing for this option and preparing a full business case. Initial indications are that a properly configured hydro generation option could be built and operated without impacting on the project’s overall risk profile and without interfering with the primary purpose of the dam which is to provide for the urban water supply, irrigation needs and environmental flows in the Waimea River.

2.29 This option would need to be funded completely separately from the existing project and would require approval from the other JV partners.

### **3 Consideration of Financial or Budgetary Implications**

- 3.1 The proposed investment structure and funding will be included in the budgets and the Long Term Plan 2018-2028 consultation document for public submissions. This will allow Council to assess the capital and funding implications in conjunction with all other projects.

### **4 Conclusion**

- 4.1 Council staff and advisers have negotiated a funding proposal for the Waimea Community Dam with Waimea Irrigators Limited (WIL) and Crown Irrigation Investments Limited (CIIL). The proposal is the best that we believe can be achieved. This will be the basis of the public consultation for funding of the Dam and governance of the Joint Venture Company. The proposal is subject to all of parties successfully raising their share of their funding and carrying out their own consultation, internal approvals and due diligence.
- 4.2 The proposal has only been more affordable due to the Government's announced \$7m Freshwater Improvement Fund grant, a \$10m zero interest free loan to Council to fund the environmental /community benefit component of the scheme, and the low interest lending to irrigators through DamCo.